Colorado Capital
MANAGEMENT

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Economic Review

Key Economic Indicators: What a difference a year makes. At the end of 2018, economic growth had slowed, interest rates were rising, markets were reeling, oil prices were low and business confidence was high. A year later, all of these conditions have changed significantly. Our color-coded summary of key economic indicators is presented below:

Key Economic Indicators	Current 12/31/2019	3 Months Ago 9/30/3019	1 Year Ago 12/30/2018
US Economy			
Quarterly Real GDP Growth	2.30	2.10	1.10
Unemployment Rate Core	3.50	3.50	3.90
Inflation (CPI)	2.25	2.36	2.21
Interest Rates			
Fed Funds Rate	1.50	1.75	2.25
10-Year Treasury Rate	1.86	1.70	2.83
Currency & Commodities			
Crude Oil (WTI)	61.40	54.09	45.15
Gold Price	1,523	1,510	1,282
Trade Weighted Dollar Index	129.36	130.75	128.52
Confidence			
Consumer Confidence Index	126.5	125.1	126.6
ISM Purchasing Managers Index	47.2	47.8	54.3
Stock Market			
Dow Jones Industrial Average	28,462	26,917	23,062
S&P 500 Forward P/E Ratio	18.2x	16.8x	15.6x

Legend: green = positive, yellow = neutral, red = concerning

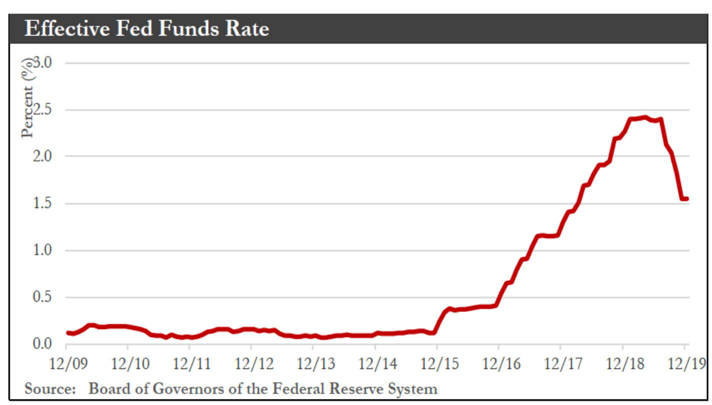
GDP: Exacerbated by global trade tensions, economic growth slowed last year, both in the US and abroad. The International Monetary Fund estimates that global GDP growth dropped from 3.6% in 2018 to 3.0% in 2019, its lowest level since the global recession of 2008 and 2009. Little change is expected in 2020. During the same time frame, the growth of the U.S. economy slipped from 2.9% to 2.3%.

However, the preliminary 4th quarter U.S. GDP estimate represents an uptick from the previous quarter and a dramatic improvement from the low point registered a year earlier. While the economy has shifted into a lower gear, it still appears to be growing at a healthy pace.

Employment: Recent hiring data in the U.S. has been strong, which is an encouraging sign for the broader economy. The labor market has continued to defy expectations and generate sturdy payroll growth, record low unemployment, and steadily improving wages.

Inflation and Interest Rates: The Federal Reserve cut interest rates three times in 2019 on worries that weakness in trade, manufacturing, and business investment, along with slowing global growth could derail the U.S. economy. By lowering short term interest rates, the Fed effectively erased the interest rate inversions that occurred earlier in the year (when longer term rates were lower than shorter term rates).

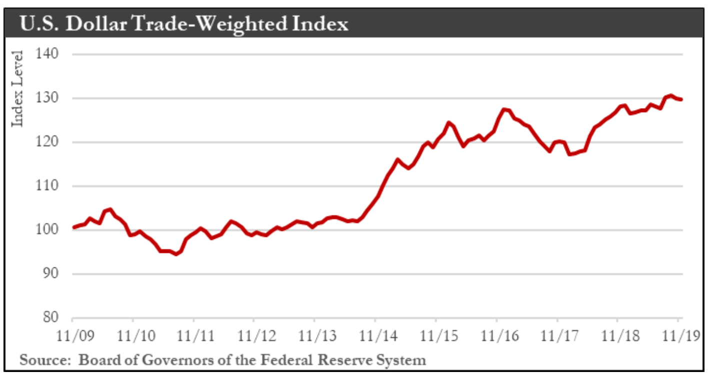
The Fed's benchmark interest rate is now in the 1.5% range. With annual U.S. inflation running below 2% for most of the past decade, and the economy expected to grow at a moderate pace, the Fed will likely keep interest rates on hold for the foreseeable future.



Source: Board of Governors of the Federal Reserve System

Business Confidence: Uncertainty related to the U.S.-China trade war led to a contraction in the manufacturing sector throughout most of the developed world, including the U.S. Reduced capital spending by businesses has contributed to the overall slowing of the U.S. economy. Although the manufacturing sector has been contracting (as indicated by the U.S. purchasing managers index falling below 50), the much larger service sector has continued to expand. Looking forward, business spending in the U.S. is expected to improve in 2020 as a result of continued low interest rates and the recent trade deals with Canada, Mexico and China.

Consumer Confidence: Consumers have remained the linchpin of U.S. growth. Solid job, wage and income gains have accounted for the persistence in elevated consumer confidence and spending. Household spending received a notable boost from one factor that was not anticipated at the beginning of 2019 – lower interest rates. With mortgage rates below 4%, sales of new homes grew last quarter at the fastest pace since 2007.



U.S. Dollar: The trade-weighted value of the U.S. dollar remained relatively stable throughout 2019. Although the Federal Reserve cut rates by ¾ of 1% since July, many other nations followed suit, which allowed the dollar to retain its value despite offering a lower effective yield. With interest rates expected to remain near historic lows around much of the world, future changes in currency values are likely to be primarily driven by differentials in the economic growth rates of various countries. To the extent that global growth rates exceed US real economic growth, we may see some modest deprecation of the dollar in 2020.

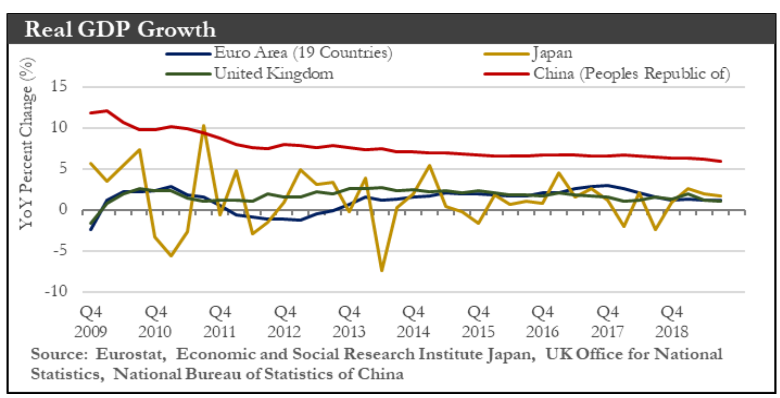
Commodity Prices: Rising concerns over various political and economic uncertainties led to sharp increases in both gold and oil prices during 2019. The price per barrel of West Texas Intermediate crude oil increased over 30% to $61 during the year (before Soleimani's death in January). The reasons for this large increase included US sanctions on Venezuela and Iran, a drone attack on the Saudi oil fields, threats to shipping, and an unusually low starting price ($45 at the end of 2018 vs. $75 a few months earlier).

We attribute the 19% increase in gold prices during the year primarily to safe-haven buying. For risk averse investors, particularly those living abroad, gold may appear to be an especially attractive investment when compared to the low and often negative yields on government bonds. Gold also appeals to those fearing a downturn in the equities markets, or even larger economic or geopolitical crises.

Outlook: The U.S. economy continues to chug along, but has pulled back from the robust pace of 2018. Consumer spending and housing growth helped fuel the economy's 2.3% growth rate in 2019, and are expected to support growth of approximately 2.0% in 2020. Underlying this view is the strength of the labor market, which is expected to absorb more and more workers while providing robust wage growth. Together with low-interest rates, the ingredients are present for household spending to continue to rise at a solid pace in 2020.

In contrast, the outlook for business investment is less promising. Global manufacturing output slumped in 2019 as a result of trade tensions. Despite recent progress, outstanding trade disagreements remain with China, the EU, and other nations. What's more, political uncertainty associated with the November 2020 election is likely to slow business investment.

In 2020, global GDP growth should continue around 3%, largely due to supportive government policies. Recent progress on Brexit and U.S.-China trade relations are signs that headwinds to growth may diminish somewhat in 2020.



Economic Review *(continued)*

Economic Downside Risks: While trade concerns continue into 2020, the largest risk to the economy appears to be the current U.S.- Iran stand-off. Should the conflict escalate, rising oil prices could undermine economic growth.

There are also domestic political risks. The polarized nature of American politics and the wide range of potential outcomes this year could cause both consumers and businesses to take a cautious approach to spending.

The outlook in most foreign economies would brighten if trade tensions between the United States and China should subside and, conversely, the outlook would darken if tensions increased further. The Brexit process has continued to cast a cloud of uncertainty over the U.K. economy as well as the European Union. A Chinese crackdown in Hong Kong, should one occur, could also impart a negative shock to global growth prospects.

To summarize, in the United States, no economic recession is expected, but the signs of an aging economic cycle are increasing. The most likely scenario is that the economic expansion that has been underway in the United States will continue for the foreseeable future, although at a subdued pace. Likewise, economic growth in most foreign economies will remain modest in 2020. However, the unsettled political and geopolitical environment at present imparts more uncertainty than usual into this economic outlook.

Sources: Institute for Supply Management, the Conference Board, Department of Labor, Department of Commerce, Morningstar, Federal Reserve of St. Louis, Federal Reserve Board, Bloomberg, International Monetary Fund.

2020 Market Comentary

Summary: The geopolitical risks that dominated the news cycle for much of 2019 subsided a bit during the year's final quarter. Trade policy uncertainty faded with the announced "phase one" trade deal between the U.S. and China. And in the UK, near-term political uncertainty fell following the Conservative Party's landslide general election victory.

The fourth quarter also saw the Federal Reserve's third rate cut of 2019 followed by a statement indicating that "the current stance of monetary policy is appropriate." No further rate cuts are expected in 2020

Given this backdrop, U.S. equity markets produced strong gains and ended the year near all-time highs. It was a "risk-on" quarter which rewarded more aggressive investing as valuation multiples (i.e., price to earnings ratios) expanded. The U.S. benchmark S&P 500 rose by 9.1% during the quarter, while small cap stocks gained 9.9%.

Results overseas were similar as the MSCI EAFE developed markets index gained 8.2%, and the MSCI Emerging Markets Index jumped 11.8%. Fixed income markets produced modest quarterly gains.

Domestic Equities: U.S. equities generated strong gains in the fourth quarter driven by an improved economic picture, alleviated trade tensions, and a dovish Fed. The U.S.-China trade deal eliminates planned new tariffs, while U.S. tariffs imposed in September are to be reduced by half. Other U.S. tariffs on Chinese goods remain unchanged.

In turn, China has agreed to increase purchases of U.S. goods, particularly agricultural products. The technology sector responded positively to the easing of trade tensions, rising more than 14% during the quarter. For the year as a whole, the S&P 500 was up over 30%. As stock prices increased much faster than corporate earnings, valuations became stretched, particularly for growth-style companies.

The market started the year priced at 15.6x projected earnings, but ended the year at 18.2x estimated 2020 earnings.

The following chart compares the year-end price-earnings ratios of various types of U.S. companies vs. historical norms. The higher the percentage, the higher the pricing vs. historical levels.

U.S. Equity Forward P/E ratios
Compared to 20 Year Average

	Value	Blend	Growth
Large	112%	117%	121%
Mid	109%	113%	121%
Small	97%	115%	150%

Source: JP Morgan Asset Management, Fact Set, Russell Investment Group, Standard & Poor's

International Equities: Developed international equity returns for the quarter were strong, but still trailed those generated in the U.S., while emerging markets produced a gain of nearly 12%. European equities, as measured by the MSCI Europe index, gained nearly 9% during the period. Chinese stocks rose 15% during the quarter on the prospect of a US trade deal, and Russian stocks rose 17%, largely due the rise in crude oil prices.

Fixed Income: Government bond yields rose during the quarter (and prices fell) as economic sentiment improved and investors sought risk. The U.S. 10-year Treasury yield increased 26 basis points (bps), or ¼ of 1%, while the two-year yield dropped slightly. The steepening yield curve (meaning a larger yield advantage to longer term bonds) reflected investor's more optimistic view of the economy. U.S. corporate bonds outperformed government issues, and high yield bonds continued to produce strong results. U.S. high yield bonds generated a return of more than 14% for the year, another example of how risk taking was rewarded in 2019.

2020 Market Outlook

Summary: A year ago, trade disputes, rising interest rates, and recession fears all weighed heavily on investors. As these concerns faded, the markets delivered remarkable returns, repeatedly setting new highs. Significant uncertainties remain, however, including the potential re-escalation of trade conflicts, a shift in central bank policies, the agenda of the next occupant of the White House, and other geopolitical risks including unrest in Hong Kong and actions by Iran.

12/31/2019 S&P 500 Valuation by Sector

	Utilities	Materials	Real Estate	Consumer Discretionary	Consumer Staples	Technology	Finance	Communication Services	Industrials	Energy	Healthcare	S&P 500
S&P 500 Weight	3.3%	2.7%	2.9%	9.8%	7.2%	23.2%	13%	10.40%	9.1%	4.3%	14.2%	100%
Forward P/E Ratio	19.9	18.4	19.9	22.2	20.2	21.8	13.4	18.8	16.9	17.7	16.2	18.2
P/E vs 20 yr. Average	138%	131%	128%	125%	120%	111%	107%	103%	106%	104%	100%	117%

Source: JP Morgan

Domestic Equities: While our outlook for 2020 remains cautiously optimistic, we believe return expectations should be lowered, particularly for large and mid-size US companies, and certain sectors of the economy. As indicated in the chart above, industries such as utilities, materials, real estate, and consumer products are highly priced (relative to projected earnings) when compared to historical norms.

U.S. stock markets should enjoy tailwinds in the form of 2019's three Fed rate cuts and improving business sentiment driven by recent progress on a U.S.-China trade deal. However, volatility is expected to persist. The fading effect of the 2017 tax cuts and various political uncertainties present potential headwinds. The upcoming presidential election offers a wide range of possible policy outcomes, particularly in the areas of taxation, regulation, and health care. A reacceleration of global growth and a weakening dollar have the potential to drive better than expected corporate earnings. On the other hand, weaker than expected earnings would likely drive valuations (and valuation multiples) lower.

International Equities: International developed equity markets sharply lagged their U.S. counterparts in 2019. Going forward, they may outperform due to their lower current cost. This is particularly true of emerging foreign markets, which trade at under 13 times projected earnings (vs. over 18x for the S&P 500). International stocks tend to be more economically sensitive than U.S. stocks. Therefore, should global growth reaccelerate, international stocks may offer greater upside potential.

An easing of geopolitical tensions and a corresponding rise in business confidence could also buoy the asset class. Foreign investments generally also benefit from any weakness in the dollar. Compared to twenty years ago, global stock markets appear to be less synchronized with each other. Given all these factors, we believe that a well-diversified global portfolio will likely add to risk adjusted returns.

Fixed Income: Rates across the yield curve remain near historically low levels. These low rates are supported by expectations of continued subdued inflation, modest economic growth, and central bank liquidity. Fixed income investors are unlikely to materially benefit from continued declining interest rates in 2020, although there could be a surge in demand for high quality bonds in the event of a stock market downturn.

Within credit markets, investment-grade bonds appear attractive relative to high yield, where valuations appear particularly stretched. Investors should be cautious reaching for yield in this exceptionally low-yield environment. Government bond yields are currently more attractive in the U.S. than in many foreign markets. Municipal securities remain a viable option for investors in higher tax brackets. Selectivity is key, however, as limited supply and strong demand have pushed valuations higher. While fixed income returns in the near-term are generally expected to be low, their fundamental role in client portfolios remains unchanged. High-quality bonds should continue to play a key role in managing portfolio risk.

Sources: Capital Market Consultants, Dept. of Labor, Dept. of Commerce, Bloomberg, Morningstar, Federal Reserve of St. Louis, Federal Reserve Board, Institute for Supply Management, the Conference Board.