

A Fantastic Decade and Year for U.S. Stocks Mutes Expectations for 2020 and Beyond

The end of 2019 closes a fabulous year and fantastic decade for U.S. stocks. New all-time highs in the U.S. have become commonplace, driving the S&P 500ⁱ up 31.5% in 2019 and over 350% during the past decade.

The U.S. market's performance last decade was particularly impressive on a global scale with U.S. equities vastly outperforming all other significant markets including historically high-flying emerging markets.

The market gains were largely driven by a U.S. economy that handily outperformed those of most other developed countries, often because U.S. companies developed and applied countless new and disruptive technologies. The U.S.'s less intrusive and more flexible regulatory structures helped the country more quickly address banking and liquidity issues after the recession than those of Europe. The U.S. also avoided many of the economic and political crises that adversely impacted global developed markets and many emerging markets. More recently, ongoing deregulatory efforts and tax cuts have helped earnings soar even further while the dollar has also strengthened. President Trump's 2017 tax cuts reduced the U.S. tax burden to one of the lowest among major world economies at 24.3% of Gross Domestic Product versus the OECDⁱⁱ average of 34.3%.ⁱⁱⁱ

Fundamentals matter, and fundamentally, America has been much stronger than other countries.

In the near-term, prospects also appear good. The Wall Street Journal's December economic survey of 57 economists projected a fairly optimistic growth outlook of 1.8%



Daniel Wildermuth
CEO of Wildermuth Advisory, LLC

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for 2020, not too far short of the estimated 2.2% rate for 2019. Few economists expect a recession in 2020, and the U.S. expansion, now in its 11th year, should continue through the 2020 presidential election.

The primary driver of economic growth continues to be the confident U.S. consumer, buoyed by the strongest job market in 50 years. Forecasters expect our labor market

to remain strong through 2020 adding not only more jobs, but also further boosting wages. The strong consumer and fairly solid service sector growth has more than offset weak business investment which has been particularly impacted by uncertain trade policy.

Yet, beyond the near-term, how confident should investors be?

Very simply, while near-term prospects look fairly solid, ongoing longer-term gains likely face less favorable conditions making a repeat of the last decade appear very unlikely.

A couple key factors are probably most meaningful. First, economic performance tends to go in cycles. Governments shift policy, technologies change (hard to believe that the first dominant cell phone company was Finland-based Nokia), companies rise and fall, currencies strengthen and weaken, and even demographics shift.

While the last decade was great for the U.S., it followed the abysmal 2000s, when the U.S. market lost value and outperformed only Japan among large markets. Surprisingly, over the past two decades, the U.S. market performance (using dollar terms) is about average amongst significant markets, ahead of Japan, the U.K. and eurozone, but behind Canada, Australia, Sweden, Switzerland and most emerging markets.^{iv}

Second, richly valued markets have never historically maintained their valuation premiums over many years, and several factors that have contributed to the U.S. market's rich valuation appear unlikely to repeat or continue.

ⁱ The S&P 500 Index or the Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

ⁱⁱ The Organization for Economic Co-operation and Development (OECD) is a group of 34 member countries that discuss and develop economic and social policy.

ⁱⁱⁱ <https://www.wsj.com/articles/trumps-tax-cuts-push-u-s-burden-lower-in-world-11575540004>

^{iv} <https://www.wsj.com/articles/a-decade-of-u-s-market-exceptionalism-probably-wont-repeat-11576633815>

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MARKET COMMENTARY

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As mentioned in last month's newsletter, U.S. market performance has been greatly enhanced by the FANG companies (Facebook, Amazon, Netflix, and Google/Alphabet) plus Apple and Microsoft. As a group, these companies are very richly valued compared with the rest of the world. American profits from overseas also skyrocketed over the past decade resulting in strong outperformance of economically sensitive cyclical sectors such as industrials, consumer discretionary and financials.

U.S. market performance has also been significantly buoyed by the strong dollar. At the beginning of this long-running bull market, the dollar started badly, falling in 2011 to its weakest level in modern history relative to its trading partners amid fears that a debt-ceiling standoff between the White House and Congress would lead to a default. While the default was avoided, the loss of the government's precious triple-A credit rating in August of that year marked the low point for the currency.

Subsequently, a recovering U.S. economy combined with struggles by seemingly all the rest of the world's economies have propelled the dollar forward, driving it up over 30% since then and above its average since 1970 according to JPMorgan Chase.

Finally, Trump's big tax cuts boosted earnings. Another large tax cut that boosts profits significantly is unlikely to repeat given current low U.S. corporate taxes.

All these factors have worked together to dramatically boost earnings while also creating much higher valuations. Said another way, in analyzing the price to earnings ratio, the earnings component skyrocketed, yet prices increased even more, propelling the market up to its record highs as P/E ratios rose.

At the beginning of 2010, the U.S. market was valued at 14.5 times expected operating

earnings over the next 12 months, according to I/B/E/S Estimates.^v Currently, the market sits at about 18 times earnings, putting a value on the U.S. market much higher than the eurozone, U.K., Japan or emerging markets. The increase in U.S. equity market valuations over the past decade were also far larger than elsewhere, especially since some markets actually experienced decreases.^{vi}

For the S&P 500 valuation to rise again by the same percentage, the forward P/E ratio^{vii} would need to rise above 21, a level last breached during the dot-com mania of the late 1990s. While it's not impossible, prices at that level would signal a significant bubble, which is not only highly unusual, they also inevitably burst.

The most recent stock market rally appears to result from hopes of accelerating economic growth and an increase in earnings. While both could result in the short-term, particularly if there is significant trade-war progress, additional tailwinds to boost earnings and economic growth longer term are hard to find. Similarly, significant longer term increases to the value of the dollar and valuations also seem unlikely. As a result, our outlook remains neutral in the short-term, and our expectations for the next decade are modest since many of the tailwinds enjoyed during the last decade are likely to disappear or reverse.

As 2020 launches, we wish you a wonderful year and fabulous decade, and we look forward to helping you reach your investment goals.

The longest bull market on record has rewarded investors who were punished during the first decade of the millennium which saw market losses and substantial volatility that included both the dot.com crash and the financial meltdown.

Investors should carefully consider the investment objectives, risks, charges and ex-

penses of the Fund before investing. This and other important information is contained within the Fund's Prospectus, which can be obtained by calling (888) 889-8981 or by visiting the Fund website www.wildermuthendowmentfund.com. The Fund's Prospectus should be read carefully before investing.

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The value of your investment in the Fund at any point in time may be worth less than the value of your original investment, even after taking into account any reinvestment of dividends and distributions.

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Wildermuth Securities, LLC
818 A1A Highway, Suite 301, Ponte Vedra Beach FL 32082 and UMB Distribution Services, LLC, 235 W Galena St, Milwaukee, WI 53212

v I/B/E/S stands for Institutional Broker's Estimate System

vi <https://www.wsj.com/articles/a-decade-of-u-s-market-exceptionalism-probably-wont-repeat-11576633815>

vii The price to earnings ratio (PE Ratio) is the measure of the share price relative to the annual net income earned by the firm per share.

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