Nicolet
WEALTH MANAGEMENT

2020 OUTLOOK

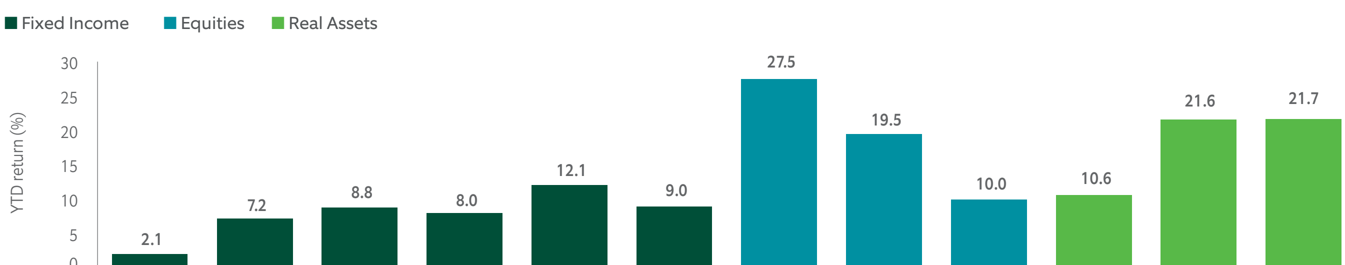
EVERYTHING IN MODERATION

We are moderately overweight risk as we prepare to enter 2020, as the global economy shows signs of stabilization after an episode of mid-year weakness. We expect markets to focus on the tensions between organic economic growth and the risk associated with geopolitical uncertainties such as the U.S.-China trade war, Brexit and the 2020 U.S. election.

We think 2020 will be another year of slow growth – durable enough to avoid recession but disappointing to those looking for improvement. The combination of moderate growth and technological innovation will continue to suppress inflation, bolstering the global central bank easing cycle underway. This leaves us continuing to favor "lower-risk risk assets" such as U.S. equities and high-yield bonds. We also remain constructive on the outlook for interest rates, leading to recommended overweights in global real estate and global listed infrastructure. We entered 2019 neutral risk as we believed the Federal Reserve was mistaken in continuing to tighten monetary policy. This concern was ameliorated in early January as Fed Chair Jerome Powell pivoted away from further tightening, and we noticeably increased risk in mid-January as a result. Early year concerns about Brexit have been reduced as odds of hard Brexit fell, and the appointment of Christine Lagarde as the new head of the European Central Bank has been well received. The U.S.-China trade wars – and the associated risks of broadening tariffs – have now taken center stage for investors. We expect this to continue to be a headwind to growth and risk taking, as we do not expect a meaningful resolution in the foreseeable future. We also expect the 2020 U.S. election to remain a concern to investors, as the Democratic and Republican platforms start to form ahead of their national conventions. We expect positive returns across most markets in 2020, but they will be unlikely to reach the lofty levels realized in 2019 (see below).

EXHIBIT 1: EARLY YEAR FED PIVOT DRIVES RISK ASSETS

The Federal Reserve's pivot away from rate hikes early in the year gave a boost to risk assets, but returns may slow.



	RISK CONTROL				RISK ASSETS							
	FIXED INCOME						EQUITIES			REAL ASSETS		
	Cash	Municipal Bonds	Inv. Grade	TIPS	High Yield	EM Debt	U.S.	Dev. Ex-U.S.	Emerging Markets	Natural Resources	Gbl. Real Estate	Gbl. Listed Infra.
YTD	2.1	7.2	8.8	8.0	12.1	9.0	27.5	19.5	10.0	10.6	21.6	21.7
2018	1.8	1.3	0.0	-1.3	-2.1	-6.2	-5.2	-14.3	-14.7	-12.6	-6.3	-9.5
5 Year	1.0	3.6	3.1	2.3	5.4	0.7	10.7	5.0	3.3	3.0	6.8	5.5

Source: Northern Trust Asset Management, Bloomberg. Year-to-date data through November 30, 2019. Five-year annualized data from November 30, 2014 to November 30, 2019. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. **Past performance is no guarantee of future results.**

EXHIBIT 2: 2020 OUTLOOK BY ASSET CLASS

		Asset Class Positioning	TAA*	SAA**	Key Views
Risk Assets	EQUITIES	DEVELOPED MARKETS **5% Overweight**	45%	40%	Positive U.S. fundamentals (modest growth and stuckflation) and a lower risk profile vs. other equity regions amid ongoing geopolitical tensions leave us biased towards the U.S. in our global equity portfolio. We also have a slight overweight in developed markets outside the U.S. due to attractive valuations and some signs of economic stabilization. Central banks in a synchronized global easing cycle will provide general support for equity markets.
Risk Assets	EQUITIES	EMERGING MARKETS **2% Underweight**	4%	6%	Irreconcilable differences between the U.S. and China along with global growth restructuring will lead to slower growth in the years ahead. Continued U.S.-China tensions will have a greater impact on emerging market equities vis-à-vis developed market equities, leaving us underweight. Attractive valuations will not be enough to offset continued geopolitical tensions.
Risk Assets	REAL ASSETS	GLOBAL REAL ESTATE/ INFRASTRUCTURE **5% Overweight**	9%	4%	Global real estate and listed infrastructure continue to offer high income and diversified risk exposures. Our expectation for lower interest rates and two Federal Reserve cuts in 2020 will positively impact these cash flow assets over the tactical horizon. While overweight both, we prefer global real estate over listed infrastructure as it should perform better in a modestly risk-on environment.
Risk Assets	REAL ASSETS	NATURAL RESOURCES **1% Underweight**	3%	4%	Equity-based natural resources help protect against unanticipated inflation and can provide portfolio protection against geopolitical risks. Currently, valuations are attractive but we sit slightly underweight, preferring other real assets in an environment of continued slow growth, stuckflation and lower interest rates.
Risk Assets	FIXED INCOME	HIGH YIELD **5% Overweight**	10%	5%	High yield's "upside participation and downside mitigation" profile makes the asset class one of our highest conviction overweights in the current environment. In addition to slow growth, 2020 will introduce more trade and political uncertainty. Solid fundamentals (including manageable default rates) and constructive technicals (due to strong demand) make high yield attractive moving forward.
Risk Control Assets	FIXED INCOME	INVESTMENT GRADE **5% Underweight**	29%	34%	We are not negative on investment grade, as we expect interest rates to remain low (and are long duration in bond portfolios). However, we are using the asset class to fund our overweight to risk assets where we see better opportunities. Investment grade bonds remain the best diversifying asset class relative to risk assets in periods of market stress.
Risk Control Assets	FIXED INCOME	INFLATION LINKED **5% Underweight**	0%	5%	Our **Stuckflation 4.0** theme underlies our underweight position. Structural forces found within both supply (technology) and demand (demographics) will prevent higher inflation in 2020. Where inflation-linked bonds are used, we prefer short, targeted duration strategies to maximize exposure to inflation expectations and minimize interest rate exposure.
Risk Control Assets	FIXED INCOME	CASH **2% Underweight**	0%	2%	The Federal Reserve's pivot at the end of 2018 led to three interest rate cuts in 2019, pressuring cash returns. Though the Fed says it is on hold, we expect two more rate cuts in 2020. Low rates at the short end will lead to better opportunities further out on the duration and credit spectrum. We view cash as an asset class used primarily for meeting near-term liquidity needs, and remain underweight.
		TACTICAL RISK POSITION: **Moderate overweight to risk**			We are overweight risk in the "lower-risk" risk assets. High-yield bonds and U.S. equities make up our greatest conviction positions funded by risk control assets (cash, investment grade bonds and inflation-linked bonds) and an underweight to emerging market equities. Resilient economic data and accommodative central banks in a global easing cycle should act as a brake on downside economic scenarios associated with trade and political uncertainty throughout 2020.

*TAA = Tactical Asset Allocation.
** SAA = Strategic Asset Allocation.
These recommendations, based on the Global Policy Model, do not include alternatives. We believe strategic holdings in both private investments and hedge funds can assist in increasing portfolio efficiency. However, we do not make tactical recommendations on these asset classes due to the strategic nature of the investments.

MACRO THEME REVIEW

Our 2020 outlook includes a review of our long-term capital market assumption themes, as published each August in our CMA Five-Year Outlook.

Our 2020 outlook includes a review of our long-term capital market assumption themes, as published each August in our CMA Five-Year Outlook paper. These themes drive our "forward-looking, but historically aware" approach to strategic asset allocation and also serve as a useful template for our tactical outlook and asset allocation positioning. Exhibit 3 details the progression of these macro themes. Highlighted below are those most important to recent market returns and future market expectations.

Global Growth Restructuring has led to continued slow-but-positive growth. The global economy is navigating changing trading frameworks and growing technological impacts. However, as it adjusts, it is benefiting from the continued transition from manufacturing to the more-stable services sector. Because of service sector stability, the global economy has handled the trade war between the U.S. and China better than many investors expected. Global equities are up over 20% on the year and an annualized 7% since March 2018, when the first tariffs on China were announced. That said, **Irreconcilable Differences** between the U.S. and China lead us to believe that trade – and broader political – tensions are not going away. As such, despite expecting modest economic growth to continue, we remain measured in our risk-taking appetite, ever-mindful of the potential geopolitical pressures that could derail our positive growth expectations.

One major reason equity markets have continued their gains in the face of trade tensions is **Stuckflation 4.0** – the fourth year our expectation of inflation remaining stuck below the 2% central bankers' target has been a strategic theme. Stuckflation has allowed for a new round of global monetary easing, a component of our **Monetary Makeover** theme that in turn has led to strong returns in global equity markets. Since the Fed first appeared to be done raising rates (hinted at in late 2018), global equity markets have risen by nearly 30%, supported along the way by three rate cuts from the Fed and a new quantitative easing program from the European Central Bank.

EXHIBIT 3: HOW OUR INVESTMENT THEMES HAVE PLAYED OUT

We introduced our 5-year themes in August 2019. Here's what has happened since.

CMA Theme	What was said:	What we have seen:
Global Growth Restructuring	A shifting economic model – due to geopolitical and technological developments – will slow growth. Legacy global trade frameworks are changing. Technology can assist in the transition (increased automation) but separately is introducing new challenges (rising inequality).	Global growth has continued to slow, with Europe and China – both traditional beneficiaries of globalization – most affected. A strong U.S. consumer and some stabilization in Europe and China suggest recession will be avoided in 2020.
Irreconcilable Differences	The U.S. and China will remain in a diplomatic dance that meanders between economic armistice and war, but never peace. The fractious U.S.-China relationship will produce a cascade of geopolitical, economic and market changes.	Although investors are eagerly anticipating a "phase one" deal that deescalates current U.S.-China trade tensions, trade peace is unlikely. Hong Kong unrest surrounding human rights issues highlights another facet of the **Irreconcilable Differences** theme.
Stuckflation 4.0	Muted growth in global demand and timid policy responses suggest Stuckflation will continue. Ongoing inflation disappointment will eventually, but not imminently, lead to a coordinated policy response between fiscal and monetary authorities.	Inflation has remained below 2% across developed markets and is still "stuck" at ~1.6% in the U.S., where inflation was close to target before moving downward. Coordinated monetary-fiscal policy remains mostly talk and little action.
Executive Power Play	Solid growth has pacified power grab concerns, but leaders are at risk of overplaying their hands. Investors have given populist leaders some leash, but will still judge them on their economic acumen.	President Trump is dealing with an impeachment inquiry and Brexit has been delayed yet again. Despite the drama, equity fundamentals have been acceptable/improving and markets have moved higher (in the U.S. more so than Europe).
Monetary Makeover	Stuckflation has left central banks without a North Star and seeking relevance as their independence is challenged. As such, central bankers will increasingly be subservient to political agendas and easy money will continue.	We have entered a new global easing cycle, including three Fed rate cuts and new European Central Bank quantitative easing. Although President Trump has routinely criticized the Fed, its easing has ostensibly been driven by economic developments alone.
Staking Out Climate Risk	Direct physical risks of climate change are still small, but the transition risk associated with regulatory change is slowly building. Regulatory impacts will come with high dispersion and sporadic embracement, weighing environmental vs. economic issues.	Developments on this theme will be slow to play out. That said, interest in environmentally friendly investments (the "E" in ESG) continues to grow. Combating climate change remains a key political issue, but remains subject to economic constraints.

GROWTH & INFLATION

We expect moderate growth and muted inflation across most regions, although political uncertainty looms.

The U.S. economic expansion is likely to register its twelfth consecutive year of growth in 2020, which is impressive but still well behind Australia's ongoing run of 28 years. Weakness in manufacturing and capital expenditures, driven by trade concerns, has weighed on growth, but a resilient service sector and easier monetary policy have helped support economic activity. We expect U.S. growth in 2020 of 1.5%-2.0%, and as with all regions globally, the risk is to the downside as compared to the consensus (see chart). The 2020 eurozone growth outlook is best characterized by continued low, but modestly positive, growth. We expect the region to maintain 1.0-1.5%, although continued global trade uncertainty means risks are tilted to the downside. At the same time, recession risk remains relatively low due to positive credit growth, incremental monetary and fiscal stimulus and a resilient services sector. The U.K. outlook for 2020 is still highly dependent on how the Brexit saga evolves. At a minimum, there will be the negative overhang of continued uncertainty. Our base case of continued uncertainty is expected to result in a further slowdown in GDP growth to 0.5-1.0%. Our expectations for Japan in 2020 are for modest GDP growth of 1.0-1.5%. Because Japan is a trade- sensitive economy, risks remain tilted to the downside, especially since the impact of the value-added tax (VAT) hike remains unclear. That being said, other parts of the economy have picked up a little and the labor market remains tight as a drum.

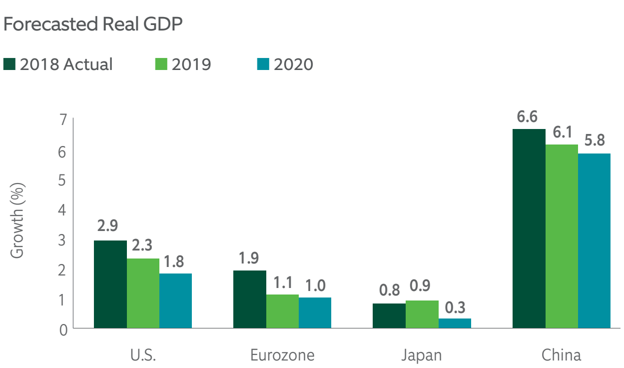
Our 2020 outlook for China is best described as cautious. The scale of China's fiscal and monetary stimulus was not enough to drive a rebound in growth, and the slowdown continued through the second half of 2019. In 2020, we expect a similar growth rate of 5.0-6.0%. Due to higher food prices, inflation is expected to come in at 3.5-4.5%. The trade dispute with the U.S. will continue to generate uncertainty and will weigh on the economy even if an incremental "phase one" trade deal is agreed.

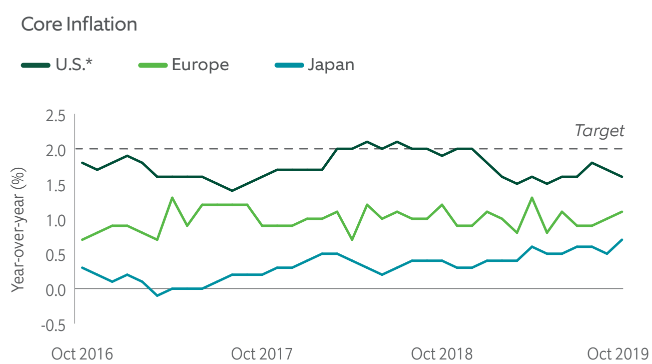
Our **Stuckflation 4.0** theme drives our view of continued muted inflation globally. While the headline numbers will jump around with energy prices, we expect U.S. core inflation to remain firmly below the 2% policy target while European inflation is expected to stay close to 1%. It will be interesting to monitor the effects of leadership changes at both the ECB and European Commission on the eurozone's reform agenda. We remain cautiously optimistic that the new leaders will generate new forward momentum.

Inflation in the U.K. should also stay low at around 1.5%, and we expect inflation of just 0.5-1.0% in Japan.

EXHIBIT 4: GLOBAL GROWTH RESTRUCTURING

Trade tensions and the evolving use of technology likely mean slowing but still positive growth, while inflation stays stuck.





Source: Northern Trust Asset Management, Blue Chip Economic Indicators November edition.
* U.S. uses core PCE while Europe and Japan use core CPI. Data from October 31, 2016 to October 31, 2019.

MONETARY & FISCAL POLICY

As disappointing inflation readings continue, we expect the Fed to further cut rates and Europe and Japan to increasingly explore fiscal policy as a way to encourage growth.

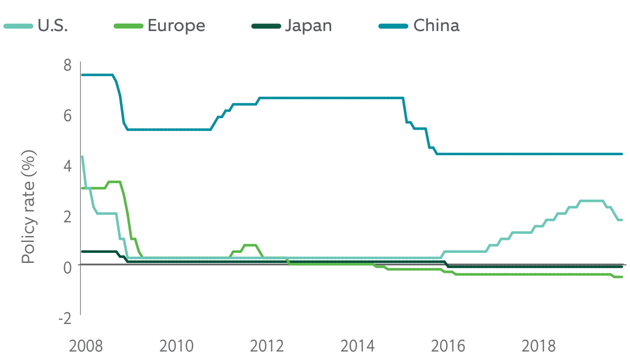
The global easing cycle that kicked off in 2019 will continue into 2020. The Fed was the first to try to "normalize" monetary policy through its ill-timed rate increases in 2018, culminating in a policy rate of 2.5% at year-end and a financial market protest that led to three rate cuts in 2019. We expect two more cuts of 25 basis points each in 2020 as a flattening of the yield curve forces the Fed's hand and disappointing inflation readings give rise to more "insurance" rate cuts. From the ECB, we expect no changes in interest rates and a steady pace of quantitative easing. The strategic review announced by ECB President Lagarde will be interesting, but should not result in any policy changes in the short term. We expect the Bank of England to cut interest rates twice in 2020 to combat ongoing weakness in both growth and inflation. Policy at the Bank of Japan should be steady, with possible incremental easing if the VAT tax hike clobbers growth. The People's Bank of China has been focused on supporting interbank liquidity and has only marginally lowered interest rates. We expect it to enact a further 0.5% interest rate reduction in 2020.

The growth slowdown in the second half of 2019 has made it abundantly clear that fiscal policy can no longer stand on the sidelines if growth falters, especially in regions like Europe and Japan, where monetary policy is already very loose. As a result, we expect fiscal stimulus to be a small contributor to growth in 2020 but not to meaningfully impact growth through 2022. The fiscal deficit in the U.S. has grown to 5% due to tax cuts and increased spending. While the impact on growth has been positive, the results have been clouded by the trade war with China. For perspective, average quarterly GDP growth during the Trump administration has been 2.6%, compared to 2.3% in the second term of the Obama administration. Despite all the noise in the eurozone, we only expect Germany and France to implement 0.1-0.2% of GDP in stimulus. In the U.K., the end of austerity means baseline fiscal stimulus of 0.2% of GDP is already baked in. Depending on how the government manages the growth slowdown, more could happen. In Japan, the government announced a bigger-than-expected fiscal stimulus to counteract the fiscal tightening from the VAT hike in 2019. The overall impact is likely going to be a small positive in 2020. In China, the government has exercised restraint in combating the growth slowdown so far, targeting fiscal stimulus to manage the economy rather than overwhelming it. We expect that dynamic to continue, with an overall modestly positive impact.

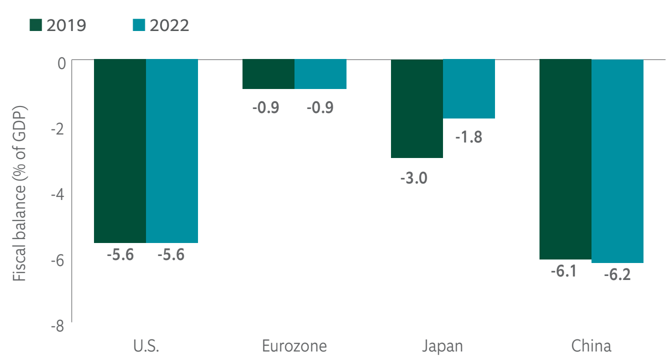
EXHIBIT 5: FIRST STEP ACCOMMODATION, NEXT STEP COORDINATION?

Central banks are back in easing mode but may eventually need to coordinate with the fiscal policies of their governments.

Central Bank Policy Rates



Fiscal Deficit Forecasts



Source: Northern Trust Asset Management, Bloomberg, IMF. Central bank policy rate monthly data from December 31, 2007 to November 30, 2019. Budget deficit forecast comes from the IMF Fiscal Monitor: October 2019.

INTEREST RATES

Low yields should keep central banks accommodative as they pursue a steeper curve.

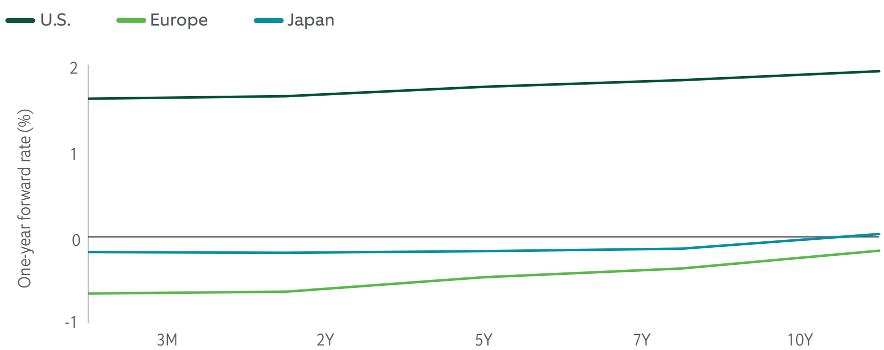
Yields fell globally in 2019 as economic growth slowed, inflation remained stuck and central banks were forced into a new easing cycle. The Fed cut rates three times in 2019, which was a welcome pivot given its apparent determination to continue raising rates heading into the year. The ECB also cut rates and entered into a new quantitative easing program. And the Bank of Japan remained extremely dovish, continuing to target a 0% rate on its 10-year bonds. Meanwhile, German 10-year bonds went as low as -0.7% and currently sit at around -0.3%. All of this has had a gravitational pull on U.S. Treasury yields, which fell from nearly 3.0% to start the year to under 2.0% more recently.

Heading into 2020, we expect these low yields to keep central banks accommodative. We believe it is irresponsible for central banks to allow yield curve inversion in the absence of any real inflationary pressures or irrational exuberance on the part of investors. As such, we believe the Fed will be forced into two more rate cuts in 2020. If it does so, we believe it can restore some steepness to the yield curve. We expect the 10-year Treasury yield to move toward 1.5% even with the Fed easing mentioned above.

EXHIBIT 6: THE FORCE OF GRAVITY

U.S. yields a year from now are expected to remain under the world's gravitational pull.

Market Yield Curve Forecasts



Source: Northern Trust Asset Management, Bloomberg. Germany serves as a proxy for Europe. One-year forward rates as of December 2, 2019.

- Global yields fell throughout 2019 as slow growth and stuckflation forced more central bank accommodation.
- We believe the Fed will be forced into even more rate cuts in 2020 to avoid yield curve inversion.
- Despite fairly flat yield curves, we still see better value out on the curve and recommend taking on duration risk in portfolios where appropriate.

CREDIT MARKETS

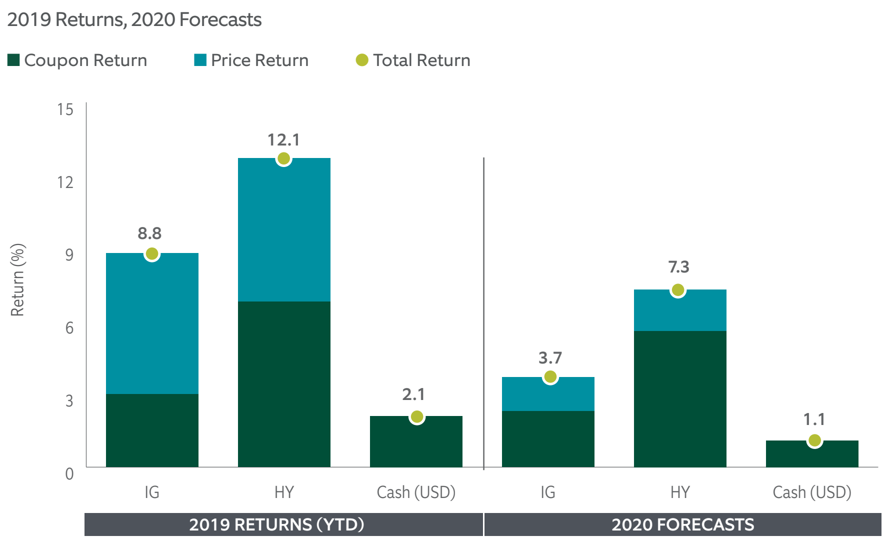
Credit spreads should remain tight, leading to return premiums for fixed income and high yield.

Fixed income returns were extremely strong in 2019, benefitting from the one-two punch of falling interest rates and tighter credit spreads. As such, fairly modest starting point yields were assisted by notable price appreciation, leaving investment-grade fixed income with a nearly 9% return and high yield with an over 12% return through the first 11 months of the year. These both represented nice premiums over cash, which – given Fed rate cuts – only garnered a 2% return. It certainly paid to take on both duration and credit risk in 2019.

We believe the same will hold true in 2020, though in a more moderate fashion. We believe interest rates will remain low and could possibly go lower (see previous page). And we believe credit spreads will also remain tight. Credit spreads – both in the investment grade and high yield spaces – are historically tight, leading some to believe there is a speculative bubble in the credit markets. But, broadly speaking, interest coverage ratios are high, as is investor demand – both thanks to low interest rates. As long as our base case of continued low rates and modest economic growth holds, we believe credit markets are reasonably valued. High yield is our highest conviction overweight. Meanwhile, investment-grade fixed income should provide a nice return premium over cash in 2020.

EXHIBIT 7: CAPITAL APPRECIATION IN FIXED INCOME?

We believe capital appreciation will continue to support bond returns, but at a lower level.



Source: Northern Trust Asset Management, Bloomberg, Barclays. 2019 total returns through November 30, 2019. Proxies: IG (Investment Grade) - BBG U.S. Aggregate; HY (High Yield) - BBG High Yield 2% Issuer Capped; USD cash - BBG U.S. Treasury Bills 1 - 3 months. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.
Past performance is no guarantee of future results.

- Fixed income returns were robust in 2019, benefiting from lower interest rates and tighter credit spreads.
- Continued low rates and tight credit spreads should support returns in 2020.
- High yield represents our highest conviction overweight in our global policy model.

Forecasted returns do not show actual performance and are for illustrative purposes only. They do not reflect actual trading, liquidity constraints, fees, expenses, taxes and other factors that could impact the future returns. Stated return expectations may differ from an investor's actual result. The assumptions, views, techniques and forecasts noted are subject to change without notice. Please see additional disclosure at the end of this document.

EQUITIES

While the valuation expansion is behind us, reduced trade tensions and easy monetary policy should lead to positive earnings growth.

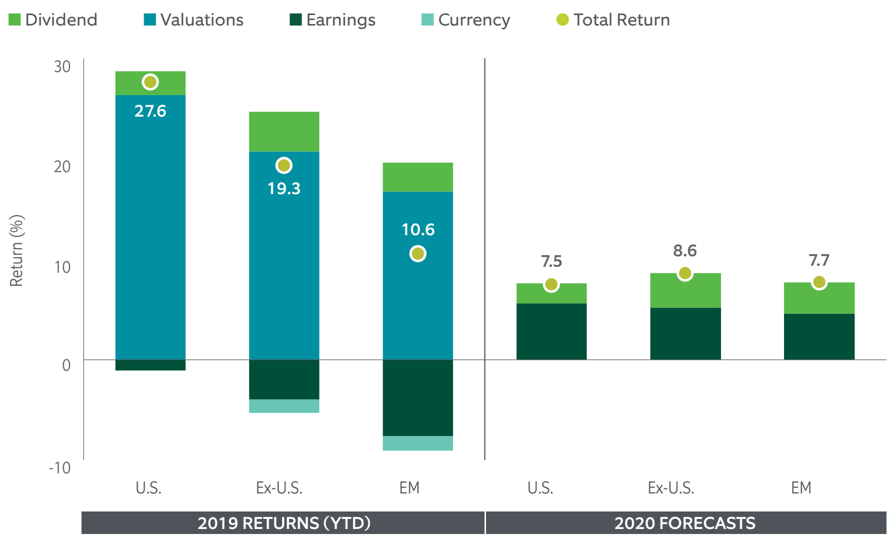
After negative returns in 2018, equity markets rebounded strongly in 2019; all it took was for the Fed to reverse course on monetary policy. The rebound started in late 2018, when prominent Fed members dropped hints about pausing its rate-hiking campaign; it gained momentum when it became clear that the Fed was going to start cutting rates again. It did so three times, which helped to distract investors from the U.S.-China trade war and slowing economic growth. In fact, as seen in the chart, all 2019 gains have been from valuation expansion (and dividends) as opposed to earnings growth, which was negative across all major regions.

Heading into 2020, we believe the valuation expansion is behind us. However, markets should return to positive earnings growth as reduced trade tensions and easy monetary policy lead to increased global economic demand. Meanwhile, stuckflation will keep margins elevated. Add in dividend yields, and we should see continued positive returns in the upper-single digits across the globe. We forecast the highest returns in non-U.S. developed markets – particularly Europe – although this prediction also includes an elevated risk profile. When taking risk into account, we still like U.S. equities the most, and this region represents the biggest equity overweight in our global policy model.

EXHIBIT 8: ANTICIPATING RESUMED EARNINGS GROWTH

Valuations rose in 2019 as investors expect the earnings decline to reverse in 2020.

2019 Returns, 2020 Forecasts



Source: Northern Trust Asset Management, Bloomberg. 2019 returns through November 30, 2019. Proxies: U.S. - S&P 500; Ex-U.S. (Developed ex-U.S.) - MSCI World ex-U.S.; EM (Emerging Markets) - MSCI Emerging Markets. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. **Past performance is no guarantee of future results.**

- It was a great year for equity investing in 2019, with double-digit gains across major equity markets.
- Modest growth, stuckflation and easy money should translate into continued equity gains in 2020.
- While we see upside potential in non-U.S. markets – particularly Europe – our biggest equity overweight remains the U.S. given risk-adjusted return expectations.

REAL ASSETS

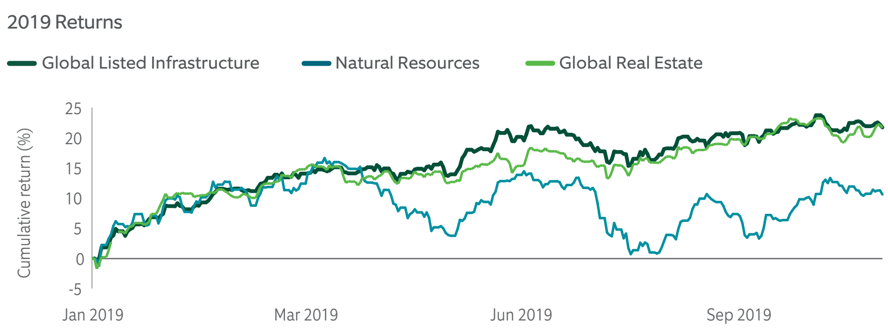
Continued slow growth prompts our underweight to natural resources while continued low interest rates supports our overweights to global real estate and listed infrastructure.

Real assets were bifurcated in 2019. Global real estate and listed infrastructure did well while natural resources lagged. Global real estate was a steady performer throughout the year, providing nice diversification to the global policy model. Driving global real estate's strong performance was its combination of equity, credit and interest rate exposures – all of which did well in 2019. Global listed infrastructure's returns were particularly impressive given stock market performance. Generally, as a safe-haven asset class, listed infrastructure would be expected to lag in strong equity markets. This speaks to the atypical nature of the 2019 equity market rally, which, as noted on the previous page, was more driven by valuation expansion (induced by falling interest rates) than robust earnings growth. The atypical nature of the 2019 rally also explains the poor performance of natural resources, which suffered from slowing global economic demand and oversupplied energy markets that kept oil prices below 2018 levels.

Heading into 2020, we remain overweight global real estate and listed infrastructure, as we expect interest rates to remain low and investors to find the income generated by these asset classes attractive. Meanwhile, we have gone to a slight underweight position in natural resources. Valuations are attractive – with dividend yields around 3.5% – but concerns around continued slow growth have prompted us to reallocate.

EXHIBIT 9: LOWER RATES, SLOWER GROWTH

Lower interest rates supported real estate and infrastructure while the slowing global economy hurt natural resources.



Source: Northern Trust Asset Management, Bloomberg. 2019 total returns through November 30, 2019. Proxies: GLI (global listed infrastructure) – S&P Global Infrastructure; NR (natural resources) – S&P Global Natural Resources; GRE (global real estate) – MSCI ACWI IMI Core Real Estate. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. **Past performance is no guarantee of future results.**

- Global real estate and listed infrastructure did well in 2019, driven by falling interest rates.
- Natural resources lagged the broader equity markets due to slow economic growth and elevated oil supplies capping oil prices.
- We are overweight global real estate and listed infrastructure and underweight natural resources.

CONCLUSION

Although we expect more muted returns in 2020, there is enough promise to justify continued risk taking.

Global stock markets continued to climb the proverbial "wall of worry" in 2019, overcoming soft economic data, geopolitical risks and a decline in corporate share buybacks after the 2018 surge. Mutual fund and exchange-traded fund investment continued its trend since the financial crisis, including significant investor flows out of equities ($204 billion) and into bonds ($228 billion). The public equity markets have also been a sobering experience for formerly high-flying private companies, as public investors have been more demanding of profitability than the private markets. Sir John Templeton famously said that bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria. The public equity and credit markets have spent some time in the optimistic camp over the last few years, but haven't reached euphoria.

Earnings growth was weak in 2019, with the U.S. likely to see a small decline, while developed ex-U.S. stocks will see a decline on the order of 4% and emerging markets (EM) earnings look set to fall around 8%. These numbers were noticeably depressed by falling commodity prices. We expect a return to broad earnings growth in 2020 as commodity price headwinds recede and we project growth of roughly 6% globally. Absolute price-to-earnings ratios on stocks are somewhat elevated relative to history, but aren't worryingly expensive when considering the interest rate environment. We are also sanguine about the outlook for corporate credit. Last year at this time, there was considerable concern about significant ratings risk for BBB-rated credits, a category that has surged in recent years. We held firm in our constructive outlook, and 2019 has seen improving credit quality with ratings upgrades outpacing downgrades by an impressive ratio of 4.3 to 1.

Our outlook piece title – Everything in Moderation – captures our recommendation of a moderate overweight to risk in an environment where so many inputs (growth, inflation, monetary policy) have been moderated. As 2019 has clearly demonstrated, it is expensive to be overly defensive in asset allocation. We expect more muted returns in 2020, but still expect real returns sufficient to justify risk taking. Several of our themes from 2019 will carry over into the New Year: trade risk protection (overweight U.S., underweight EM), favoring lower-risk risk assets (high-yield bonds), and interest rate exposure (global real estate, global listed infrastructure, long duration bonds within fixed income portfolios). As always, we'll be updating our outlook monthly as events develop and look forward to communicating those views as the year progresses.

INVESTMENT PROCESS

The asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic returns are developed using five-year risk, return and correlation projections to generate the highest expected return for a given level of risk. The objective of the tactical recommendations is to highlight investment opportunities during the next 12 months where the Investment Policy Committee sees either increased opportunity or risk.

The asset allocation recommendations are developed through the Tactical Asset Allocation, Capital Markets Assumptions and Investment Policy Committees. ViewPoints reflects data as of 12/11/19.

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