Broadleaf Partners, LLC

Our 2020 Playbook January 17, 2020

It's that time of year again when we like to look back on the year that was and consider what we got right, what we got wrong, and what we might have learned in the process. We then turn our attention to the year to come, hoping that by putting our thoughts in writing, we'll gain greater clarity on the factors that might drive our investment returns going forward.

We share this ritual with you, our clients and friends, in the hope that you gain a better understanding of the influences that may drive our investment decisions in the coming year. As always, these decisions are fluid and may change with the circumstances, but are also made with a longer term perspective and intent to drive superior investment returns over time.

Thank you for your continued confidence in our approach and interest in our work!

Looking Back

In our *2019 Investment Playbook*, we made three general observations on the economy, the financial markets, and politics in general, as has been the pattern for several years. What follows is an italicized summary of each opinion from last year's Playbook along with our comments and assessment of what actually came to pass.

<u>The Economy</u>

"While we believe the economy will slow in 2019, we do not believe there will be a recession. In 2012 and 2015, the rest of the world caught a cold, led by weakness from China. The same pattern appears to be occurring today, but similar to the prior two periods, we don't believe the weakness will prove powerful enough to cause a domestic recession. We believe U.S. GDP growth should be 2-2.5% in 2019, assuming the Fed puts additional hikes on pause."

This assessment was generally spot on. The economy did slow and there was considerable talk about a recession throughout the summer months given an inverted yield curve. But largely due to a reversal in Fed policy along with a hoped for Phase 1 trade deal with China, we finished the year without a recession and positive, albeit, slow GDP growth. The Fed not only put additional hikes on pause, but also cut rates three times and the year closed with GDP growth in the low 2's.

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The Markets

"The markets experienced significant volatility in 2018, both early in the year and then at the end. We believe the Fed has hiked rates enough and that they are now very close to the neutral level, that which is neither stimulative nor contractionary to the economy as a whole. As such, we don't believe many, if any, additional rate hikes will be necessary in 2019. Inflation remains tame and employment is very solid.

Advancements in artificial intelligence and other technologies should enable the neutral rate to stay lower for longer as almost all industries in the economy remain immensely competitive and thus wage pressures generally restrained, even at high rates of employment. Along with the continued benefits of lower tax rates, a milder Fed, progress with trade talks, and fading recessionary fears should set the markets up for excellent results by the end of 2019. Successful stimulus efforts from China's central bank would also help assuage global growth concerns. We would fade traditional safe havens and invest with innovators, those that can and will grow in spite of the economy."

These thoughts also proved to be generally accurate. Inflation remained tame and unemployment rates hit new lows as many formerly disenfranchised workers reentered the workforce AND found work. The Fed has justified lower rates on the view that they can afford to overshoot inflation to the upside for several quarters since it has similarly undershot to the downside for far too long. The stock market's results were indeed excellent, with the S&P 500 rebounding up 31.5% for 2019. While all areas of the market did well, innovators did outperform.

Politics

"There will not be an end to the divisiveness. President Trump believes he was put in office to shake up the Washington establishment, and like him or hate him, he will continue to do so, even if it costs him a second term.

We believe a trade deal with China will ultimately be achieved in 2019, but enforcing it may prove to be the larger issue. Intellectual property laws haven't kept China from violating them in the past and we wouldn't expect a new trade agreement to change behavior without adequate and consistent enforcement. Although we suspect President Trump will reach a trade deal with China, he will likely be vigilant in enforcing it, meaning the trade risks won't soon dissipate."

Again, our outlook for the political environment remained generally accurate. Donald Trump continues to shake up the status quo so much that he was even successfully impeached by the House of Representatives! While a phase 1 trade deal with China has been signed and some tariffs have been rolled back, uncertainties remain as we enter 2020.

Looking Forward – Our 2020 Playbook

Our format of the past few years has proven successful, so we'll stick with it and discuss our views on the economy, the markets and politics for the year ahead.

The Economy

The economy should experience a bit of a rebound on the basis of lower interest rates and a pause in the trade war. Global growth may similarly get a bit of reprieve. All that said, we do not believe GDP growth will exceed 3% by the end of the year and wouldn't be surprised if it hovers in the mid 2's. In our view, growth will remain slow for as far as the eyes can see as whole swaths of the economy continue to be remade by technological and societal change. While the Fed will remain on hold for most of the year, we think an additional cut may be more likely than any hikes.

The Markets

As indicated in our recent CNBC Appearance, in a slow growth economy, we believe investors will be best served by investing in companies that can grow "in spite of it all". In addition to the recent Iran scare, there is no shortage of things for investors to worry about, the least of which will be the coming 2020 Presidential election. And while a Phase 1 trade deal has been reached, we suspect the sabre rattling between the Trump administration and China will resume at some point during the year. That's why you call something a Phase 1 deal, rather than just simply a "deal".

The markets are already up a few percent in January as we write this update and it would appear that they have adopted the "Teflon" Don persona. Good news is good news and bad news is good news. We suspect the markets could correct at some point, simply because we've had so many positive days in a row. But the trend, barring a recession, remains constructive. We don't expect a recession and believe, once again, that in spite of all the things worth worrying about, the markets should enjoy positive results for 2020.

According to data from 1928 on compiled by macroeconomics firm Cornerstone Macro, after the markets have had a down year 1 – the case in 2018 – and an up year 2 – the case in 2019 – they have historically had a higher than normal probability of positive returns AND a higher average return in the third year – which is where we sit for 2020. Similar circumstances have existed 21 times since 1928.

To be sure, history doesn't always repeat itself, but it often rhymes.

Politics

There will be some scares along the way, but the old saying "It's the Economy Stupid" will serve as our mantra as we scan the political environment in 2020. The election will likely be Donald Trump's to lose given record lows in unemployment and a solid, albeit slow-growth economy. In spite of the impeachment proceedings and his vastly unconventional style, his campaign will likely focus on the positive economy and statistics that promote gains by a broad swath of Americans during his first term in office.

While it remains a close race in the Democratic primaries, a succesful Presidential candidate will likely need to move to the center to win the general election. Right now, some of the liberal proposals being tossed about are an affront to capitalism, and even if tempered by the reality of

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a balance of powers, anxiety and fear might likely restrain the markets from doing what they otherwise might do.

We'd generally caution against making drastic changes to your portfolio in anticipation of or because of the election outcome. Just as the markets didn't fall apart with President Trump's win as some thought they would that night - they also recovered significant ground under the Obama administration following the housing and banking crisis. Presidential policies can and do impact the markets, but the balance of powers is intentional and there are usually areas worth investing in regardless of who occupies the Oval Office.

We'll close our 2020 Playbook as we have always done, by reminding investors that our business is never easy, but it's always an intellectual challenge worth pursuing. May God bless you abundantly in the coming year, even if it comes in ways you don't expect!

Kindest Regards,

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