DANN ASSET ADVISORS, LLC

Fourth Quarter 2019 Update

January 13, 2020

4Q19 Highlights

- U.S. stocks rally strongly, capping off best year since 2013
- Recession fears ease and Fed indicates comfort with current growth/inflation balance
- Chinese trade issues and Brexit move toward partial resolution
- International stocks improve in fourth quarter but again lag for the year

The table below summarizes the performance of some key indices during the fourth quarter and full year:

Market Performance Index	% Ch. 4Q19	% Ch. YTD
S&P 500	9.1	31.5
MSCI All Country World ex US	8.9	21.5
MSCI Dev. Markets (ex US)	8.6	22.4
MSCI Emerging Markets	11.8	18.4
US Aggregate Bond	0.2	8.7
Liquid High Yield	2.8	14.7

Source: Morningstar, iShares

Equities. Following a modest third quarter gain the market rebounded strongly in the fourth quarter as economy and trade related fears ebbed. The full year return of 31.5% represented the market's best return in six years and only the fifth gain of 30%-plus in the last 30 years. It's worth noting that 2019 began after the market had sold off significantly in the fourth quarter of 2018, so to some extent 2019's gain stemmed from starting off a low base.

Investors focused on more aggressive sectors during the quarter. For example, indices of biotech and semiconductor stocks each rose more than 20%. And small company stocks, as measured by the Russell 2000 index, modestly outperformed large cap stocks for the first time since the second quarter of 2018, possibly reflecting better sentiment toward the economy. The only frustrating issue for investors with diversified portfolios is that value stocks continued to underperform growth stocks, with the Russell 1000 Value index returning only 7% in the quarter vs. 11% for the Russell 1000 Growth index.

For the full year, the difference between value and growth was an unusually large 10 percentage points. Also for the full year, large company stocks outperformed small by six percentage points, marking the third straight year of large cap companies leading the market. Large cap U.S. growth stocks (and technology in particular) have been the place to be the past three years.

International stocks finally had a decent quarter with emerging markets exceeding the S&P 500's return. We believe this was due to better perceptions around trade, as well as to signs that the Chinese economy may be bottoming. Developed country stocks excluding the U.S. continued to lag slightly, as key European country economies remain weak.

Fixed income. The 10-year treasury yield rose to 1.92% at year end from 1.68 % at September 30. For the year, 10-year yields declined 75 basis points (a basis point is 1/100 of a percent) from

2.67% at the end of 2018. Two-year treasury yields were nearly unchanged in the quarter, ending at 1.57%, but still down significantly from 2.50% at December 31, 2018. The spread between the 10 and two-year treasury expanded to 35 basis points at year end after having briefly inverted (possible recession signal) in the third quarter of 2019. Even with a just above breakeven fourth quarter (as measured by the Barclays U.S. Aggregate Bond index), with the full-year decline in rates bonds generated strong total returns in 2019.

Market sectors. Led by biotech, the healthcare sector bounced back as the strongest performing group in the fourth quarter. Healthcare had been the second worst sector through the first three quarters and we're not sure why the group rebounded, other than possibly investors were looking to buy lagging stocks as the market continued rising. Technology was the second-best performing group, adding to its market leading gains. Financials were a close third, helped, in our opinion, by better than expected earnings and a modest increase in rates. For the full year, tech stocks trounced other sectors with a gain of 45%-50% (exact gain dependent on the specific tech index).

Indicative of a strong market, sectors perceived as conservative lagged in the fourth quarter, with utilities, real estate companies and consumer staples stocks flat to up less than 5%. For the full year energy was the worst sector with a return of just under 10%. All other sectors returned at least 20% for the year.

Portfolio Positioning

For nearly all clients with fixed income we remain 70% or more in short duration (which we define as three years or less) and 80% or more in investment grade funds. For some clients with very short duration exposure in the one-year range we modestly extended maturities during the quarter. On equities, our primary transaction for most clients was selling the remainder of an Asia-focused mutual fund we'd sold roughly half of in August 2019. As poor relative performance continued with this fund through much of the fourth quarter, we lost patience with the managers and decided to sell. A portion of the proceeds were put into a newly purchased fund with a broader international focus, and the remainder into already-owned positions.

2020 stock market outlook. Towards the end of our 2019 outlook we stated that "… if the downshift in corporate profits that we anticipate proves short term and moderate, as we currently expect, we believe the market will end 2019 higher than where it began." Directionally we were right, but we never would have guessed the market would generate a return in the 30% range. In most years we'd be happy with an annual return similar to the fourth quarter's 9%. Stock market wise 2019 was a very good year.

As we begin 2020, the U.S. economy seems to have weathered a slowdown in the manufacturing and industrial sectors, with consumers continuing to drive growth. As a whole, the largest international economies seem to be stable to modestly improving. Interest rates remain near historically low levels. In this type of environment, corporate earnings should continue to grow and support stock prices. In many ways, this is a perfect environment for stocks.

However, stocks usually are considered forward looking indicators with prices moving in advance of anticipated earnings. We believe the market's fourth quarter gain reflects the economy, and thus corporate earnings, potentially being stronger over the near term than contemplated by investors earlier in 2019. While it's difficult to remember with the market hitting numerous highs in the fourth quarter, during the summer investors had been worried about yield curve inversions and the potential for a U.S. recession.

We have no better idea than anyone what will happen with the markets in 2020. Similar to many others, we believe that a Democratic controlled congress in combination with a victory by one of the more liberal Democratic party presidential candidates would be bad for the stock market (not a comment on our politics). Beyond that, with the market trading at 18.4x 2020 consensus earnings estimates (per Yardeni Research) and our belief that earnings will increase at most mid-single digits in 2020, we judge that a lot of positives already are reflected in stock prices and that any negative development could cause a material decline.

Putting the foregoing together, our best guess is that the market is flat to up modestly in 2020. Regardless of whether that proves accurate, we feel confident that at some point during the year there will be a decline of 10%-20%, if for no reason other than that the market currently seems to be priced for perfection and something negative almost always comes up (even if it proves to be irrelevant beyond the short term).

We note that market history argues for an up year in 2020. Spurred by a comment from Art Cashin, a long-time, respected market observer, we looked at the performance of the S&P 500 in the year succeeding a year with a return greater than 25%. Going back to 1960, we found 11 years with returns of 25%+. In eight of the following years the market was up and in the three succeeding years that showed declines the largest was 8.7%. The average return of the 11 succeeding years was 11.4%. We appreciate that this is a relatively small set of numbers and that the economy, earnings and interest rates will be the real determinant of market performance in 2020. Still, based on the past, the odds seem to favor another positive year.

Economy

Third-quarter GDP grew 2.1%, in line with the 2.0% gain of the second quarter. Consumer spending increased a solid 3.2%, even though down from very strong growth of 4.6% in the second quarter. Of note, homebuilding and related spending rose 4.6%, the first increase in seven quarters (according to the Wall Street Journal) and probably a reflection of the strong consumer and falling mortgage rates. Business investment continued weak, declining 2.3% but still a small improvement from the 2.7% decrease of the second quarter.

In essence, the third quarter represented a continuation of the recent trend of a strong U.S. consumer and a weaker industrial/manufacturing sector, the latter likely hurt by relatively softer international economies and uncertainty around trade. Fourth-quarter GDP will be reported in the next couple of weeks and is expected to grow at a slightly slower 1.7% pace according to a recent Wall Street Journal survey of economists.

Despite expectations for only modest growth in the fourth quarter our sense is that the first half of 2020 could see better growth. In our opinion, the widening of the spread between 10-year and two-year treasuries, improved homebuilding numbers and what we perceive as a bottoming in the manufacturing sector (recent purchasing managers' surveys have been better) are good indicators that growth could pick up in coming months. Although we believe that the phase one trade deal with China lacks substance (relative to stated goals) and that much still needs to be done around Brexit, sentiment around these two issues seems to have improved significantly, reducing their potential negative impact on the economy.

Additionally, employment remains strong with wages growing, both of which should support consumer spending. Finally, our guess is that in an election year President Trump will be less combative on trade with a goal of not wanting to risk hurting the economy. Putting all these

factors together leads us to believe that growth should be decent over the next couple of quarters, absent unforeseeable issues. We note that in connection with its December meeting the Fed indicated comfort with current growth rates and an expectation of keeping rates stable through 2020.

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