Summary of Sage's 2020 Market Outlook

- **2019 Review**: Most global asset classes experienced widespread gains. What was perhaps most notable in 2019 was the change from the tightening of global monetary policy, especially from the Fed, that characterized 2018 to easier financial conditions and more accommodative central banks across the globe. Although trade policy disputes ebbed and flowed during the year, the overall trade situation improved in 2019, and the monetary policy pivot reassured global financial markets.

- **2020 Economic Outlook**: As we enter a new year, Sage's outlook is that global economic growth will expand slightly. We think that U.S. economic growth will remain stable or slightly decelerate, but that a recession is not imminent.
    - The Fed's mid-cycle monetary policy adjustment via lower interest rates should begin to translate into tangible economic support early in 2020, replacing the fading effects of the financial stimulus provided through tax reform and leading to general GDP growth stability.
    - De-escalation in the U.S./China trade disagreement promises to boost global trade and business confidence.
    - Consumer sentiment and spending remain strong, supported by low unemployment and positive real wage growth for workers.
    - For these three reasons, we think that U.S. GDP growth will be positive and fall within a range of 1.5% to 2.5%, reflecting a still-strong U.S. economy. Moreover, EM countries (aided by accommodative monetary policy in the U.S. and elsewhere, steady U.S. consumption of global goods, and greater stability in global trade, especially in Asia) can help lead to marginal increases in global GDP growth.

- **Monetary Policy and Interest Rates**: Although lower inflation in emerging market countries affords some emerging market central bank flexibility to lower rates, most other global central banks, including the Fed, seem poised to allow their current policies time to work.
    - The Federal Reserve is likely to remain on hold with interest rate policy in 2020 (or perhaps cut one more time), barring some sharp and sustained spike in inflation or some similarly alarming deterioration in economic, price, or labor conditions.
    - The Fed's threshold for changing interest rate policy is now much higher than it was before the mid-cycle adjustment that characterized 2019.
    - Some global central banks are likely to continue cutting rates, and no central banks currently project that policy rates will be higher in a year.
- **Bonds and Credit:** Overall, a scenario in which U.S. rates move slightly higher because of steady growth and in which spreads are stable will likely leave fixed income investors with a positive return in 2020, but one that is lower than the 8.7% return for the Barclays U.S. Aggregate Bond Index in 2019.
    - Because many foreign government bonds trade at negative or very low yields, demand for U.S. Treasuries will likely keep rates below levels observed earlier in the current economic cycle.
    - Given very tight spreads between the yield of corporate bonds and risk-free Treasuries, Sage does not think that yields can grind much lower from here, and this condition will create a lower total return environment for fixed income investors going forward.

- U.S. bond yields will likely trade within a range but not suffer a sustained spike higher. The 10-year Treasury yield might fluctuate, on average, between 1.75% and 2.25%. It is possible, however, that it could go lower if conditions turn out much weaker than we anticipate, or higher if conditions are much stronger.

- **Equities**: Sage's current base case is that global equity returns in 2020 may be positive, but that returns are likely to be much more moderate than 2019's 31.5% gain for U.S. stocks (via the S&P 500 Index) and 21.5% gain for foreign equities (via the MSCI ACWI ex-USA Index). We hold this view for two main reasons: global equity valuations are at or above their trailing 25-year average, and major central banks seem content to remain on the sidelines in a "wait and see" approach.

- **Inflation**: Overall, inflation is likely to remain well-contained and run near the Fed's long-term target of 2%. Both headline and core measures of inflation may at times run slightly above 2%, but the Fed has indicated that it will tolerate somewhat higher readings for a time as a way to balance out longer stretches of sub-2% inflation, and it may formally move to target inflation "averaging."

- **Employment/labor market**: There may be some incremental gains in employment, but on the whole, we think the unemployment rate is likely to remain within a narrow range of 3.2% to 3.8%. Currently, it is 3.5% as of the November release.

- **Risks and Volatility**: The major potential risks to our base case view are that (1) the Phase One deal on trade between the U.S. and China collapses or tensions re-escalate, prompting negative economic and market gyrations and (2) geopolitical concerns -- whether from Mideast uncertainty, policy tweets, or the upcoming U.S. presidential election – contribute to periodic flashes of worry or even temporary market corrections.

- **Portfolio Implications**: Our outlook for 2020, as outlined above, influences our thinking about portfolio positioning in the following ways.
  - ***Fixed Income***:
    - *United States*: In the U.S., bond yields will likely trade within a range but not suffer a sustained spike higher. However, because of the potential for a "watch-and-see" approach by the Fed and the potential for steady economic growth, we have a little less duration in our portfolios than we would generally expect to have over the long term.
    - *Foreign bonds*: The persistence of low and some cases negative bond yields in developed market countries such as Japan and in Europe makes EM bonds, with higher yields and a backdrop of likely increasing growth, more attractive to us on a relative basis.
  - ***Equities***:

    - *United States*: Given our outlook for relatively steady growth and no recession, we are currently maintaining our slight overweight to U.S. stocks with a bias toward large-caps.
    - *Foreign stocks*: Emerging market (EM) stocks may present a better return opportunity than developed market (DM) foreign stocks because of lessened but remaining uncertainty about Brexit and structural (demographic and political) challenges in Japan and Europe and thus we are overweight EM equities compared to Developed Market Equities.
- ***Alternative Investments***:
    - In view of low current interest rates and tight spreads (from a fixed income perspective) and average or somewhat elevated stock valuations (from an equity perspective), we will be on the watch for opportunities to add diversifying strategies in 2020.
    - Incorporating non-traditional assets and investment strategies into our current portfolios could allow for additional sources of potential return since we think that portfolios might do well to depend less heavily in the coming years on traditional stocks and bonds than they do now.

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