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Below is the majority of my year-end letter to clients which many folks ask to read. It is not the full letter in its entirety. One theme that continues over the years, bull market, bear market, economic expansion, recession, Republican, Democrat, no one every accused me of brevity!

Welcome to 2020 and a brand new decade in our lives! The 2010s, 2019 and Q4 certainly went out with a bang. What a stark contrast to the previous decade which saw two 50%+ stock market declines. Q4 of 2019 built on the same theme I have been discussing for three years; it was all about Trump in one form or another, love it or hate it. The global fascination with President Trump does not show any signs of abating, something I thought would happen by now. In casual conversation, I often say "ABT" when people engage me in a discussion about the President. All 'Bout Trump.

There were many major events that occurred in Q4, just like other quarters, however, this time, we also saw a number of those reach resolution. In the United Kingdom the BREXIT saga seemed like it would never end. When Prime Minister Boris Johnson called for a new round of elections to take place in December, many believed it would be his Waterloo, that the Labour Party and Jeremy Corbyn would garner enough support to push the UK into radical socialism and remain within the EU. In what can best be described as one of the single greatest repudiations of the Labour Party in the UK, voters overwhelmingly supported Boris Johnson and his Conservative Party to a level not seen since the days of the great Margaret Thatcher. BREXIT will be forging ahead in 2020 and the UK should be much better off in the 2020s without the EU.

Back on our shores, the House of Representatives formally put forth articles of impeachment against President Trump, or did they? The majority of the House voted to impeach the President with a few Democrats jumping ship. I am certainly not a constitutional scholar so I will leave it to the legal eagles if the articles have to be delivered to the Senate before Donald Trump is officially impeached.

Although Congress didn't have a lot to show for itself in Q4, after too long of a wait, the House finally approved the USMCA trade deal between the major North American economies of the U.S., Canada and Mexico. Along with negotiating favorably with China, USMCA was one of Donald Trump's big campaign promises as the previous deal, NAFTA, was not the huge win many people thought it would be. While I am not so sure USMCA is a big boon to our economy, I do think it is better than its predecessor.

Keeping on the theme of trade deals, the nonstop rhetoric with China was like the Energizer bunny. It kept going and going and going. From not striking a bad deal to not striking any deal, the administration announced a piecemeal deal, or in "phases". We heard much about Phase I, but very little substance. You can use whatever analogy you like. All hat and no cowboy. All foam and no beer.

As I had mentioned several times during media interviews, I continued to believe that no real and substantive trade deal with China would be signed by election day. I do not see China's incentive. While their economy has been reeling, from a negotiating standpoint, they already know what the U.S. demands under Trump. If it looks like the President is going to be reelected, they can come to an agreement near the election. Otherwise, they can take their chances with Donald Trump's successor. Remember, China doesn't have the plague of short-termism like we do. And President Xi isn't going anywhere anytime soon.

I also thought that the tariffs scheduled to be implemented on December 15th would not come to fruition. Recall, those were the ones that were postponed from earlier in the year. In my view, the economic damage in 2020 was too much to risk for the President in an election year. Additionally, what was once significant market reaction to the trade tiff with China has become almost completely muted.

As I have always explained, markets will adjust to both positive and negative scenarios and outcomes, but it has a very difficult time dealing with uncertainty. The longer a particular issue goes on, whether it's trade with China, BREXIT or an impending military conflict, markets will increasingly adapt. In real terms, if oil suddenly spikes $50, markets will react very negatively. If oil slowly grinds $50 higher over a period of quarters or years, the market will more easily adjust and price it in.

In the Middle East, Saudi Arabia's long awaited initial public offering of the state-run oil company, Aramco, came to market. Aramco has the distinction of being the largest IPO of all-time as well as the largest and most profitable company on earth. Several years ago, I wrote how significant it was for the closed country of Saudi Arabia to begin to allow women to drive. As ruthless a dictator as Mohamed Bin Salman is, he certainly understands his country's absolute need to open up and accept more western influences for his regime to survive.

Selling shares of Aramco to the public is only the first in what will likely be a string of public asset sales to raise money for the government to diversify away from its total dependence on energy. As one who grew up during the oil embargos and gas lines of the 1970s, if you told me this would happen in my lifetime, I would have thought you were insane. But then again, imagine someone told you that we would be using telephones without wires or sending messages through the air and driving battery operated cars.

Turning to the global central banks, they are all lined up in accommodative mode, meaning that interest rates are low, and money is easy. Like so many other things from a year ago, this is the exact opposite of what was seen during Q4 2018 and partly responsible for the big rally in U.S. stocks in 2019. There are many problems I see with the global central banks, but particularly our own Federal Reserve.

Fed Chair, Jay Powell, was doing a fine job of flaunting the Fed's independence in 2018, but as soon as the markets strongly pushed back, Powell and most of his minions quickly ran to the other side of the spectrum, tails between legs to accommodate the markets. Don't get me wrong. This certainly helped the markets, helped you and helped me. However, it puts the Fed in a very tough spot when the economy turns south or some exogenous event hits.

One of the most overused expressions in the industry is, "Don't fight the Fed." More simply put, when the Fed is lowering rates, life is good. When they hike rates, life isn't so good. The problem with that is the last two 50%+ stock market declines occurred with the Fed lowering rates over and over and over. For those curious, that was 2001 and 2007. The media conveniently forgets to mention these "little" bear markets.

Historically, stocks perform their best after the Fed has stopped lowering interest rates and early in the rate hike cycle. The pundits seem to forget this as well. More recently, over the summer you may have heard the yield curve inverted and that always leads to recession and a bear market. The yield curve is simply measuring one short-term interest rates like the 90 day and/or two-year against a long-term rate like the 10 or 30 year. When short-term interest rates are higher than long-term rates, the curve is inverted.

Yield curve inversions themselves do not cause bad things to happen in the markets nor economy. Inversions are dangerous because money becomes tight and banks lose the incentive to borrow short-term and lend long-term. If money becomes tight, companies begin to struggle, especially the ones who were teetering in the first place. They don't have easy access to borrow and spend. So companies begin to curtail spending and new hiring. That's typically how recessions begin.

After being in the news nonstop for weeks, you don't even hear about the yield curve anymore. And that's exactly when you should start becoming concerned. Later in Q3, the yield stopped being inverted. The correct term is that it steepened, meaning that long-term rates were back above short-term rates which helps the banks. Pundit after pundit in the media sounded the all-clear. President Trump's chief economic advisor, Larry Kudlow, became giddy during this parade of interviews.

The problem with all this is that the yield curve is an absolutely horrid timing tool for recession. Two things are important about the yield curve inverting. First, the longer it lasts and worse it gets, the more severe the impending recession is. Second, the countdown to recession typically doesn't begin until the yield curve stops being inverted. After that, the economy usually begins to sputter 12 to 24 months later. In today's case, the yield curve inverted for a short period of time and the inversion was not very deep. The steepening began in early September and continue to steepen right to year-end. There have been lots of victory laps taken, including by the Fed, but I think the risk remains in front of us later in 2020 and into to 2021.

None of this should come as a surprise as I have continually written about the prospects for a mild recession beginning before the 2020 election. To their credit, the Fed did do a 170 degree turn 12 months ago to recognize some risks, but appeasing the markets is not in their mandate. Additionally, the tax reform package passed in late 2017 did juice the economy and elongated the historic economic expansion longer than I originally thought.

I am going to add one more item regarding the Fed and that's what is being called the Repo Crisis. There is a major banking market called Repo or repurchase agreement. Essentially, banks lend top rated securities, mostly treasuries, to one another on an overnight basis to receive cash for immediate needs. Late in Q3, overnight interest rates began spiking as banks needed more cash than they had on hand and other banks were not in a position to lend.

The Fed immediately stepped in to what has become hundreds of billions of dollars of cash in order to keep rates where the Fed wanted them. People have speculated that tax payments along with changes in the regulatory framework were responsible for this. Other have deemed the Fed's response as quantitative easing, also known as QE IV, after the Fed created money three times before to help the economy emerge from the Great Recession and financial crisis.

I do not believe the Fed is quantitatively easing as they did in the past to spark the economy. Rather, I believe they are desperately trying to keep the banking system functioning properly by holding short-term interest rates in their predetermined 1/8%

range. The real problem is that I haven't heard anyone definitively conclude the cause of the crisis and how the Fed can extricate itself from creating hundreds of billions or even a trillion dollars. The Repo market is on my list of possible potholes for the markets and economy in 2020. And hasn't it been "interesting" or "curious" that President Trump stopped his assault on Jay Powell and the Fed just about the time the Repo Crisis became public? Did Trump get the inside read?

One thing would not surprise me, if somehow the much-maligned European banking system has a hand in the Repo Crisis. The European Central Bank has kept their system afloat with enough duct tape and Band-aids to last a lifetime. I have long written about what I deemed as a failed experiment creating the Euro currency in 1999 and the rubber is going to meet the road over the coming few years. Remember, there remains almost $15 trillion in negatively yielding bonds. Think about buying a bank CD for $100 and receiving back $99.50 when it matured. Negative interest rates are not having their desired effect of stimulating the European economy. They are, however, creating imbalances in the global financial system which will surface sooner or later. As I always say, money flows where it's treated best.

Finishing up on the Fed, they ended the year in neutral mode regarding interest rates and that should be the theme for Q1 as well. I was vocally very critical of their mini rate cutting cycle last year as their rationale did not fit with their Congressional dual mandate of maximum employment and price stability. The unemployment rate was at a 50-year low and inflation was tame without trending towards deflation. The only historical comparisons are 1995 and 1998 where the Fed cut rates at or near all-time highs in stocks in an economy that was softening. Both times, those cuts reignited the economy and juiced stock market returns which sounds similar to 2019.

With all that said about the Fed, I am sure many would take away a theme of negativity. That's not the case as we enter 2020. The economy plodded along in Q4 and I think we are in for more of the same in Q1. Earnings estimates are a little high for my taste, but that doesn't lead to a bear market nor recession. Inflation is tame. The best word to use is Goldilocks. The economy is not too hot and not too cold.

For several years, I had forecast a mild recession to begin before the 2020 election. Every single president succeeding a two-term president saw recession in his first term. Obama, Bush II and Bush I are the recent examples. I did not believe that Trump and the GOP, given his trade policy with China, would be able to forestall recession. So far, I have been wrong, and the data do not suggest recession is imminent. If this continues, I will happily do a "mea culpa" and enjoy the economic growth and market prosperity. If the economy does weaken, it is likely an event for later in 2020. You can bet the President desperately needs the economy to forge ahead for him to have a chance at being reelected.

Most presidential elections end up being all about the economy. Voters typically vote their wallets. What's going on today, politically, is anything but typical, especially with impeachment apparently moving forward. By the time Q1 ends, that event will likely be behind us with President Trump remaining in office. We will also likely see the field of candidates to oppose Trump winnowed down even more. Three months from now, there will be a small handful left with the only debate being whether there will be a clear-cut winner before the convention this summer.

Speaking of the election, I am often asked about its impact on the stock market in 2020. First, contrary to what some of the big players said, I do not believe stocks will close at or near all-time highs the day of the election and then crash if Bernie Sanders or Liz Warren win. That's just absurd and not how markets trade. If a far-left candidate gets the nomination and if the market starts to smell a possible victory, stocks will trade lower into the election. It was interesting that Medicare for all and the wealth tax were somewhat put on the back burner in Q4 as the moderates made their move.

Most markets saw significant moves in Q4; however, volatility was very tame. Most markets essentially saw straight line trends. Stocks, oil and gold surged while bonds and the dollar corrected. The stock market did not see a single discernable or even mild pullback except for the two down days to begin Q4.

Looking ahead to 2020 and Q1, I think the same trends that were in place to end the year will carry over. Since mid-November, stock market sentiment has become very positive, giddy and even downright greedy. This is a 180 degree turn from 12 months ago where fear, despondency and despair ruled the market. I published a special update on December 26, 2018 showing a precedent setting degree of negativity only seen before major stock market rallies. As 2019 closed, the exact opposite, historic extreme was seen, comparable to January 2018, January 2017, May 2011 and early 2000 during the Dotcom Bubble.

Historic extremes in market sentiment are never repaired by stocks rallying or even going sideways. Market weakness is needed to fix that problem. Stock market bottoms where fear is always seen happen very quickly. Peaks do not. They tend to roll on and on, sometimes for months before punishing risk takers.

Today, unlike January 2018, January 2017, May 2011 and early 2000, the stock market's foundation is much stronger and on better footing. Only the small cap Russell 2000 is lagging on the index side. Semiconductors and consumer discretionary are leading on the sector side with banks and transports acting constructively. High yield bonds, one of my favorite canaries in the coal mine, are scoring all-time highs and the New York Stock Exchange Advance/Decline Line, which measures participation is also at a new high. These kinds of readings do not appear before 10%+ market corrections, let alone as bear markets begin. Until proven otherwise, weakness should be bought, and the bull market should live on.

Three months ago, I offered "with investors continuing to hate and disavow the longest bull market in history, it will be difficult for the bull to end unless the masses stop behaving like each and every bout of weakness is signaling the end. When investors start using pullbacks as buying opportunities, the clock will begin ticking faster on a bear market beginning." Q4 finally saw investor behavior change to greed.

My longstanding target of Dow 28,000 was reached to close the year and I remain focused on 30,000 as I first mentioned at Dow 20,000. The stock market still needs to see a string of deterioration in the market's foundation before any long-term concern begins to creep in. When that day comes, our lineup of investment strategies has many different methods to play defense depending on the risk tolerance of each individual strategy.

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