Welcome to 2020!

The new year is upon us and it’s a time to leave 2019 behind and look forward to the opportunity 2020 will bring our way.

We turn the calendar leaving behind market fears and uncertainty around the global growth picture, extensive Central Bank intervention, unbelievable behaviors in the political world and some of the best annual performance we have seen across many asset classes in years. It’s been an incredible year.

We believe this is going to be a year of divergent views in the marketplace and a year in which active management really shines (albeit we recognize our natural bias in that statement). We have read strategists’ 2020 predictions that interest rates are going to zero and others that believe that interest rates are going to 3%. We don’t see rates moving down a one-way street but believe that volatility will remain high this year. While we dislike repeating a theme from 2019, we believe that heightened interest rate volatility will be a key theme in 2020 and will bring great opportunities. In the current environment of low interest rates, we cannot lose sight of the all-time tights in credit spreads, reinforcing our view that individual security selection AND security avoidance will be critical in 2020.

At the moment we can feel sentiment shifting, with a much more positive view on the horizon. The commentary has changed from concerns around a global recession to a bottom being reached and recovery underway in many regions globally. The consumer remains strong domestically and we have a Federal Reserve that is willing to keep liquidity in the system to help sustain this economic expansion. We believe this will allow the recovery to continue but wildcards, including the election and inflation expectations, will be ever present.

Below you will find our 2020 Themes. We will be sending out more in-depth write-ups on the themes throughout the year. These write-ups will be in addition to our well-received 5x5 communication and other market relevant updates. We promise to stick with our commitment of not publishing just to publish. We want our communication to be focused on markets and transparency into what we are seeing, hearing and thinking with an occasional non-market thought or reflection. Considering the themes presented, we believe the most important theme for investors in 2020 will be a focus on capital preservation and a keen focus on risk-adjusted returns. In our opinion, these core tenants will differentiate the winners and losers in 2020 as sentiment ebbs and flows throughout the year.

As I mentioned in our ‘2019 reflections’ write up (sent last week), I am ever more convinced of the importance of active management - an active process that focuses not just on the risks being taken in the portfolios but the overall risks in the Capital Markets. The words “Flexibility” and “Fortitude” come to mind in thinking about an effective process - the flexibility to alter portfolios based on different points in the cycle and the fortitude to deviate from the broad-based indices; saying “no” to index weightings and consensus thinking (the power of zero). We are entering a new frontier in markets that creates an even greater need for fixed income portfolios to provide a ballast for investors - seeking returns when risk is priced right and avoiding drawdowns and preserving capital when volatility arises.

We appreciate your support and the trust in our team. Please let us know what we can do to serve you in 2020.

Let’s talk.

2020 Themes

Even More Extreme Outcomes

We anticipate another year of volatility but feel the outcomes will be very different this year

We realize that 2019 was a doozy and just as you are catching your breath, 2020 is fast approaching and bringing along its own idiosyncrasies. We expect another year of volatility (oh boy!) and with even more extreme outcomes (even better!). Our recovery is rather seasoned, as we discussed in our reflections. This is at a point when we are heading into an election year and on the heels of impressive returns with equities marking all-time highs, the 30-yr U.S. Treasury marking an all-time low and credit at year-to-date tights (2019). What could possibly go wrong?!? The market has a good deal of information to digest, a new landscape ahead that we believe will bring even shorter cycles, more extreme outcomes, and unintended consequences. If 2019 taught us anything, it is to expect the unexpected!

1) Politics
    a. Elections
    b. Democratic ticket?

c. Outcome Issues

i. Social Issues – enhanced or addressed?
ii. Importance of global financial services de-regulation
iii. Fiscal stimulus – states are the focus. Global?
iv. Deficit spending - MMT
v. Tax and spend or tax and redistribute?
vi. Foreign relations
vii. Trump's second term – legacy term

2) Inflation and Inflation expectations: We warned about rebasing in 2019. It happened. Is Inflation working its way through the system?

a. Are we too complacent or properly conditioned?
b. All about expectations
c. The Fed and other Central Banks will close their eyes and look away
d. Globalization, Technology, Demographics…. higher wages?

3) Interest Rates: Another year of volatility and uncertainty

a. The power of interest rates. The good, the bad and the ugly
b. Pensions, Banks, Insurance Companies – lower for longer problems
c. Discount rate, risk free returns, and real rates
d. Why real rates matter, and negative interest rates make zero common sense
e. Remember that inverted curve?
f. Monetary and Fiscal policy party

4) Credit: The Haves and Have Nots - The Winners and the Losers

a. The power of a strong capital structure
b. Why margins and FCF matter more today
c. Options are a CFO's best friend
d. Those pesky Rating Agencies might be growing a little restless – Downgrades, Upgrades, and Defaults. The Power of Zero.
e. When Dividend yields are higher than 30-year Corporate Bond yields – Warning sign?

5) Cost of Capital, Value Creation, and Creativity

a. Leveraged Finance in Public/Private capital markets
b. Loans, CLOs, and Private Credit
c. Fun with shadow banking

    d. Rational capital structure execution = enhanced returns and greater prospects. Or levered capital destruction?

6) Active Management – The great debate will continue but results will speak for themselves
    a. The real issue = risk mitigation and capital preservation
    b. The math behind return seeking
    c. Indexation is a cheap way to get long U.S. Treasury and credit duration, extension risk, and greater volatility