HAVERFORD

2020 OUTLOOK

Published: December 30, 2019

HAVERFORD

A Message from the Chairman

2020. It is a number most people associate with vision. With the calendar turning to 2020, there is no better time to look back at where we've been and peek forward at the year ahead. While we can't see everything the future will bring, one thing we can guarantee is that Haverford Trust always keeps a keen eye on what it takes to help our clients succeed.

I'm happy to say we saw much growth both at Haverford and in the markets throughout 2019. With an ongoing focus on recruiting and retaining top talent, our team is now more than 100 strong. We continue to invest in our people, and in true Haverford style, those investments are paying dividends. Our strong results and strong client relationships are directly correlated with the efforts of our team. Throughout our company, a genuine passion for helping others achieve their goals is seen and felt day in and day out. Our client retention rate is at 97 percent[1], with ongoing growth in a number of areas, including wealth management, endowment and foundations, and retirement services.

We continue to support our clients by helping them develop and implement clear visions for their futures. We are expanding our already-robust financial planning and trust administration services to support them at every step along the way. We are encouraging all of our clients to have meaningful conversations with family members—conversations that transcend tax planning and explore real-life financial situations and necessary decisions.

When it comes to hot topics, you need only look at the headlines or listen to living room and board room conversations to know that ESG—environmental, social, and governance—is something on just about everyone's minds. At Haverford, we see ESG as a natural extension of our *Quality Investing* philosophy. We believe that integrating ESG into our investment process may help us enhance returns, mitigate risk, and build strategies that best meet client needs. As we say, *Quality Investing* is Responsible Investing. And that is true in any market.

While the markets performed incredibly well in 2019, the year hasn't been without volatility. As we look ahead, we expect the volatility we experienced at times this year to continue into 2020. We are confident that our *Quality Investing* philosophy is well-positioned to sustain market swings, because we invest in the long term and are not distracted by the latest investment fad. We know these times can be trying, but your experienced Haverford team is here with you every step along your financial journey, ready to answer any questions and help you stay the course.

We are truly honored that you have chosen Haverford to be your partner not only through market changes but also life changes. It's a responsibility we take very seriously, and putting together our annual *Outlook* gives us an opportunity to reflect on past successes and ensure they continue well into the future. Let it be a reminder of our commitment to you and your family. As 2020 begins, we firmly believe our vision has never been clearer. Now, let's clarify yours and see it through—together.

Wishing a healthy New Year to you and your loved ones!

Sincerely,

JOSEPH J. MCLAUGHLIN, JR.
Chairman & *CEO*
The Haverford Trust Company

1 For the 12 month period ending 12/31/19.

Six Themes for the New Year

Cue the noisemakers

Everyone expects noisemakers to make an appearance for New Year's Eve celebrations around the world. Throughout 2019, however, the noise seemed ceaseless. Numerous and repetitive headlines shouted crisis and clamored for attention: impeachment, protests in Hong Kong, rising income inequality, mounting national debt levels, Brexit, and labor strikes just to name a few. The U.S. Equity markets largely ignored most of the noise and instead rationally focused on what really matters for long-term returns: low inflation, low interest rates, decent Gross Domestic Product (GDP) growth, corporate earnings growth, and strong balance sheets. Of these factors, we believe the Federal Open Market Committee's (FOMC) policy reversal was most beneficial to the market.

As we enter 2020 and the presidential election draws near, the noise will likely become deafening as a common political strategy starts to play out in the headlines. In this strategy, the party out of office seizes the opportunity to create a crisis environment that only their policies can correct. Given the current strength of the U.S. economy and the consumer—record low unemployment and rising wages—candidates will look to other issues to incite concern. We cannot let politics get in the way of investing. As it did in 2019, we believe the stock market will look past the fearmongering and focus on the fundamentals.

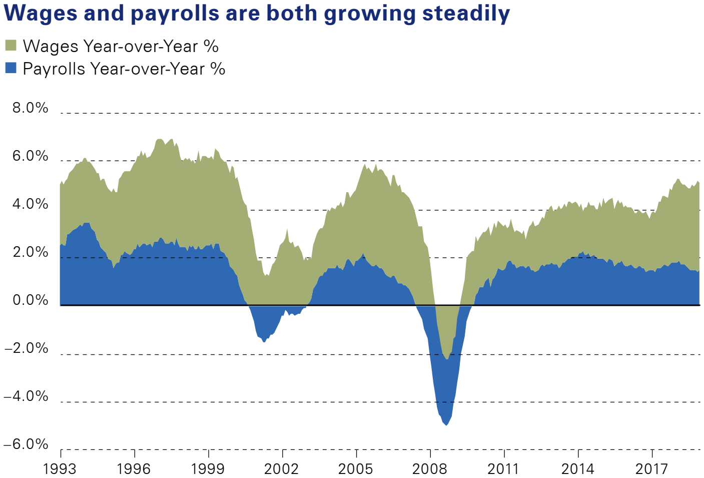
The U.S. economy should strengthen, not weaken

We expect a slightly stronger economy in 2020, with better earnings growth and continued low inflation and interest rates. While U.S. GDP growth slowed to roughly 2% in 2019 from the previous year's 3% growth rate, we believe economic momentum is being underestimated.

In 2019, the uncertainty surrounding trade and tariff policies offset the positive impact of tax cuts and regulatory reform. Businesses require some degree of certainty to commit to business investment and capital spending. The growing trade war triggered a decline in CEO confidence for six consecutive quarters and caused the Institute for Supply Management (ISM) Manufacturing Purchasing Managers' Index (PMI) survey to slump below 50 for four consecutive months—a reading under 50 implies a contraction. Manufacturing is a small share of U.S. GDP, so fortunately thus far the trade and tariff uncertainty has had limited effect on the rest of the economy.

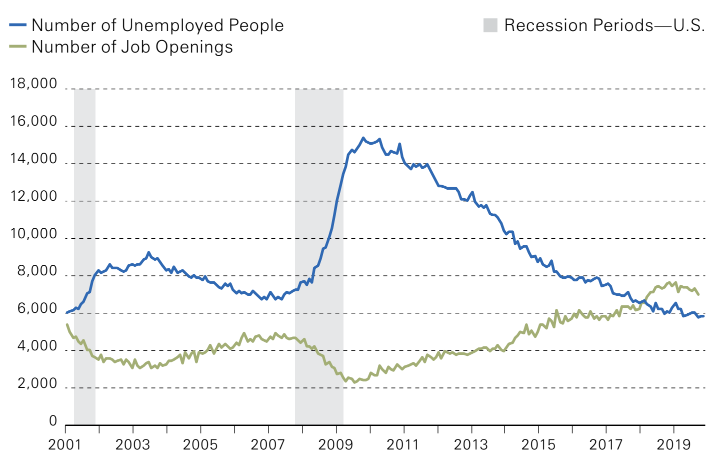
The combination of continued job creation and strong wage gains paints a strong picture of the consumer heading into 2020.

Wages and payrolls are both growing steadily



Source: Factset Research Systems

More job openings than people unemployed



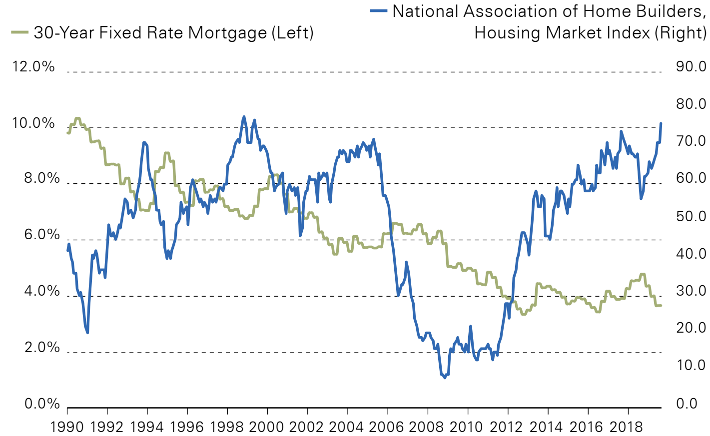
Sources: Factset Research Systems, U.S. Bureau of Labor Statistics, JOLTS (Job Openings and Labor Turnover Survey)

Consumer spending and services account for more than 70% of U.S. GDP and here the data is overwhelmingly positive. Unemployment is at a 50-year low; there are one million more jobs available than active job seekers; wages have grown above 3% for seven quarters, well above inflation; the consumer savings rate has risen to 8%; consumer confidence remains near cycle highs. With the consumer this healthy, the odds of recession materializing in the next 12-18 months remain very low in our opinion.

In fact, we forecast GDP growth will accelerate to 2.5% in 2020. Starting in August of 2019, the Federal Reserve has cut interest rates by a quarter point three times. There is generally a lag of six to nine months before monetary policy decisions affect the economy. Lower rates should start to boost the economy in mid-2020. Already the housing market has shown some improvement from cheaper mortgage rates. However, trade policy should have the biggest impact on GDP growth in 2020. The Trump administration has already inked deals with South Korea and Japan, and is close to completing the USMCA (NAFTA 2.0). All that is left is a phase one-trade agreement with China. We believe this will occur early in the New Year.

The bullish scenario is simple: most first term presidents want to become second term presidents. The greatest factor in determining re-election is the health of the economy

Homebuilder sentiment hits 20-year high as mortgage rates remain low



Sources: Factset Research Systems, National Association of Home Builders

and the consumer. We believe rising equity and housing prices will provide support to an already strong consumer as household net worth increases. Deficit spending is set to rise in 2020 following December 2019's federal spending deal, leaving trade policy as the strongest lever the president has to affect GDP. Coming to a phase-one deal with China removes some uncertainty, which should boost business confidence and revive the capital investment cycle. We believe this scenario is likely to play out in 2020.

Europe should find its bottom as trade tensions ease

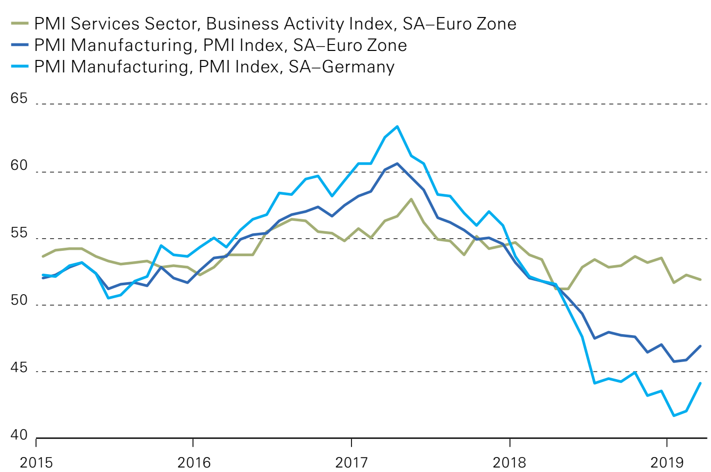
Across the pond, 2019 was a more challenging year. European GDP growth decelerated across the region, and Germany narrowly avoided a recession. The Eurozone Manufacturing PMI, a barometer for economic sentiment, recorded 10 straight months of contraction to its lowest level in six years. Several issues are to blame: the sharp slowdown in Germany's auto sector, U.S.-China trade war, and Brexit. However, with positive developments expected on all these fronts, the worst could be over for Europe.

The escalation in U.S.-China trade rhetoric is having a disproportionate impact on Europe. The continuing uncertainty is hurting demand for complex industrial machinery and luxury automobiles, markets in which the Europeans play a dominant role. Manufacturing and exports are a much larger component of GDP in Europe when compared to the United States. For example, German exports account for almost half the country's GDP, while manufacturing jobs as a percentage of the total workforce are more than double the U.S. level.

European carmakers are heavily reliant on the United States, both as an export market and as a manufacturing base, with a complex global supply chain. A shift to an "America First"

PMI (Purchasing Managers' Indexes) surveys

PMI surveys show the Eurozone service sector is still expanding (a reading above 50). After sharp declines, manufacturing data has started to stabilize, particularly in Germany.



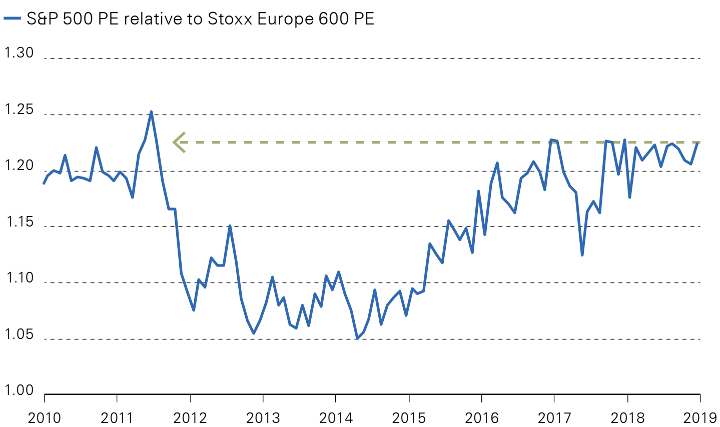
Sources: Factset Research Systems, Strategas policy introduces additional risks to the global trade system. Recent U.S. tariffs on French wine and Italian parmesan are hardly catastrophic; however, Trump's 25% tariff threat on European autos would have dire consequences and provoke retaliatory measures. By delaying his decision on auto tariffs until mid-2020, Trump has given a much-needed reprieve to the industry.

Other bright spots are emerging in manufacturing, labor, and exports. The PMI data has stabilized in recent months, and manufacturing weakness has not spilled over into the service sector so far. Meanwhile, like the United States, Europe's labor market looks robust, with the unemployment rate at a decade low and wages rising at their fastest pace in years.

The ongoing Brexit drama continued into a third year, holding back private sector investment as the potential economic consequences of a withdrawal agreement, or lack thereof, alarmed businesses. However, with Prime Minister Boris Johnson's conservative government now in the majority, the stage is set for a withdrawal in early 2020. While Johnson's bizarre campaign trail prediction of a baby boom is unlikely, a Brexit endgame should boost confidence and economic performance in 2020. Furthermore, it allows the European Union to push ahead with its own priorities for reviving growth. The European Central Bank is now leading the call for increased government spending and tax cuts, particularly for those countries with strong fiscal positions.

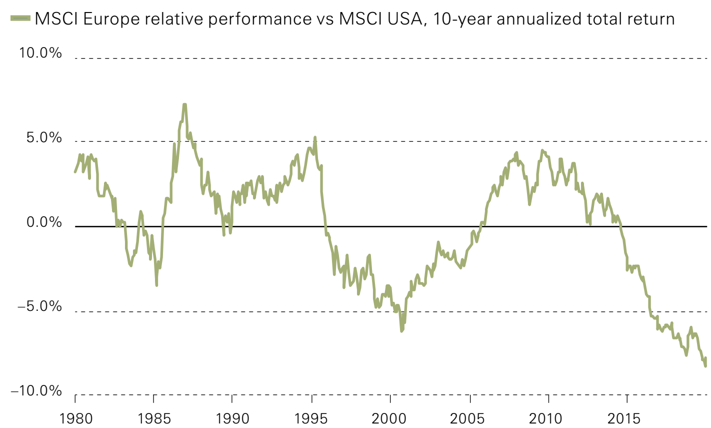
European equity markets have moved higher on the back of these developments, gaining more than 20% in 2019, and the underperformance and discounted valuation relative to U.S. equities indicates there could be more upside for European stocks.

U.S. equity valuations relative to Europe are at their highest levels since 2012



Source: Strategas Research Partners

European equities have sharply underperformed U.S. equities over the past decade



Source: Factset Research Systems

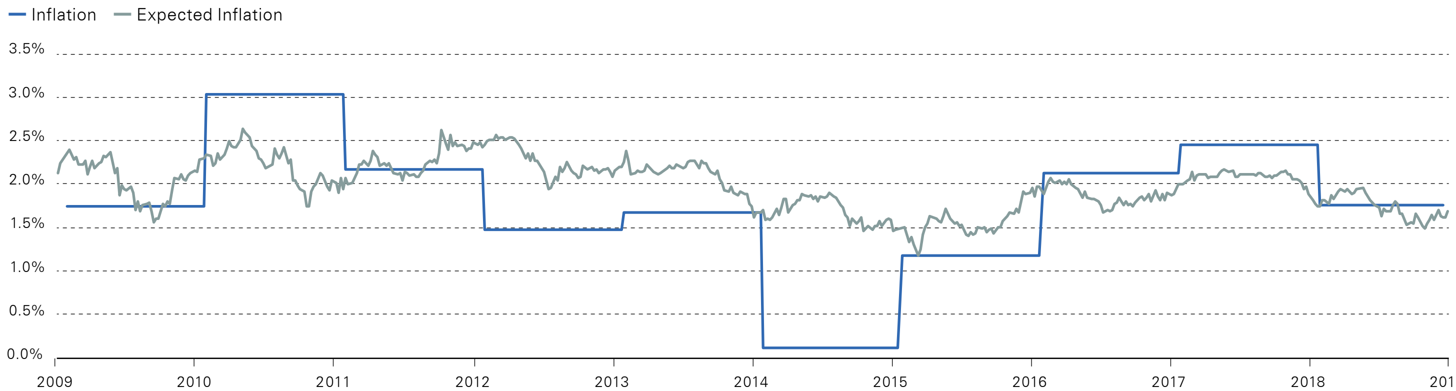
The Fed is in a good position to stand pat

Federal Reserve Chairman Jerome Powell has made it clear on several occasions that he believes the Fed Funds rate is at an appropriate level for the time being. Either a substantial slow-down, or significantly higher inflation expectations will likely prompt the Federal Reserve to move from the current target of 1.50 to 1.75%. We envision neither happening during the next six months, after which time the November election will be right around the corner. The FOMC is always hesitant of changing course just ahead of an election. The Fed itself is a non-partisan entity, and we believe it will stay that way.

Starting in August of 2019, the Federal Reserve cut interest rates by a quarter point three times. It is conventional wisdom that it takes six to nine months for interest rate changes to have an impact on the economy. We believe the effects of the three sequential cuts in August, September, and October of 2019 will manifest themselves later in 2020. We are already seeing increased liquidity as U.S. money supply growth has reaccelerated significantly, which should boost economic activity and asset prices.

Previous instances of three cuts and a significant pause, a so-called "mid-cycle" adjustment, have been positive for investors. According to Strategas Research Partners, the stock market has appreciated by +14% on average in the quarters following a mid-cycle adjustment.

Inflation vs. Expected Inflation



Source: Factset Research Systems

Equity investors should temper their expectations for 2020

The market appears poised to enter 2020 with momentum. However, we are circumspect on the market's ability to provide much more than an average return in 2020. Of course, average returns are still good returns in this low-interest rate environment. Considered along with earnings growth, valuation levels, macro expectations, investor sentiment, and consumer confidence, this market appears rationally priced. Unlike December 2018, when the market fell 19% in the fourth quarter, we are not in an oversold position. The market is also not egregiously overvalued, overheated, or overloved. Investors have rationally discounted the prospects of a trade deal and average economic growth in 2020, while minimizing focus on the circus in Washington, D.C.

Three basic factors create the foundation for a market return assumption: earnings growth, dividend yield, and valuation changes. Earnings are forecast to grow 11% in 2020, although we acknowledge that forward estimates are almost always too optimistic one year out. We temper our expectations and assume earnings per share growth of about 6.5% for 2020: 4.5% from topline sales growth, +0.5% margin expansion, and +1.5% from share buybacks. The current dividend yield should provide a nearly 2% return in 2020. Together, earnings growth plus dividend yield should provide an 8.5% return for investors if valuation multiples (e.g., price to earnings ratios) stay at current levels. The S&P 500 is currently trading at 17.7x expected earnings in 2020. This is slightly above the 10, 15, and 30-year average for the market, which is closer to 16x. We believe this level is sustainable, although there may be pressure due to election-induced jitters. All in, we estimate the building blocks of return total about 8% for U.S. equities in 2020.

Fixed income opportunities while the Fed is on hold

Since December 2015, the FOMC tightened interest rates nine times, followed by the three recent easing moves. A period of Fed stability will be both welcome and offer a different set of opportunities as compared to when rates are more volatile.

Mortgage-backed securities (MBS) represent the one such opportunity. MBS have lagged for much of the past year as the Fed sold its holdings to shrink its balance sheet. There was also a refinancing boom during the summer while rates were at their lowest. We anticipate supply and demand for these high-quality U.S. Agency securities will come into balance in 2020. Currently, MBS offer extra yield, stable cash flows, and manageable supply, which is a good combination in a stable environment.

Heavy supply in the taxable municipal bonds sector has also created the opportunity for extra yield. Both MBS and municipal bonds offer a lower correlation to equity markets than do corporate bonds. Following a very strong year for both equities and corporate bonds, adding less correlated assets in bond portfolios while gaining extra yield is an added bonus. We believe the combination of high quality borrowers, favorable supply/demand factors, and a lower correlation to equity markets should remain an attractive portion of a balanced portfolio for taxable investors.

Relatively, municipal bonds also provide a safer and higher quality after-tax fixed income option for tax-paying investors. State and local government finances are in great shape, not something we've been able to say for much of this economic cycle. The number of municipal credit upgrades by Moody's has outnumbered downgrades for the past 11 quarters. Supply will not continue to be adequate for demand for a third year in a row in 2020. The fundamental and technical good news may be in the price, but that does not mean investors have better options for after-tax strategies. The yield on a municipal bond portfolio still provides an after-tax return only at or slightly above inflation.

Canceling out the noise

If only there was an investors' version of AirPods Pro, Apple's latest must-have accessory. We could certainly benefit from active noise canceling headphones. Luddites could always choose 3M's 35¢ Classic Earplugs. Either way, sensible, long-term oriented investors will benefit from canceling out the noise next year.

If the Fed holds pat and trade tensions ease as we predict, the consumer should remain strong and global trade should strengthen. Everything else is a sideshow. In this scenario, GDP growth could accelerate to 2.5% in 2020 and markets can reward investors with average returns in the mid-to-high single digits.

We wish our clients a happy and prosperous 2020.

About Haverford Trust

As an independent, privately owned wealth management firm, The Haverford Trust Company has the strength of more than $9.0 billion* in assets under management or consultation and offers a wide breadth of services. From serving a wide range of investors, Haverford has learned how to translate real-world situations into effective financial strategies.

Our clients all have one thing in common—a wealth management need that may be fulfilled by the goals of *Quality Investing*: preservation and growth of capital, stable income growth, lower volatility, predictability, objective advice, risk management, stability, and service.

We are uniquely positioned to service those investors with $1 million or more of investable assets, including:

- Individuals and Families
- Institutions and Institutional Consultants
- Endowments
- Private Foundations
- Employers
- Employee Benefit Plans
- Nonprofit Organizations
- Trusts and Estates
- Religious Organizations
- Financial Advisers

* As of 11/30/19.

With the right people, the right solutions, and the right client experience, let us show you the difference Haverford *Quality Investing*® can make. Please contact your Haverford Relationship Manager or, if you have yet to meet with us, call our offices to arrange a time that is right for you. Either way, we're looking forward to getting to know you.

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