FOURTH QUARTER 2019

Matt's Market Update

IN THIS REPORT

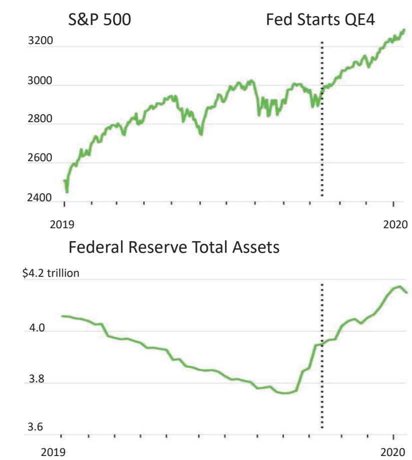
Matthew H. McPhail, CFA
Chief Investment Officer

Market Review

Global stocks surged higher in Q4 putting many of the key market benchmarks at all-time highs to end the year. In fact, 2019 could aptly be described as the year when everything rallied higher. Consider that the S&P 500 rose +31.49% for the year while small-caps (Russell 2000 index) +25.52%, foreign equities (MSCI ACWI) +21.51%, core fixed-income (Bloomberg Barclay's US Aggregate) +8.72%, the long treasury bond +30%, the price of oil +30% and gold +18% all produced high returns. Diving deeper, growth strategies outperformed value as the S&P Technology sector gained +50% for the year. REITs, Utilities and Financials had strong years thanks to the decline in global interest rates. Once again, foreign markets lagged the U.S on a relative basis, but did produce strong returns in stark contrast to the weak growth exhibited in overseas economies.

What caused the broad-based rally in global markets last year? In short, we can't point to the fundamentals. Consider the following: U.S. nominal GDP growth for 2019 is expected to finish at 2.2%. A decent result relative to other world economies, but far from robust. In Q4, S&P 500 earnings on a year-over-year basis are expected to be slightly negative for the fourth quarter in a row. In other words, corporate earnings didn't grow at all in 2019. A substantial trade deal with China never materialized in 2019, but a smaller "Phase One" deal was agreed to early in 2020 (with trade tariffs still in place). To sum up, low growth, weak earnings and continued roadblocks to global trade. How then to justify a 30% rise in the S&P 500? The answer is money flows from the global central banks and corporations that found its way into the equity markets. According to Rosenberg Research, global central banks enacted 47 rate cuts in 2019 that amounted to 2,270 basis points of stimulus. The Federal Reserve has super-charged this stimulus in Q4 by starting to expand its balance sheet again. Essentially, a new program to support the overnight "repo" market for the banking system has had similar results to their prior Quantitative Easing (QE) campaigns. Please see the chart on this page. From a corporate perspective, S&P 500 firms are flush with cash and have steadily used it to buy back shares in the open market. In fact, this will be the second largest year ever for corporate buybacks according to Goldman Sachs. With such massive amounts of liquidity available to go into equities, it's really no wonder that stocks rallied so hard in 2019.

IT'S NOT A COINCIDENCE
Stocks started to rally after the Fed started to expand its balance sheet.



Source: FactSet; Federal Reserve Bank of St. Louis; WSJ

Sentinel Benefits & FINANCIAL GROUP

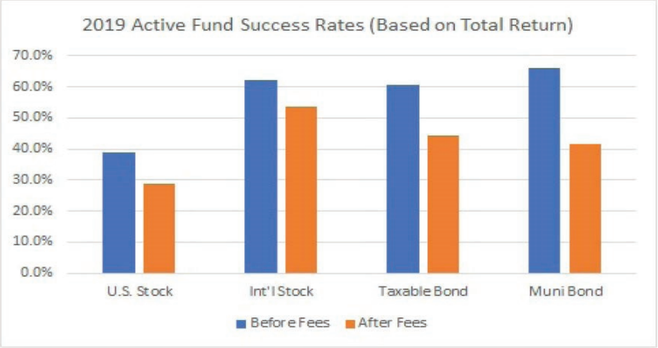
Active Lags Indexing in 2019

A recent report from Morningstar tallied the results from last year and once again it was very difficult, but not impossible, for active managers to beat their index benchmarks. Over the past ten years since the financial crisis, index funds have had the edge in performance. Index funds are well-known for their significant cost advantage over active managers. Even for the most competitive active managers, the indexes typically have at least a 50 basis point return advantage built in based on fees. This isn't to say all active managers fail to beat benchmarks (as is widely thought). Many managers, especially those oriented to growth and technology strategies, easily outperformed last year. As you can see from the chart on this page examining trends from 2019, results vary depending on the broad asset class. Here are a few of Morningstar's summary findings:

- Around 40% of active funds beat their indexes last year (after fees, 53% outperformed before fees), a slight improvement from 2018.
- Active U.S. stock funds continued to slump, with only 29% of such funds surpassing their benchmarks after fees.
- 53% of active foreign stock funds outperformed their bogies last year.
- On average, successful active funds beat their benchmarks by around 3% in 2019, while unsuccessful funds lagged their indexes by about 3.60% last year.
- Of the active funds that succeeded in 2019, around 12% had also beaten their benchmarks in 2018 and another 16% had three-peated, outperforming in 2017, 2018, and 2019.

While not stating otherwise, we're assuming the Morningstar analysis covers the entire universe of funds. But what if the data was modified to include one simple screen? That being, how did the active funds with fees below their peer group average do when compared against the benchmark in 2019? After all, if you were looking to allocate assets to a new active manager, it's safe to assume that you wouldn't consider a fund with above average fees. We applied this simple screen to four widely held fund categories. The results were telling as the success rate went up in each case by simply concentrating on those managers with below average fees. Here are the success rates for active managers with below average expenses in calendar 2019: U.S. Large Blend (28%), U.S. Small Blend (42%), Foreign Large Blend (64%) and Intermediate Core Plus Bond (75%). At first glance, active management within U.S. based categories for funds with competitive fees failed to beat the indexes last year, but the success rates within foreign funds and fixed-income were very strong. This exercise could be carried out further to include the cheapest quartile of funds across all fund categories and time periods in order to come to stronger conclusions regarding the index vs. active debate. In the end, the likely conclusion is that both strategies have a role to play in a fully diversified portfolio.

2019 ACTIVE FUND SUCCESS RATE
(Based on Total Return)



Source: Morningstar

Plan Sponsor Pulse

In no particular order, here are the topics that most frequently occurred during our retirement plan committee meetings in 2019:

1. Plan design / Fewer investment choices. Now ongoing for several years, the trend of shrinking the plan investment lineup has gained real momentum. While seemingly everyone agrees that some sort of portfolio ("do it for me") option is necessary in the plan (target date or target risk funds), after that the views are mixed. Long gone are the days when two choices in

every style box is represented in a plan line-up. The reality today is that an increasing portion of plan assets are going into managed portfolios and most participants are unwilling or unable to research an excessive number of funds.

2. Focus on fees and benchmarking. Our clients have fully embraced the process of reviewing and benchmarking all plan fees, not just those related to the plan investments. Having full knowledge of the fees paid in return for services is a responsibility of all plan fiduciaries.

3. Changing the participant meeting approach. How can engagement with participants be more meaningful? How can attendance at meetings be increased? These are common questions. One technique used by many of our clients is to target the meetings to certain topics and audiences. For example, a meeting on social security planning for participants over age 55. Moving away from the one size fits all 401(k) presentation may get your people more engaged in their retirement planning.

4. Legislative updates. Always on the agenda to keep clients informed of news out of D.C. At year-end, the SECURE ACT was passed into law. The far-reaching bill includes significant provisions aimed at increasing access to tax-advantaged accounts and preventing older Americans from outliving their assets.

5. HSA accounts. Similar to the Roth IRA ten years ago, Health Savings Accounts (HSA) are slowly gaining attention from plan sponsors as they take a more holistic view of their benefits. The HSA, which is available only to participants who have a high-deductible health plan, offer a trifecta of tax benefits for people who use them to save money for medical expenses: deferrals go in pre-tax, money grows tax-free and can be withdrawn tax-free as long as you use it on qualified medical expenses.

David Batchelder, CFA, CFP
Senior Investment Officer

Wealth Management Corner

The U.S. bond (debt) market is gigantic, totaling over $40 trillion in value at the end of 2017. In comparison, the U.S. stock market has approximately $30 trillion in value. Taking it one step further, the world bond market is over $100 trillion. These are indeed big numbers.

With such an enormous opportunity set for investors to research, the type of investment to choose could be daunting. When it comes to choosing the type of bond instrument to invest in, i.e., government, corporate, municipal, or international, it depends on several factors. For one, are you seeking tax-free income or want to stretch for yield? If tax avoidance is your ultimate goal, the primary bonds that offer tax-free income are municipal bonds. By the numbers, U.S. Treasury debt was $14.4 trillion, $9.2 trillion mortgage-related bonds, $8.8 trillion in corporate bonds at the end of 2017.[1] The municipal market is a much smaller portion of the market at approximately $3.9 trillion.[2]

Even though a relatively small segment of the bond market, municipal (muni) bonds issues are unique in how they are structured and generally issued by state and local governments. They tend to be less risky than corporate bonds and less sensitive to interest rates than Treasuries. The term muni bond is a fairly generic term. There are a wide variety of muni bonds. The primary types are general obligation/revenue bonds and private activity bonds. General obligation/revenue bonds are tied to town and state tax collections and general municipal operations. Private activities could be used to finance roads, water systems and schools to name a few.

The key area of difference for muni bonds from other bonds is that they tend to offer a more modest nominal yield. The reason for this yield is that they provide taxable investors what is known as a tax equivalent yield, which you can calculate from dividing a bond's annual current yield by the sum of all the avoided tax rates. Depending on your tax situation, this could be very valuable and distinctive. Since muni bonds tend to exclude most if not all state, local and often federal taxes, they are geared toward investors in higher federal tax brackets. This tax avoidance is another reason why muni bonds are typically held in taxable investment accounts and not retirement associated accounts, such as traditional and Roth IRAs or retirement plans such as a 401(k).

Supply and demand of these instruments has been in flux recently. Corporations typical use of them in their investment portfolio has declined due to new tax bill from 2018 that reduced their benefit (as corporate tax rates declined.) Also, the same bill caps tax payers' ability to deduct state and local taxes against their federal taxes.[3]

These changes have impacted the short term demand of these instruments yet, they still remain an attractive asset class for taxable investors. Something to keep in mind, when investing in muni bonds, as with most bonds, is that they still tend to be subject to interest rate risk, reinvestment rate risk, call risk, and inflation risk.

Our Portfolio Strategy & Allocation Outlook

There were no major changes to our asset allocations in Q4. The across the board rise of all asset classes in 2019 has left very few pockets of value in the global markets. While certain asset classes are more attractive on a relative valuation basis, very little is cheap on an absolute basis. Here are some brief thoughts on our positioning across the three key portfolio segments within our wealth management client portfolios:

U.S. Equity – The best performing and most expensive asset class based on a variety of valuation measures. To complement our core index holding, the active manager mix currently has a small tilt towards value strategies. As we mentioned in our last update, one of our favorite themes continues to be strategies that emphasize dividend income.
Foreign Equity – While foreign holdings continued to lag domestic in 2019, the gap narrowed considerably. Global volatility based on trade disputes and central bank actions create good opportunities for active managers to exploit. Our favorite strategy within this segment is the small & mid-cap theme. Emerging markets are also attractive on a relative valuation basis vs. developed foreign markets.

Fixed-Income – Our base case continues to be that interest rates stay in this current low range for an extended period of time. Now is a great time for all investors to review their bond holdings with an eye towards higher quality. Those managers that put up double-digit returns in 2019 likely did so with over weights to corporate and high yield debt. These sectors are especially rich from a valuation standpoint at the moment. Lowering return expectations in 2020 and viewing fixed-income funds for their roles as portfolio diversifiers is how we're approaching this sector right now.

Please let us know if you'd like to discuss your personal investing and financial planning needs.

Matthew H. McPhail, CFA
Chief Investment Officer

David Batchelder, CFA, CFP®
Senior Investment Officer

Market Scoreboard

Index Returns (%)	Q4 2019	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	9.07	31.49	31.49	15.28	11.70	13.56
DJIA	6.67	25.34	25.34	15.74	12.59	13.41
NASDAQ	12.17	35.23	35.23	18.58	13.63	14.74
Russell 2000	9.94	25.52	25.52	8.60	8.23	11.83
MSCI ACWI Ex USA	8.92	21.51	21.51	9.87	5.51	4.97
Barclays Aggregate Bond	0.18	8.72	8.72	4.03	3.05	3.75

Source: Morningstar

Sentinel Benefits
& FINANCIAL GROUP

[1] Bond Market Size Vs. Stock Market Size, by Steven Melendez, updated March 6, 2019, Zacks
[2] K U.S. muni bond market rises to $3.853 trillion in second quarter: Fed, Laila Kearney, September 20, 2018, Reuters
[3] Changing Market: Municipal Bonds After Tax Return, Broadridge Advisor Solutions Copyright 2020

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

Date of First Use: 1/27/2020 QMR-004-01272020