Washington Trust Bank
Wealth Management
& Advisory Services

ECONOMIC REVIEW

Steve Scranton, CFA
Chief Investment Officer
and Economist

The story for the economy in the 4th quarter remains true for what played out for most of the year: it's all about the consumer. Consumer spending continues to be the engine that is powering economic growth for the US.

Consumers

- So far, the consumer has been relatively unfazed by the political drama and the trade dispute. What appears to be keeping the consumer confident and willing to spend is:
  - New jobs continue to be created;
  - Wages continue to increase;
  - Net worth continues to increase as home values and investment portfolios continue to rise.
- Consumer confidence remains near historically high levels and this has translated into the spending that supported economic growth in the 4th quarter and throughout the year.
- Reports from retailers indicate that this year's holiday spending was solid.

Businesses

- As a whole, business spending remained constrained in the 4th quarter due to uncertainty over the outlook for trade policy and the impact of tariffs. National surveys of both business CEOs and CFOs continued to reflect high levels of concern over the outlook for the economy.
  - The bright spot from a business spending perspective is that small businesses had a far more positive outlook on the economy. This translated into increased spending on wages, equipment and buildings.
- The industrial side of the economy continued to be hit by the negative impacts of tariffs and uncertainty over what US trade policy will be for the future.
- Some of the uncertainty was reduced when the US and China announced that an agreement had been reached on the Phase One trade agreement but the agreement is not scheduled to be signed until Jan. 15, 2020. Skepticism remains over whether the trade agreement will hold or whether a new round of tariffs might be in store in 2020.

Summary

- Even though much of the social and traditional media content was focused on political issues during the 4th quarter, the economy appears to have continued on a steady pace in the 4th quarter.
- We will not get the first estimate of 4th quarter Gross Domestic Product (GDP) until the last week of January, but preliminary estimates are projecting 4th quarter GDP to come in close to 2% again.
  - This would give us three consecutive quarters of growth around the 2% level.
  - If 4th quarter GDP plays out the way the forecasts estimate, then we will end up with full year GDP just over 2%. That is slower than last year but in line with the average growth rate for this expansion.

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ALTERNATIVE STRATEGIES

Rick Cloutier, CFA
Chief Investment Strategist

At the close of 2018, investors were feeling a little different. The S&P 500 just lost over 13% in the 4th quarter; but, by the end of March, the markets gave investors back their 4th quarter losses.

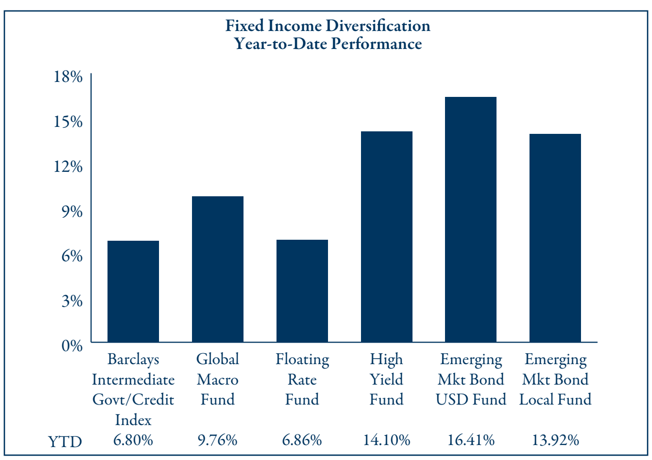
So, we started the year with a positive quarter and continued to move up for the remainder of the year. Large cap domestic stocks led the rally with the S&P 500 returning 31.5%. Small cap and international stocks weren't far behind with small caps gaining 25.5%, international stocks returning 22.0%, and emerging market stocks climbing 18.4%.

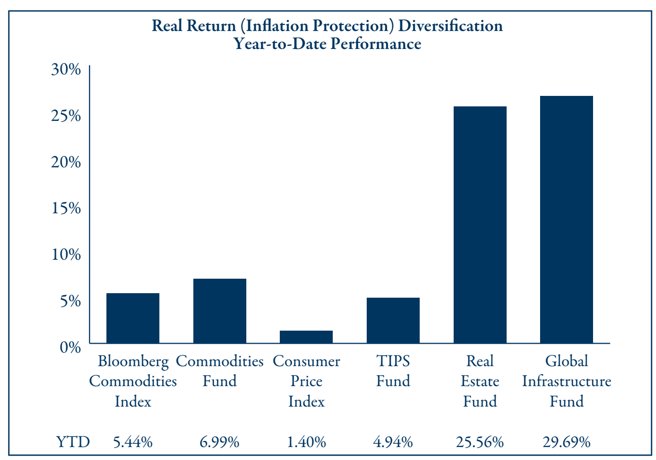
Bond investors also had something to cheer. Due to the Fed cutting rates three times, bond values appreciated. Core bonds were up over 4%, with shorter maturities gaining less than longer maturities. High yield and emerging market bond investors were also rewarded earning 14.1% and 13.5%, respectively. During the year, the yield curve inverted, which portends a coming recession, but before year's end the curve returned to a positive slope. Yields were off last year's close by about ¾% to 1%.

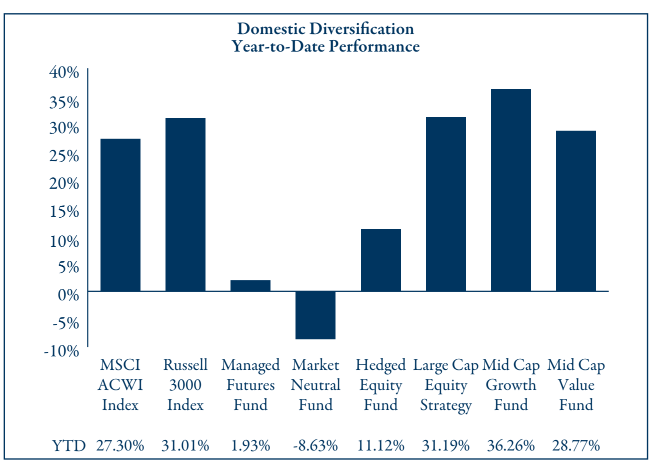
Real return strategies had an impressive year as well. Real estate investors were rewarded with values surging 28.7%. Infrastructure investors enjoyed gains of about 27.0%. Commodity prices rose 7.7%. Within the group, energy prices were mixed: oil surged over 30%, but natural gas declined about 25%.

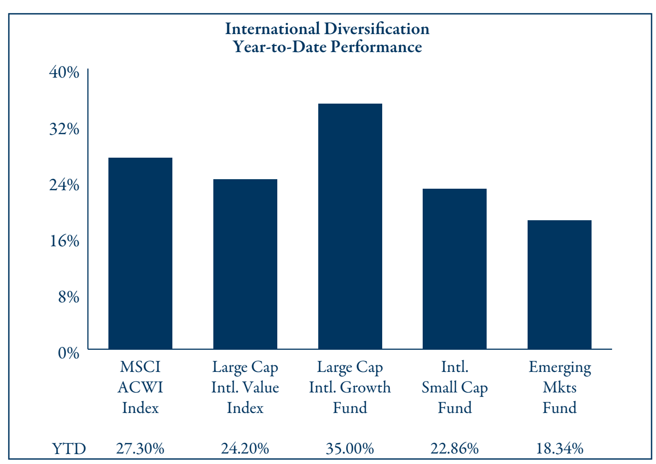
Absolute return strategies, which serve to reduce equity risk, highlighted by their overall rise when the market declined last December, produced returns which varied greatly among the strategies. Global macro strategies produced nearly double digit returns whereas market neutral strategies lost value. Overall, the returns were in line with bond returns with the group producing growth of close to 4%.

So, investors enjoyed a stellar year — a reversal of last year which saw over 90% of asset classes lose value. Along with our investors, we celebrate these gains; however, as always, we stress caution. **Over-exuberance can lead to excessive risk taking and a lack of prudence. For most, investing is a long-term endeavor replete with incredible gains and unfortunate losses.**









DOMESTIC EQUITIES

Gayle Sprute
Senior Portfolio Manager

What a difference a year can make. In contrast to last year's difficult 4th quarter, domestic stocks delivered a nice 4th quarter rally this year.

The technology laden Nasdaq Composite provided leadership, up 12.5%, followed by the small cap oriented Russell 2000, up 9.9%, the S&P 500, up 9.1%, and the Dow Jones Industrial Average, up 6.7%.

Gains were fueled in large part by a de-escalation in trade dispute gamesmanship that began in September. While the negotiations ebbed and flowed, by quarter-end the equities market had all but priced in the successful completion of a Phase One deal, even though an agreement has yet to be formally signed. This hopefulness was a powerful catalyst for market performance during the quarter.

A change in policy by the Federal Reserve (Fed) also had an effect on market behavior during the quarter. The stock market has long been addicted to accommodative monetary policy. So, the central bank's signal in September that it might be done cutting rates for now was not what the market wanted to hear. However, as the quarter proceeded, the Fed reinforced that it viewed the economy as stable and that it would consider lowering rates if warranted by economic data. This appeased concern about monetary policy (and the economy) for the time being.

At the sector level, 10 of the 11 sectors delivered positive performance. Leaders and laggards showed that "risk on" was the theme. Defensive sectors were at the back of the pack: real estate down 0.5%, utilities up 0.8% and consumer staples up 3.5%. The best performers were information technology, up 14.4%, health care up 14.4%, and financial services up 10.4%. From a style perspective, value, up 9.9%, beat growth, up 8.3%.

The 4th quarter capped off a strong year and decade for stocks and which saw the major equity indices surge to new all-time highs. Stocks start 2020 at a rich valuation level. The current price/earnings (P/E) multiple is 18.3X forward earnings estimates. Investors will be closely watching the global and domestic economies, corporate America's earnings results, the next steps in trade negotiations, the presidential election, and the Fed's communications.

FIXED INCOME

Brian Brill, CFA
Senior Portfolio Manager

The 4th quarter started out all doom and gloom but an optimistic ray of light soon took hold to move interest rates higher.

Impetus for the doom and gloom centered on the ongoing trade dispute between the US and China and its negative effects on the global economy. The weakness was clearly evident in the manufacturing sector with Europe leading the way. But the manufacturing sector in the US was also under pressure. The big fear was that this weakness would start to negatively affect the US consumer, which up to this point had escaped the brunt of the damage.

A hard Brexit was also another source of concern as investors feared the ramifications of the UK leaving the European Union without a trade deal.

But the 4th quarter saw changes on both fronts. Tensions between the US and China began to ease as the likelihood of a Phase One trade deal took hold. And finally, clear direction came to Brexit with the resounding victory by Boris Johnson. It is basically certain that the UK will leave the EU with at least some form of negotiated deal instead of the feared "hard Brexit" which would have seen the UK leave the EU without any deal. Global de-escalation in the form of movement on Brexit and US/China trade seemed to be the impetus for investors that had grown accustomed to negative news.

With the escalation of negativity easing, economic data also began to follow suit. Caterpillar's CFO Andrew Bonfield stated it succinctly, "Our customers are not facing financial difficulties. It's more that they seem to be waiting to see what happens with the economic outlook before making decisions."

Taking the cue, the US Federal Reserve and the EU seemed to move monetary policy to the pause switch. After cutting the Fed Funds rate in late October, Chairman Jay Powell indicated that it would take a "material reassessment" of the committee's economic outlook to alter its bias toward a pause, but also added that it would take a "serious" increase in inflation to consider an increase in rates.

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INTERNATIONAL REVIEW

Derrick Wilson
Portfolio Manager

There were some turbulent times in the global equity markets in 2019, but equity markets ended on a very positive note before ringing in the New Year.

Europe closed out the year up 29.36%. Japan saw an increase of 20.6%. China surged 39.19% over the course of year. Taking center stage in Europe, once again, was the UK and Brexit. An early general election saw Boris Johnson retain his position as Prime Minister, winning by a great margin. Markets took this result as confirmation there will be an exit from the EU with some sort of agreement. The current deadline is set for January 31, 2020.

Economic data within Europe continues to show the weakness in manufacturing, although it looks as if it may be bottoming, with results better than expected being reported throughout the quarter. On watch over past quarters was Germany, which avoided a recession.

Another major breakthrough was the **Phase One trade deal** between the US and China which helped push equities higher around the globe. While this deal may not put an end to the entire ordeal, it eased investor concerns about the ongoing trade dispute and the potential to drag on with no resolution.

Social unrest in Hong Kong lingered on. In November, violence overwhelmed the campus of Hong Kong Polytechnic University as protesters battled surrounding police. Demonstrators further supported these acts nearby. There has clearly been an economic impact since protests started as the Hong Kong economy contracted 2.9% in the 3rd quarter. Notably, this is the first contraction since Q3 2009.

Investors had plenty to celebrate closing out the quarter, the year and, finally, the decade. On the first trading day of 2020, equity markets stayed on the same path as they continued to move higher on renewed optimism. Then came the US airstrike targeting and killing a high-ranking Iranian military general. Global equity markets have since taken an about-face leaving investors a new situation to worry about over the coming months.

Additional and expanded information to this newsletter discussion may be obtained by contacting your Relationship Manager. We will be happy to expand our discussion with you to meet your individual requirements as a client of Wealth Management & Advisory Services.

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