ALTMAN
INVESTMENT MANAGEMENT

EQUITY STRATEGY FOCUS

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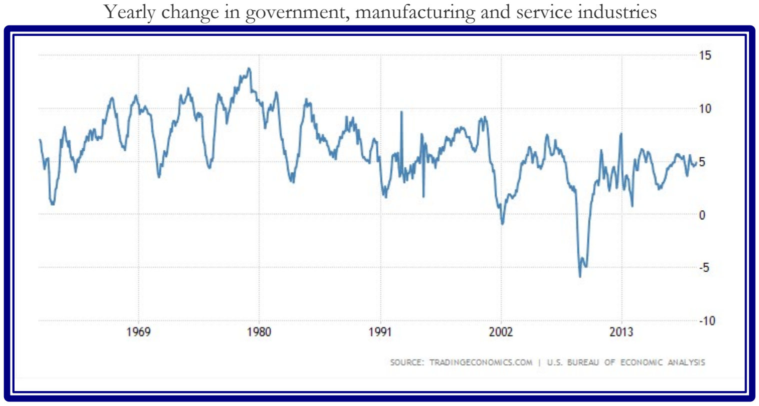
IN VIEW: Key Economic Themes

In December, the Federal Reserve held rates at 1.5%-1.75%, with the view that they would need to see a significant and persistent increase in inflation to justify another rate hike. The labor market was categorized as "strong" by the Fed Chairman in his FOMC statement further indicating that some slack remains. Therefore, wage growth is not at a level that is deemed at risk of inflationary pressures, even with a 3.6% unemployment rate. Going forward, the committee will monitor "the implications of incoming information for the economic outlook, including global developments and muted inflation pressures, as it assesses the appropriate path of the target range for the federal funds rate."

There are several reasons why wage growth seems to have hit a resistance level, even in this low unemployment environment. For one, global growth is anticipated to slow and thus the demand for workers is waning. This leads to workers accepting lower pay raises for available employment. The trade war is another factor. As business confidence erodes, major long-term decisions and consequently hiring decisions, are put off until details of the potential trade deal are evident. Productivity remains weak and the number of part time workers is relatively high which works against wage gains.

Wages and Salary Growth

Yearly change in government, manufacturing and service industries



Immigration and its impact on the U.S. economy has been a key policy issue that is growing in significance as the 2020 election nears. Over the last several years, we have seen an escalation of the nationalistic ideology. Domestically, "America First" is the policy platform of our current leadership, but the United States is not the only country moving towards isolationist policies. China is looking to grow internally, Italy continues to adopt nationalist policies, and the nationalist party in Germany is gaining representation in state parliament. A BBC poll in May of this year showed that in many countries, nationalists got higher scores in opinion polls and their representation within European Parliament is growing.

Some view globalization as a means to integrate via technological advancement. It's also a way to gain access to promote cross border integration whether it be to gain knowledge or productivity to bolster innovation and development. But to some, globalization enables disproportionate power amongst a few developed countries. Those that hold that view see nationalism as a way to protect against international instability and foreign competition.

It is debatable whether immigration, technological advancement, and/or global outsourcing is the leading cause of domestic job loss. A timely report produced by the Federal Reserve in December measured the impact of the recent increase in tariffs (which relates to the current use of tariffs for protectionist policy) on the U.S. manufacturing sector. The report found that any anticipated benefit from import protection was more than offset by the rising input prices and retaliatory tariffs. Keep in mind, supply chains have become more globally interconnected over the past few decades complicating the traditional impact trade policy has had on production costs in the past. The report, therefore, was unable to conclude that the increase in tariffs produced a measured contribution to U.S. manufacturing activity, and thus job growth.

CLOSE-UP: Equity Investment Overview

Market Performance Overview:

The S&P 500 benchmark index climbed 31.5% during 2019. Small cap stocks underperformed this year, only gaining an advantage beginning in September following the first of three rate cuts by the Federal Reserve. The MSCI All Country World Index (ex U.S.) returned 22% for the year - while bonds (Merrill Lynch Corp and Gov't Bond Index) returned 6.8%. Value stocks lagged this year as measured by the Russell 1000 Value and Growth Indexes.

Led by Apple and Facebook, the FAANG stocks contributed 5.39% of the S&P 500 return, amounting to just under 1/5th of the market return for the year. Adding over a trillion dollars in combined market cap this year, FAANG stocks are once again nearing peak market representation at nearly 14% of the index. Apple was by far the out-performer, surging 86%, adding over $500 billion in market cap in anticipation of the upcoming 5G upgrade cycle. Facebook climbed a hefty 58% during the year on add revenue growth.

As FAANG representation in the market grows, it's important to keep their valuations in perspective. On most metrics – namely price to earnings, price to sales, price to book, price to free cash flow, and p/e to growth rate – these stocks trade at a premium to the overall market. Apple's $58 billion in free cash flow is the exception that awards it a discount on price to free cash flow. According to Bloomberg consensus estimates, earnings growth rates are anticipated to decline in 2020 in all but Netflix. Stiff competition has kept pressure on this stock which underperformed the FAANG group this year. Heading into 2020, the performance of the market continues to rely on current leadership to maintain momentum. If history is a reasonable proxy, a change in leadership could be on the horizon for the next decade opening the window for the undervalued sectors to pull ahead.

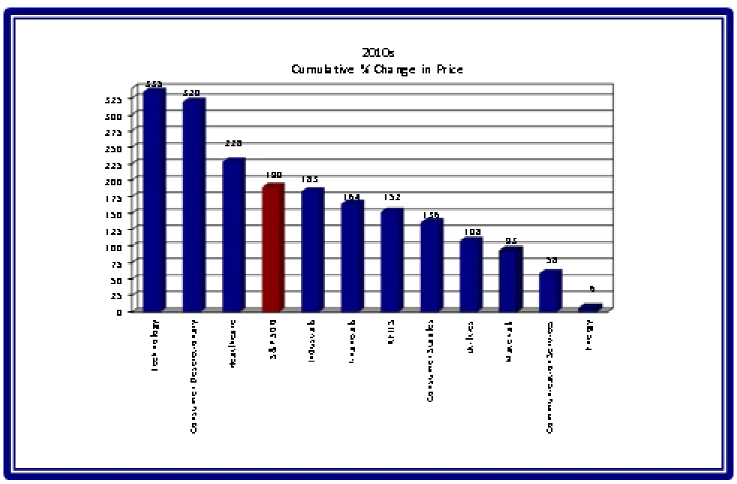
The AIM composite delivered strong performance during 2019 with Information Technology, Financials, Industrials and Healthcare contributing most. Energy and Materials detracted most from performance.

- Top performing stocks for the year in the portfolio were Applied Materials, Conagra, Keysight Technology, Microsoft, and Accenture.
- The worst performers in the portfolio were Occidental Petroleum. Dupont, Pfizer, Halliburton, and Marathon Oil.

Portfolio Strategy:

The AIM composite is positioned to benefit from a change in leadership stemming from a recovery year in earnings off a growth recession with evidence that global PMI's will recover. As we discussed at length in our Q3 commentary, a silver lining exists in oils via OPEC and Russia production cuts and what could potentially be rising global demand. Additionally, we could see slower than anticipated U.S. production as a result of aging fracking wells and subdued oil prices. Of course, any improvement in trade negotiations with China would be a plus to global growth and subsequently to oil demand. A longer recovery or a major spike in oil prices is doubtful, as OPEC would likely reverse course and raise production. At least over the next 12 months, oil production and supply appear to be more in balance than they have been in a long while and could help the downtrodden sector.

S&P 500 Sector Price Performance % Over the Last Decade



We are emphasizing cyclicals going into an earnings recovery year off a growth recession with evidence that global PMI's are recovering. Energy is close to 9.0% of the portfolio. If history is a reasonable proxy, oils should become leaders in 2020 with improving valuations and consensus eps growth of 19.9% growth versus a decline of 28% this year. For a more detailed review, please refer to our Q3 commentary where we wrote extensively about the oil patch.

In Q4, we reigned in our semiconductor exposure by trimming Keysight Technologies and used the proceeds to add to our position in Conagra (CAG). Conagra Brands is a leading food company with a broad array of well-known brands such as Birds Eye, Chef Boyardee, Healthy Choice, Hunt's, Reddi-wip, Slim Jim and Marie Callender. As we enter the 10th year of the economic cycle, adding to CAG, and thus our consumer staple exposure, seems consistent with our view that the S&P 500 is no longer undervalued. Taking a more cautious market outlook; the defensive nature of consumer staples stocks and the emergence of relative attractive valuations in the industry provides greater appeal.

CAG is gaining market share benefiting from a demographic tailwind, growth in health and wellness, and a shifting consumer preference for convenience foods key pillars of their long-term strategy. We have gained greater confidence in management's ability to navigate headwinds, such as the recent setbacks resulting from the Pinnacle Foods acquisition. We are encouraged that the company is out of the woods allowing us to expand our position at current levels. CAG's P/E ratio is below its five-year and peer group averages. In addition, the stock offers an above market yield of 3.0%.

Keysight Technologies (KEYS) is a test and measurement company providing services and software solutions to its customers in the communications and electronics industries. It advanced over 65% this year as 5th generation (5G) initiatives strive for faster signal speeds to meet the rising standards. As more providers ramp up 5G roll outs, KEYS is well positioned to benefit with its over-the-air (OTA) testing solutions. Revenue growth has suffered recently as U.S. China relations soured resulting in a ban on selling to Huawei, one of China's leading technology companies. Restrictions on Huawei could amount to a 250bp drag on revenue growth for 2020, according to analysts at Bank of America, Merrill Lynch. Any progress made on this front will benefit KEYS.

IN CONCLUSION:

The current economic expansion has been accompanied by weak GDP growth on a relative basis, when compared to other expansionary periods. Despite unprecedented amounts of global stimulus, we think economic growth could remain at a modest 2.5% level in the coming year due, in part, to aging demographics as well as high and rising debt levels (as a percentage of GDP, nonfinancial corporate debt, and U.S. federal government debt).

Now that the Fed is on hold, at least for now, the stock market return will be more reliant upon earnings growth moving forward. Q3 posted top line revenue growth of 3% and a decline of -1% in earnings per share growth year over year. Share buybacks continue to be additive to earnings, but were offset by declining net margins. Multiples expanded despite the dip in EPS buoyed by lower interest rates.

To date, the consumer remains resilient, the Fed is keeping rates low, and the overall jobs market is healthy. Inflation remains subdued and global growth is moderate supporting our preference for stocks over bonds. The upcoming elections coupled with uncertainty surrounding trade negotiations with China could add to volatility on a short-term basis.

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Any performance reference represents a hypothetical composite compiled from actual equity, fixed income or balanced client portfolios and includes cash. These three composites reflect aggregated returns that address differing objectives. As such, the performance of each composite does not reflect the actual total portfolio returns earned by our clients. The investment performance records are compiled from a capital weighted average of the equity, bond and cash components of a broadly representative group of discretionary accounts that meet certain minimum size thresholds.

No gross performance returns that are referenced that are calculated after brokerage commissions but before investment counsel fees are presented without the comparable net performance figures after both commissions, investment counseling fees and other custodial charges. The net counseling fees are the actual average counseling fee calculated across all the portfolios included in the composite. All performance figures are presented on a time-weighted total return basis and assume all income is reinvested. The investment advisory fees are disclosed in Part II-A of the Investment Form ADV. Some clients may benefit from available discounting in the management fee schedule associated with the overall size of the portfolio. Management fees will reduce overall returns to the client.

The composites were created in 2001 and the inception dates start on August 17th, 2001.The composites include only discretionary fee-paying accounts managed in the strategies, and additional information associated with the composites are available such as: dispersion in individual portfolio results as well as the % of the firms AUM in the strategy. All performance calculations are presented within the GIPS® guidelines of the CFA Institute. The CFA institute does not endorse or promote this organization nor does it warrant the accuracy of the content herein.

Investing entails inherent risks and results may be altered by material market or economic conditions. Investment returns and principal values may fluctuate, and losses are possible. Past results are not a guarantee of future comparable results or trends. Our process benchmark is the S&P 500 Index with dividend reinvestment, and our performance benchmark is the Russell 1000 Value Index with dividends reinvestment.

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