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Dear Clients of MacDougall Financial, January 22, 2020

War is how Americans learn geography.
In chaos, there are opportunities, which multiply as you seize them.

Our saber-rattling President and soaring stock/bond markets proved both of the above sayings in 2019. Resilient economic data and accommodative central banks have supported the financial markets and reduced investor concerns. Truly the past decade has been exceptional with the S&P 500 compounding at an annualized 13.4%. The US consumer is strong, seeing gains in wages/income and in spite of record levels of debt, their debt to disposable income ratio is below 10%, its lowest level in 30 years. The decade long underperformance of international stocks is clearly shown in the MSCI EAFE 10 year avg. returns of 5.6% and the MSCI Emerging Markets index at 3.2%. This is partly driven by weakening manufacturing activity around the world as trading volumes decline and the tariff wars continue. However, the importance of the manufacturing sector has declined significantly in America where the service and consumer sectors now dominate. The four key economic indicators - inflation (low), unemployment (low), interest rates (low), and liquidity/credit availability (high) - all point to continued strength in the broader economy. Despite ample worries like trade wars, Brexit, the US election, China, etc., the fundamentals and sentiment support further gains.

In the ecstasy of the moment, let us not forget that only a year ago, we were experiencing a 20% decline in the S&P 500 and even as recently as October 2019, the 1-year return for this index was 0.8%. The year ultimately witnessed a gain of 31.5% with the tech sector leading the way with a 50% increase! All eleven of the S&P sectors were positive with energy at +12% (lowest) and all the remaining sectors showing solid +20-30% gains. It was as impressive as it was improbable with US markets adding $9 trillion in value and global markets $17trn. Corporate earnings grew by only 1.1% so the rise was due entirely to an expansion in the P/E multiple (rising by 37% from 13.5 to 18.5). The market was also less volatile last year with the largest downdraft of 6.6% versus the 35 year average of 14%.

Global monetary policy performed a U-turn in 2019 for the year saw 5.5 interest rate cuts for every increase (globally) whereas 2018 witnessed 2 increases for every cut. This interest rate pivot by the Central Banks caused sentiment to quickly reverse in the last four months as shown in the 4th quarter improvement in the per day up/down split of the S&P 500 stocks. Prior to September, it was running circa the 50/50 level (50 up days, 50 down days) but by year-end, it stood at 60/40 (50-year average is 53/47). Similar reversals were seen in cash which moved from the top performing asset class in 2018 to the bottom in 2019; and the appropriately named CNN Fear & Greed index (0-100) went from 12 in Dec. 2018 to 97 in Dec 2019. The US Agg bond index rose 8.7%, it's best since 2002. Three long term statistics that I came across in my readings that should give you some confidence in market investments are that 1) the Agg Bond Index has 3 negative readings in the last 44 years, 2) 84% of all rolling 3 year S&P500 returns since 1929 have been positive, and 3) the S&P 500 is up 40 of the last 50 years (avg. gain = 18% 40 years; avg. loss = 15% 10 years). This should a) remind you why you are invested in the market, b) reaffirm the belief that time in the market is critical, and lastly that all markets climb walls of worry.

Your portfolios participated in the rally as you can see by looking down the 2019 column of double-digit equity returns. While we will not claim either brilliance or responsibility since pretty much every asset class rose, at least our selection of mutual funds generally equaled or exceeded

their benchmark returns. Even our perennial albatross, the international funds, sported returns in the low 20% range. 2018 saw mostly single-digit declines in all asset classes while 2019 saw double-digit returns. A stunning reversal and one which begs the question: Are point in time returns more noise than signal? A lengthy subject for another day. The risks are ever-present: record levels of public and corporate debt, weakening forward indicators such as the Purchasing Managers Index, anemic corporate earnings growth, but so far, no one is willing to buck the old adage: "Don't fight the Fed". Low-interest rates remain a fact with 80% of global bonds yielding under 3%. Pensions and insurance companies are struggling to earn the returns required to meet their obligations and negative interest rates hurt more than they help. Japan has had 3 decades of zero growth and this could be the US unless we engage in some structural fiscal reforms of our taxing and spending policies. However, such changes are the 'third rail' of politics. It remains a conundrum as to why Germany's sovereign debt shows negative yields out to 30 years while the US debt has the highest positive yields in the world. It is a sad and strange day when the US pays more for 10-year money than Italy! Underlying some of the US market strength are the twin facts of declining numbers of public companies (1980 = 11,500; today circa 5,000 or less) and the high level of share repurchases ($737bn in 2019). Growth investments continued their long run of outperformance though the spread over value investments narrowed. It remains an open question if this is the beginning of the reversion to the mean. In closing, it was an excellent year for investors and financial advisors alike.

2020 also looks bright due to the aforementioned positive fundamentals and the forecast for an S&P500 earnings growth of between 5-10%. A recession is rarely foreseen but it does not look likely in the near term (3-9 months). Both forward revenues and earnings per share are at or near record highs. Goldman Sachs forecasts global GDP growth of 3.4% and they favor a globally diversified 60/40 portfolio with a bias to alpha (active) over beta (passive). To temper our euphoria, note that netting the 2018 -20% decline against this year's gain results in an overall gain of 10%. Not exceptional but acceptable…. and hopefully leaving room for single-digit 2020 returns! "Secular Stagnation" is the topic du jour among many and yet since 2010, global growth has averaged the same 3.5% as in the 30 years prior to 2010. Debt levels continue to rise inexorably with the US issuing $2.5 trillion in 250 trading days and total gov't debt rose to $23trn (+$11trn in the last 10 years!). It remains an enigma why interest rates remain so low in the face of massive global issuance. Truly the last decade was about how printing money solves lots of problems and the coming decade will be about dealing with the problems this printing produced. My caveat to all this positive news is the slightly modified adage : "We have nothing to fear but nothing to fear" meaning that perhaps it pays to be fearful when all are greedy. We will continue our vigilance in protecting your financial well-being as some of these problems are worked through.

We enclose our updated ADV which is required by the SEC due to the 2019 addition to the firm of my daughter, Elizabeth MacDougall. Forgive me for being the proud father in noting that Liz graduated Summa cum Laude in Finance at the University of Richmond and spent a year in Private Equity in DC before joining us. She has been a very positive addition to our team and we look forward to introducing her to you in 2020. Please contact us with any questions.

Best, Lanny

PS: One factoid that did not fit in the letter but does show you the size and importance of the Chinese market is that in the last quarter, Grubhub delivered 457,000 meals per day in America, impressive and well above my estimate, but Meitung Dianping (Chinese equivalent) delivered 28 million meals per day in the same quarter! China's urban population is approaching 1bn!