WestStar

Wealth Watch

January 2020

The Next Frontier

The prospect of launching into a new decade and the vast unknown that lies before us is reminiscent of the classic television show Star Trek and its iconic introduction:

"Space: the final frontier. These are the voyages of the starship Enterprise. Its five-year mission: to explore strange new worlds; to seek out new life and new civilizations; to boldly go where no one has gone before."

The final line in particular rings true as we progress into unprecedented territory amid the longest economic expansion in history, "disruptive" technological innovation, and shifting demographics. As the 2020's commence, what might we expect going forward? How might the presidential election affect markets, and will US markets continue to lead the world or do opportunities exist abroad? Let us forge ahead into the next frontier to explore and seek out answers to these questions and more.

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Your wealth, well managed.

What You Need to Know:

- In 2019 all major asset classes were positive
- Stocks have posted positive performance in two-thirds of election years historically
- A negative market has typically followed an incumbent party loss but rebounded the year after
- An incumbent party win has been likelier when not in a recession
- Stocks have historically performed differently depending on the combination of presidential and congressional composition
- Opportunities are arising in international markets

Asset Class Index Performance* 2019

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- US Large Cap Stocks 31.49%
- US Small Cap Stocks 25.52%
- Real Estate 23.06%
- International Developed Market Stocks 22.66%
- International Emerging Market Stocks 18.90%
- High Yield Bonds 14.32%
- US Investment-Grade Core Bonds 8.72%
- Commodities 7.69%
- Alternative Investments 6.65%
- International Bonds 5.09%
- Cash 2.31%

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These are the Voyages: Market Performance & Tactical Strategy

If consumer spending, which represents two-thirds of economic growth, can be thought of as the means of propulsion for the economy, then government stimulus via tax cuts and higher expenditures could be akin to Star Trek's "warp drive." Indeed, stimulative measures did boost the economy in 2019, however other factors—such as trade war uncertainty—held it back. The net effect of these opposing forces equated to economic growth that was just about right. The market reacted accordingly, with stocks being the best performing category. In particular, US stocks led the way with large companies leading the pack. Within the fixed income asset class, high yield bonds outpaced their investment-grade counterparts by a wide margin. In a complete reversal from 2018, all major asset categories were positive in 2019.

There were, however, true obstacles that could have posed problems for investors. Our job is to navigate the portfolio vessel through capital market asteroid fields to advance whilst remaining relatively unscathed. As such, we did deploy "deflector shields" by implementing a defensive posture in 2019, however our strategies performed near or above benchmark for the year.

Five Year Mission: Politics & Presidents

One of the largest looming factors facing 2020 is the presidential election. The next five years relating thereto—election year through the next presidential term—will have major implications on the economy and markets in a number of ways. Because at the time of this writing we are weeks away from the first Democratic primary elections, we will relegate economic policy analysis to future discussions when a clearer picture of the eventual nominee emerges. In the meantime we will examine historical market behavior surrounding presidential elections.

Source: Ned Davis Research	Election Year	Post-Election Year	Mid-Term Year	Pre-Election Year
Years Dow Jones Id. Avg. Up	69%	53%	57%	80%
Average Gain/Year	7.7%	6.8%	3.8%	12.2%
Average Gain Breakdown by Party				
Under Republicans	10.3%	5.3%	3.4%	5.7%
Under Democrats	4.8%	8.6%	4.2%	19.7%
Incumbent Party Wins	14.6%	6.2%	2.6%	5.3%
Incumbent Party Loses	-2.9%	7.7%	5.5%	22.7%
Incumbent Republican Wins	19.8%	8.2%	-1.3%	-0.1%
Incumbent Republican Loses	-6.1%	15.1%	-0.3%	30.1%
Incumbent Democrat Wins	8.2%	3.7%	7.5%	12.0%
Incumbent Democrat Loses	0.3%	0.4%	11.3%	15.3%

The table at left shows the history of the Dow Jones Industrial Average broken down by the four years of a presidential term going back to the year 1900. We can quickly ascertain that the market has been positive over two-thirds of election years historically, with an average gain of 7.7%. We also find, however, that the results have diverged widely based on the party in power and whether said party wins or loses the election.

On average the market has performed best during election years wherein the incumbent party wins, however when the incumbent Republican wins it has been up over double the amount as when the incumbent Democrat wins. In the same vein, the market has tended to do worst during election years that the incumbent Republican loses. Based solely on these historical averages, this would suggest that if President Trump were to win we might see a market rally and vice-versa. Yet, should he lose the election, historical averages of post-election years indicate patience is warranted, as the market might rally in 2021.

Historical analysis of presidential elections also indicates a distinct difference based on economic conditions. Between the years 1900 and 2016, the incumbent party has only lost 32% of the time when not in a recession but 80% of the time when in one. Because at this time we do not find evidence of a recession in the very near future, this would seemingly be good news for President Trump's prospects in

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets I
Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity Ind

November. That being said, 2016 was an election year that violated this concept, so it can and, in fact, has happened in recent history. But what about Congress and its composition?

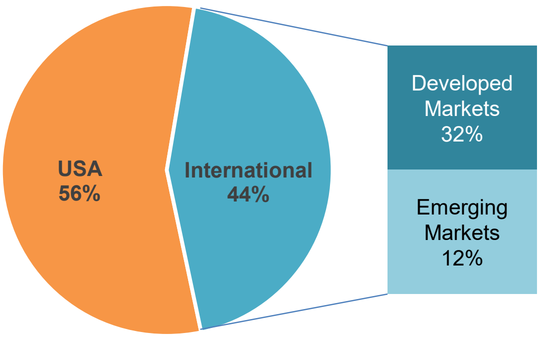
Source: Ned Davis Research *Dow Jones Industrial Avg. Performance*	Gain/ Annum	% of Time
Republican President & Congress	7.67%	10.1
Republican President/Split Congress	-4.25%	3.4
Republican President/Democratic Congress	2.44%	33.6
Democratic President & Congress	9.05%	24.4
Democratic President/Split Congress	10.37%	10.1
Democratic President/Democratic Congress	7.17%	18.5

The table at left shows performance of the Dow Jones Industrial Average going back to the year 1901 based on varying presidential/congressional composition. We find that the stock market has tended to do worst under a Republican President/Split Congress combination and best under a Democratic President/Split Congress one. It should be noted that the former scenario has only occurred 3.4% of the time and the latter 10.1% of the time, so the small sample size reduces accuracy. The data does show that in general the stock market has done better under Democratic administrations than under Republican ones, therefore a Trump election loss may fare fine over the course of the next president's term.

Explore New Worlds: International Investing

As we have these discussions about US politics and the economy it is important to remember it is a big planet and many opportunities exist beyond our borders. Indeed, as the chart at right shows, 44% of the global equity opportunity set exists abroad. As the crew of the Starship Enterprise boldly went where no one had gone before, we must not be afraid to explore new worlds or seek out new civilizations in our investing. This holds particularly true when we grow concerned over domestic volatility, as international markets might be expected to perform differently.

MSCI All Country World Index



When investing we must always remain cognizant of valuation—that is to say the expensiveness or cheapness of the asset in question. One way to measure this is by the price-to-earnings (P/E) ratio. As shown on the table at right, the S&P 500 Index presently has an 18.2 P/E ratio—higher than its 20 year average of 15.5—meaning it is expensive. In contrast, the international stock index is much closer to its long-term average and, as a percentage of its US counterpart, is presently cheaper. Furthermore, the dividend yield on international stocks is higher than US stocks, making them more attractive from an income perspective.

Source: JP Morgan	P/E	20-Yr Average	Dividend Yield	20-Yr Average
S&P 500	18.2	15.5	1.9%	2.1%
MSCI ACWI ex-USA	14.2	13.8	3.3%	3.1%
As a % of US	78%	88%	169%	151%

Live Longer and Prosper: Maintain Focus on Long-Term Strategy

As the journey into the next decade commences, we gaze in many ways across a vast unknown. Astrophysicist Carl Sagan noted, "By looking far out into space we are also looking far back into time." As it relates to our investments, we know that the most effective way to achieve our future objectives is by learning from the past and maintaining a long-term focus. The short-term market fluctuations can be mitigated by adhering to a prudently-devised and constructed investment strategy. We will monitor and study developments in the global economy, the political realm, and the capital markets to ensure our clients are appropriately positioned. In so doing, achieving the Vulcan benediction often spoken by Star Trek's Mr. Spock, "live long and prosper," will have the greatest probability of success.

ts Index; Core Bond: BbgBarclays Aggregate Index; Int'l Bond: BbgBarclays Global Aggregate ex-USD Index; High Yield: BbgBarclays US Corporate High Yield Index; Cash: BofA Merrill
ndex; Alternatives: Wilshire Liquid Alternatives Index

The team you can trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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