Economic Commentary

January 2020

Index Total Returns	QTD	YTD	12 M
Domestic Equities			
S&P 500	9.06	31.48	31.48
DJIA	6.67	25.34	25.34
Nasdaq	12.49	36.74	36.74
Russell 2000	9.93	25.49	25.49
International Markets			
MSCI EAFE	8.17	22.01	22.01
MSCI EM	11.84	18.42	18.42
Fixed Income			
US Treasury	-0.79	6.86	6.86
US Credit	1.05	13.80	13.80
Municipal Bond Index	0.74	7.54	7.54
US Corporate High Yield	2.62	14.32	14.32

Maple Capital Strategy & Portfolio Changes

During the fourth quarter, we trimmed exposure to certain equity holdings that had displayed exceptional gains. Year-to-date total returns have been strong across the board and we believe capitalizing on a small portion of this performance is warranted given increasing potential risk from various sources.

On the fixed income side, conditions remain favorable and the strains in the repo market did not cause any harm to the overall market. Given the low or negative yields prevailing across the globe, U.S. yields remain attractive to foreign buyers. We remain cautious and discriminating as we invest across the maturity spectrum.

We maintain the belief that a diversified portfolio of high quality and long-term earnings compounders reduces risk and outperforms over the full cycle. This requires occasional position size adjustment.

"It was a very good year"

- Frank Sinatra

Investors were rewarded handsomely in 2019 no matter the market. Domestic and international equities both experienced big rallies and fixed income returns were quite impressive despite slow growth and tremendous uncertainty stemming from the trade war. Investors correctly anticipated the Federal Reserve (Fed) would shift from a tightening to an easing policy, so equities hit record-highs and the bond market also rallied which sent Treasury yields plunging. With the Fed in easing mode by mid-year, yield spreads tightened which helped prices move still higher, leading corporate bonds, mortgage-backed securities, and municipal bonds to all perform well. It's unusual for equities and bonds to rally in sync, but the Fed's pre-emptive policy actions provided plenty for both markets to cheer about.

The trade war created a great deal of uncertainty among businesses since global supply chains were impacted and rhetoric from both sides was disturbing. By early December, however, a Phase One deal was reached which propelled U.S. equity markets to new highs. Even though the details of the agreement were scant, the fact that some level of agreement was reached was reason enough for investors to buy.

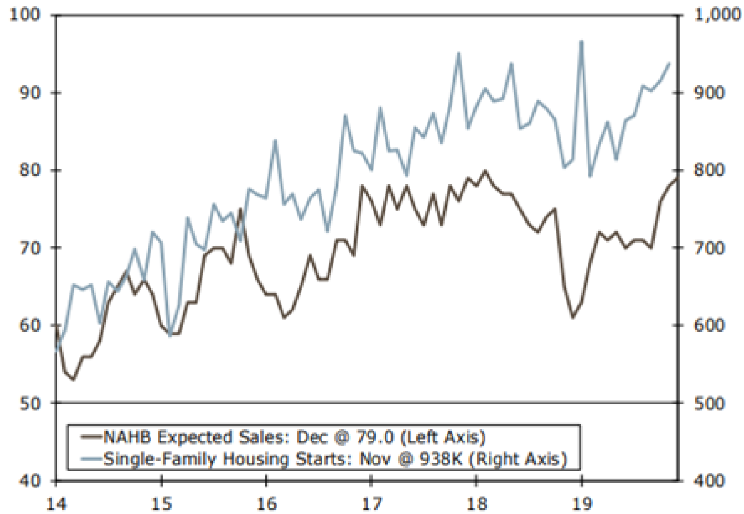
Lower interest rates resulted in easier financial conditions for businesses and consumers alike and helped revive the stalled residential real estate market, sending new home sales to the highest level since 2007 (see chart on the following page). The labor market also improved throughout the year, confounding many who thought job gains would dissipate since the labor pool is now so small. With the unemployment rate at just 3.5%, consumers appear resilient and it remains difficult to identify any major imbalances in the economy that could be sources of instability. The weak manufacturing sector remains a vulnerability for the overall economy, so the next path for trade negotiations will be critical as the new year unfolds.

What else is in store for 2020? Probably not a recession, but it's the forecast of a future recession that is probably going to be most damaging to financial markets, not the actual onset of a recession itself. That's why the fourth quarter of 2018 was so volatile for financial markets since investors expected the Fed would raise rates four times in 2019 and the trade war would impact growth more severely. The policy pivot by the Fed was instrumental in easing investors' concerns and aligning monetary policy with other global central banks. This year, the Fed is not expected to continue cutting rates if growth and inflation remain on their current trajectory, but we believe they would cut further if either takes a turn for the worse. In the case of inflation, a turn for the worse would be lower inflation since the Fed is trying to engineer higher inflation (2% to be exact).

Most of the developed world remains trapped in long-term secular trends of aging and declines in working-age populations, both of which are deflationary, so inflation has been exceptionally low across most of the globe. Key central banks remain committed to extraordinary easing measures such as buying bonds, but economic growth is expected to remain contained regardless of these measures since other powerful forces are also affecting the nature of economic growth. Chief among these is technology, which is enabling disruptive entrants into more and more industries, challenging job growth, keeping inflation low, and forcing some out of the labor force since they lack the necessary skills. Investment spending in actual plant and equipment --- the things that powered old economic recoveries --- is simply less necessary in today's economy.

NAHB Expected Single-Family Home Sales vs. SF Stats

Index; SAAR, Thousands



Source: Housing Chartbook: January 2020, Wells Fargo Securities

If no recession is likely to develop in 2020 then more of the same is probable: low growth, tame inflation, and slowing overseas growth due to the on-going trade war as well as the demographic issues noted above. Equities can continue to offer decent returns to investors if earnings growth is maintained, but there could be greater volatility for the broad averages. Bond yields probably won't decline as much and may even rise a bit, but they're unlikely to rise significantly since the Fed will likely keep its messaging consistent with the recent tone. If Treasury yields remain range-bound, corporate and mortgage-backed bonds should prove good sources of income. Municipal bonds are also expected to continue performing well since voracious demand is being met with limited supply, and tax-saving strategies are less abundant since the tax changes of 2017.

The now record-long economic recovery, prolonged by the Fed's "insurance" rate cuts, is late-stage and many traditional valuation measures in equity and fixed income markets appear stretched. It is imperative that investment decisions be based on thorough research and deliberate risk-taking since the market tends to punish earnings misses rather harshly. Quality is the dominant theme at Maple Capital, and quality is not necessarily defined by a single metric but instead is a mosaic of factors that are uncovered through a careful and rigorous investment process...and a healthy dose of skepticism!

We thank you for entrusting us with your financial assets and we are inspired by the confidence you have placed in us.

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