# Investor Intelligence Newsletter©

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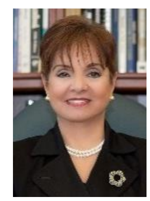
## From the Executive Desk

**Edmundo J. Garza, PhD**
**Chief Executive Officer & President**

As time goes by, it becomes increasingly obvious that the U.S. business cycle has become increasingly monetary in nature. While in 2008, the country experienced a severe recession when the equilibrium interest rate plunged, in 2019, the Federal Reserve paid attention to market warnings and there was no recession when equilibrium interest rates plunged. In 2008, the Fed ignored near-term shortfalls in aggregate demand, while in 2019 Reserve officials frequently talk about the need to make up shortfalls in inflation with future above target inflation. Ten years ago, the Fed obsessed about above target inflation even in sight of plunging GDP growth. Today, the members of the Federal Open Market Committee (FOMC), the committee within the Federal Reserve System that is charged under with overseeing the nation's open market operations, talk about the value of GDP as a policy indicator, and warn that inflation can be a misleading indicator. So, what will the Fed do in 2020? While no one knows for sure, we could reasonably expect them to do nothing at all. With a presidential election this year the Fed will probably try to keep interest rates at current levels and avoid claims from either of the major parties. Except for 2012, when the Fed did a third round of quantitative easing right before President Obama was re-elected, the central bank has taken a mostly hands-off policy during election years. It seems keeping rates right where they are is the politically neutral thing to do.

## Economic Perspectives

**Myrna Rivera, CIMA®**
**Founder & Senior Investment Advisor**



The U.S. economy added 145,000 jobs in December 2019 and the unemployment rate remained at 3.5%, according to nation's Department of Labor. The New York Times notes that "for the full year, the economy added 2.1 million jobs, fewer than the 2.7 million created in 2018, but more than enough to handily outpace population growth." The labor force participation rate remained steady at 62.3% in December. An analysis by the Brookings Institution warns that while monthly jobs reports provide critical information on the state of the economy, there should be a deeper focus on baseline employment conditions. Their study found that 53 million workers ages 18 to 64, or 44% of all workers, earn "barely enough to live on" with median earnings of $10.22 per hour (about $18,000 per year). The analysis also shows that more than half of low-wage workers work full-time year-round and about half of those workers are primary earners or contribute substantially to family living expenses. Most low-wage workers (77%) have less than a college degree, and research from the Federal Reserve suggests that there are not enough decent-paying jobs for people without bachelor's degrees. There's cause for concern because workers without bachelor's degrees continue to make up most of the U.S. labor force, so the shortage of such jobs for this sector has wide-ranging consequences. While the costs of basic inputs in life, such as health care, housing, and education, have risen over the last decade, wages for most workers (except those at the top) have stagnated or declined. If society's interests are best served by having people employed, housed, educated, and healthy, then the fundamentals behind U.S. economic and social policies need to be revisited to achieve long-term sustainable growth for all.

## Indicators (As of December 31, 2019)

**United States:**
CPI: 2.0% Chg. from yr. ago
Unemployment Rate: 3.5%
GDP: 2.1% Comp. Annual rate of Chg. on 2019: Q3
Ind.Prod.Index: 1.1% change from previous month
***Source:*** *St. Louis Fed. Res.*

**Eurozone:**
CPI: 1.3% Chg. from yr. ago
Unemployment Rate: 7.5%
GDP: 0.2%, Comp. Annual rate of Chg. on 2019: Q3
Ind.Prod.Index: -0.5% change from previous month
***Source:*** *Moody's Analytics*

**Japan:**
CPI: 0.7% Chg. from yr. ago
Unemployment Rate: 2.2%
GDP: 0.4%, Comp. Annual rate of Chg. on 2019: Q3
Ind.Prod.Index: -0.9% change from previous month
***Source:*** *Moody's Analytics*

**Puerto Rico:**
CPI: 1.1% Chg. from yr. ago
Unemployment Rate: 7.9%
Payroll Employment: 1.1% Chg. from yr. ago
EDB Econ. Act. Index: -0.3% Chg. from yr. ago
***Source: P.R.E.D.B.***

## Market Recap

**Evangeline Dávila, CIMA®**
**Chief Research & Investment Officer**

**Stocks:** The strategy to overweigh the US vs other developed economies has been one of the most consistently successful asset allocation approaches in the last decade, and it worked again in 2019. Since January 2010, US equities generated total returns of 252% vs 94% for Japan and 75% for Europe. Why has the U.S. consistently outperformed? One of the reasons is the U.S. Tech sector, which weighs twice as much as the second, third and fourth leading sectors of the S&P 500 index (Basic Materials, Energy & Industrials) combined. This is not true for Europe or Japan, where Tech represents less than 25% and 50% respectively of the combined strength of these other sectors.

**Bonds:** Looking to spur economic growth the European Central Bank has implemented negative interest rates since 2014. European bank equity returns, and valuations have trailed the US during this time, but without negative rates, the region could have been in even worse shape due to rising corporate defaults, which would have made life even worse for banks. The ECB is considering cutting rates even further in 2020, reducing the current policy rate from -0.5% to -1.0% over the course of the year. Bond investors beware.

**Alternatives:** Uncertainty over U.S. elections could dent the appeal of holding U.S. dollars in 2020. Also, the Fed began injecting liquidity into financial markets by buying US$60 billion of T-bills every month. Such quantitative easing is often associated with currency weakness, because it expands the money supply and threatens to debase the purchasing power of the currency.

## The Advisor's Corner

**Eileen Rivera**
**Due Diligence Officer & Investment Adviser**

Financial markets staged a solid recovery in 2019 as several key economic challenges from last year faded and new ones emerged. Although risks remain, several positive signals could lead to a more constructive outlook with lesser odds of a negative scenario unfolding. In 2019, the U.S. economy was supported by a strong service sector and resilient consumers, offsetting weakness in manufacturing. Progress on U.S. - China trade relations have reduced one of 2019's main concerns. Trade relations have improved as the two countries near a "Phase One" trade deal. That said, there remains friction between the world's two largest economies and there is no certainty that they will reach a deal that significantly improves the outlook for the global economy. Emerging-market economies overall are expected to rebound, while developed-market growth may continue to decelerate marginally. Brexit is looking a bit better than it was 12 months ago, as the risk of a "No Deal" Brexit has shrunk. However, the U.K.'s departure from the EU will still inflict economic damage, even if it's less than what was initially feared. The U.S. presidential election in November is also likely to provide a new source of uncertainty as the campaign unfolds. However, whatever the results, the U.S. economy continues to show signs of stretching out the later stages of its business cycle. Monetary easing has helped stabilize the economy and the boost from lower interest rates could kick in on a lagged basis. According to [RBC Global Asset Management](), over the last six months economically-sensitive sectors have outperformed defensive sectors, value stocks have led the growth style, and international markets have participated in the stock rally. The S&P 500 rallied over 25% in 2019, and stock markets outside the U.S. also had attractive runs. In the past, these types of market rotations have been associated with improving economic and growth in corporate profits. Held in combination with the macro view above, it suggests that the bull market may still have room to run.

## What to Do?

Recent outlook reports continue to support expectations for continued world economic expansion in 2020, but capital markets appear highly dependent on favorable monetary policy and dualistic outcomes that may have more to do with political negotiations and geopolitics than economic trends and market developments. Investors should keep a watchful eye on changes in economic fundamentals and risks that may flair up again domestically and abroad. ***Amid an uncertain scenario we continue to recommend prudent asset allocation and risk assessment, based on future capital needs, for plan sponsors, institutions and individual investors. Due diligence reviews and an adherence to a well-developed investment policy remain the most prudent course for long-term investors. Continued fiduciary education is paramount.***

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