STALEY CAPITAL ADVISERS, INC.
FOURTH QUARTER 2019 REVIEW AND COMMENTARY

Market Review: The equity market provided stellar returns in the fourth quarter, with the Standard and Poor's 500 Stock Index gaining 9.1%. Additionally, it was the first quarter in some time investors were not punished for diversifying away from U.S. megacaps. The Russell 2000 Small Cap Index gained 9.9% and the rest of the world, as reflected in the MSCI All World ex-U.S. Index, gained 9.0%. In another countertrend, the Value component of the S&P 500 gained 9.9% versus 8.3% for Growth. The S&P 500's 31.5% return for all of 2019 nevertheless dominated every major equity market index and category. It was also the second highest return in over twenty years, slightly trailing 2013. The Barclays Aggregate Bond Index gained 0.2% in the quarter and 8.7% for the year. Gold rose 2.9% in the fourth quarter and 17.9% in 2019.

Price to Earnings Perspective: The S&P 500 Index's stellar return in 2019 was not driven by a robust corporate earnings environment. In fact, after 2018 earnings were boosted by tax cuts, earnings for 2019 only increased by approximately 4%. As a result, over 80% of the S&P's return was driven by a significant expansion of the Index's price to earnings ratio. Specifically, at each year end, the P/E ratio moved from 16.5 to 20.4. The two largest companies in the S&P 500 Index, Apple and Microsoft, contributed 15% of the Index's 2019 return. Apple's earnings were flat year over year and the stock price gained 85% as the P/E expanded from 13 to 24. Microsoft's shares rose 55% in 2019, and while earnings grew 20%, more than half the of the return came from the shares moving from a P/E of 23.5 to 30. Valuation is not a reliable indicator for timing market movements but stretched valuations inevitably pull returns forward from the future. The market will likely be dependent upon an earnings acceleration to continue its ascent in 2020.

The Federal Reserve: One definite factor in the P/E expansion was the Federal Reserve's sharp policy reversal and the decline in market interest rates from year end 2018. Pointing to a "mid-cycle adjustment" the Fed reduced their Fed Funds target by 0.25% three times; in July, September, and October. Additionally, disruptions in the overnight funding markets beginning in September prompted the Fed to respond with significant and continuous liquidity injections. Restarting a quantitative easing program that was shelved in 2018, the Fed has expanded its balance sheet by over $300 billion at a time when the economy appears to be on solid footing and trade tensions have softened. Central bank liquidity continues to be a major factor in the market.

The Big Picture: Capped off by 2019, the S&P 500's annualized return for the decade was 13.5%. If you owned the Growth component of the index your annualized return was 14.8%. There were no 20% declines in the decade and no recessions. The previous decade experienced two market declines of at least 45% and two brutal recessions. The annualized S&P 500 return for that period was -1.0% pulling the twenty-year annualized return for the Index down to only 6.1%. We can anticipate the upcoming decade will again be quite distinct from the most recent. The past decade was best characterized by moderate economic growth, benign inflation, low market volatility, negative global interest rates and a resilient equity market dominated by U.S. technology stocks.

We thank you for your continued trust and we welcome the opportunity to more specifically review your financial goals and investment mix.

YOUR STALEY CAPITAL INVESTMENT TEAM