December 2019

Perspectives
Where Did We Go from There?

REQUISITE
capital management

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Where Did We Go from There?

What a difference a year makes! In our December 26, 2018, Perspectives piece, "Where Do We Go From Here," we made the case that the sell-off was a rare occurrence. As of December 24, 2018, the S&P 500 was down -15.74% month to date. Monthly losses over 10% had only occurred seven times since 1960. We are consistently reminded that the only thing new in the world is the history you don't know.

Below is an excerpt from last year's piece:

> ***STAYING THE COURSE***. *December is setting up to be one of the worst months for the S&P 500 over the last six decades. As of Monday's close (Christmas Eve), the S&P is down 15.74% in December alone. It seems the only thing stopping stocks from going lower is the closing bell. The market is experiencing what feels like an outright buyers strike as bad market technicals, global political unrest, unpopular Fed policy, trade wars and now, a government shut-down, are outweighing the bevy of strong fundamentals (+3% GDP, low unemployment, low inflation and strong corporate profits). Fear in the market has clearly overwhelmed economic reality. Famed professor Jeremy Siegel aptly noted, "Fear has a far greater grasp on human action than the impressive weight of historical evidence."*

Annualized One and Two Year Returns after Monthly Drawdowns Greater than 10% (December 1960 - December 2018)

Date	Monthly return	One Year Later	Two Years Later (Annualized)
February 29, 2009	-10.65%	53.62%	37.22%
September 30, 2002	-10.87%	24.40%	19.02%
November 30, 1973	-11.09%	-23.76%	1.79%
September 30, 1974	-11.52%	38.15%	34.24%
August 31, 1998	-14.46%	39.82%	27.53%
December 24, 2018	**-15.74%**	**???**	**???**
October 31, 2008	-16.80%	9.80%	13.11%
October 31, 1987	-21.54%	14.80%	20.46%

Source: Morningstar, thechartstore.com

The table[i] in our original piece highlighted the seven previous periods. We asked the question, "What happened if you stayed invested over two years? Outside of 1973, the forward one-and-two-year returns were compelling. Here we are today, one year later.

So, what happened? Through December 24, 2019, the S&P 500 is up 39.88%[ii].

What will 2020 bring?

Date	Monthly return	One Year Later	Two Years Later (Annualized)
December 24, 2018	**-15.74%**	**39.88%**	**???**

Source: Morningstar, thechartstore.com

Markets are not as inexpensive as they were this time last year, but time will tell if there is an appetite for continued multiple expansion, i.e., if investors will continue to pay for higher equity prices at the current level of earnings. The S&P 500 has traded at close to its historical average P/E of 16.5 for most of the year. In the fourth quarter alone[iii] , the S&P 500 is up 9.35%[iv], so, as we close the year, the S&P 500 trades at roughly an 18.2 P/E ratio using S&P 500 consensus earnings estimates of $177 for 2020. This is above average, but not by much.

What has not been average are fixed income yields, specifically U.S. Treasuries, which set the base for the rest of the bond market and are at multi-generational lows. As we wrote in our third quarter piece, "The Great Divide," the valuation between stocks and bonds are at historical extremes when comparing the "earnings yield," of the two asset classes. The valuation gap is still compelling. The earnings yield for the S&P 500 sits at 5.5% ($177/3240[v]), while the 10-year Treasury bond yields 1.87%.[vi]

As we enter 2020, we expect a digestion period for the stock market as markets absorb the strong returns from 2019.

Although we focus on fundamentals long-term, technical analysis can give insight into the market over the short-term. One indicator we follow is the percent of S&P 500 companies below or above their 200-day moving average.

S&P 500 One and Three Month Returns After 80% + of Companies Above 200-DMA

Date	1mo	3mo
8/19/2016	-1.89%	0.44%
3/1/2017	-1.25%	1.94%
1/26/2018	-3.04%	-6.72%

Source: Morningstar, thechartstore.com

When 80% of companies are above or at their 200-day moving average, markets tend to be overbought on a short-term basis (see table). Since 2011, there have only been three periods where 80% or more of stocks were above their 200-day moving average. As of December 26, 2019, 81% of companies in the S&P 500 are above their 200-day moving average. When equities reach the 80% mark, it is not necessarily a sign of an impending sell-off, but a period of market digestion. We would not be surprised for markets to take a breather or have a period of consolidation following a year when the S&P 500 returned almost 30%. Investors should remember that the average annual intrayear peak-to-trough decline for the S&P 500 is -13.8% since 1980; this is a statistic we would not be surprised to see occur again in 2020.

Regardless of the unknowns that 2020 will bring, 2019 was an excellent reminder that **time in the market, not timing the market**, is the key to investor success. We believe in allocating portfolios to both public and private market investments. While our private market investments have the potential to generate returns in excess of the long-term returns of public markets, private investments are less liquid and therefore, mandate a longer-term time horizon. Public investments provide daily liquidity, but they also provide daily volatility, which is the price of admission of owning equities.

Investors should have a balance between public and private market exposure. In public markets, low cost, tax-efficient index strategies continue to deliver top quartile returns. We complement our public market exposure with private investments to offer high-quality long-term returns that are not path dependent on interest rates moving lower and/or stocks moving higher to generate 100% of their returns.

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[i] Source: the chart store S&P 500 (Total return) December 1-December 24 returns: money.net

[ii] Bloomberg 12/24/2018-12/24/2019 total return

[iii] Bloomberg 9/30/19-12/27/2019 S&P 500 total return 9.35%

[iv] Source: Bloomberg

[v] S&P 500 close as of 12/27/19

[vi] Source: Bloomberg 12/27/19