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2019 HITS AND MISSES

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2019 was a difficult year to forecast after 2018 ended with the worst December since the Great Depression. While our positive stock market outlook proved too conservative, we are pleased to report we got more right than wrong for 2019. Here we recap our 2019 predictions and highlight some hits and misses.

TOUGH TEST

In December 2018, the stock market threw a tantrum that came perilously close to ending the bull market, based on the most widely used definition: a 20% decline on S&P 500 Index closing prices. Stocks fell on a combination of global growth fears, trade uncertainty, and concerns that the Federal Reserve (Fed) had hiked interest rates one too many times. On December 24, 2018, the S&P 500 closed 19.8% below its September 20 closing price, coming within a fraction of a point of ending what has become the longest bull market ever.

With the S&P 500 having traded below 2,400 in December 2018 and starting 2019 at just 2,507, sticking with a 3,000 year-end fair value target was difficult. Nearly every Wall Street strategist lowered their target, and we seriously considered it. In the end, however, we thought fundamentals were strong enough to justify the optimism early in the year. We also believed the issues weighing on the market were temporary and would be resolved soon.

Now we know our 3,000 target was overly conservative. We ended up taking risk down by reducing our equities allocation recommendation from overweight to market weight in March and April 2019. In retrospect, staying aggressive would have captured additional upside in model portfolios. Nonetheless, we consider maintaining a market-weight equities allocation since March as stocks surged a victory.

WHAT WE GOT RIGHT

Large caps over small. We came into 2019 favoring benchmark-level exposures to large and small cap stocks while urging some caution as the economic cycle matured. We also anticipated that further progress on trade would help large caps. In our March 18, 2019, *Weekly Market Commentary: Movin' On Up (In Market Cap)*, we forecasted better performance for large caps relative to small caps and, in a timely move, reduced small cap stock exposure in some of our model portfolios.

Though the path on trade was longer and bumpier than we anticipated, the large cap Russell 1000 Index has outperformed the small cap Russell 2000 Index by 6.6 percentage points since March 18, 2019. Year to date, the Russell 1000's 31.1% return is about 5 percentage points ahead of the 26.2% return for the small cap Russell 2000 Index.

Cyclical sector leadership. Favoring the most economically sensitive, or cyclical sectors, worked in 2019, particularly technology, which so far has topped all S&P 500 sectors with a return of 49.5%. The next-best performers—communication services, financials, and industrials—also are cyclical and have each posted year-to-date returns near 30%. Not favoring 2019's worst performing sector—energy—was also helpful, though we did maintain limited exposure to underperforming but higher-yielding master limited partnerships in income-oriented portfolios during the year.

Developed international. We favored U.S. equities over those in developed international markets throughout 2019. Concerns about economic growth, global policies, and low interest rates drove our caution on European and Japanese investments last year, a view we have maintained in *Outlook 2020: Bringing Markets Into Focus*.

Minimal cash allocations. In early 2019 in many of our managed portfolios, we reduced cash allocations in favor of actively managed, high-quality short-term bond strategies, which contributed to returns.

WHAT WE GOT WRONG

Emerging markets. We maintained a modest allocation to emerging-market equities in 2019 due primarily to a relatively strong economic growth outlook, attractive valuations, and expected resolution to the U.S.-China trade dispute. Trade tensions escalated further and lasted longer than we had anticipated, which put emerging markets in the miss column—although the 18% year-to-date return is certainly respectable.

Growth vs. value. In our *Outlook 2019* publication, we recommended that suitable investors consider tilting equity allocations toward value in anticipation of a pickup in economic growth and our belief that valuations for growth stocks had become stretched. The pickup in economic growth did not materialize, mainly because of trade tensions, and valuations seemed to matter only in September, the one month of the year during which value stocks outperformed growth stocks materially. The Russell 1000 Growth Index has returned 36% year to date, outpacing its value counterpart by nearly 10 percentage points.

Interest rates. The 10-year U.S. Treasury yield sat at 3.01% at the end of November 2018, so our forecast for a gradual rise to 3.25%, the low end of our initial forecast range, hardly seemed farfetched at the time. Rates tumbled from there amid slowing global economic growth, continued U.S.-China trade tensions, rate cuts by the Fed, and falling—and negative—sovereign bond yields throughout Europe and Japan. All of these factors eventually led to an inverted yield curve (short-term Treasury yields above long-term Treasury yields). We ended up lowering our rate forecast twice during the year, with the latest move in August to 1.75–2%.

Although this was clearly a miss, credit-sensitive positioning of our fixed income allocations within portfolios was beneficial and provided an offset to our decision to emphasize short- and intermediate-term rather than long-term bonds.

Those are some of our hits and misses from a rewarding 2019 for many investors. For more of our review of 2019, please refer to the December 26 and 27 *LPL Research Blog*. For our insights for the year ahead, please see our *Outlook 2020: Bringing Markets into Focus*.

WEEKLY MARKET PERFORMANCE REPORT

Please see our new *Weekly Market Performance* report with insights on major asset classes.

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