January 15, 2020

What a difference a year makes! In 2018, stocks ran hard for the first nine months (15.6% for client stocks, and 10.5% for the S&P 500 at 9/30/2018) before slamming into the hot fire of a long smoldering Trade War. From there, the 4th Quarter year-end results virtually nullified the whole, leaving us thankful to be flat, besting a softer performance of the S&P 500. This then fed a negative consensus at the start of 2019, but thankfully trading broke out with another monster rally – twice as strong as 2018's, cranking client stocks to a 28% nine-month advance and 20.5% for the S&P 500. Following this déjà vu, many held their breath as the fourth quarter unfolded, but sighed with relief and slack-jawed amazement at year-end. Fact is, by the lights of our conservative Investment Plans, each quarter offered a full year's return!

Understandably, this leaves investors with high expectations as they look ahead to 2020. With many of last year's risks cleared, some measure of the ample cash on the sidelines will assuredly get put back to work, and most will likely flow into stocks. But for our part, having kept exposure largely intact through 2019 with a minimum of changes in weight and composition, we anticipate few adjustments in the year ahead so long as the market's internals continue to be fed with positive breadth and momentum. Though anything can happen, we hope this refreshed optimism can help defer mean reversions, shake off fears, and even help absorb minor exogenous events. Better, the market has a history of climbing "walls of worry".

Nevertheless, it's worth a pause to consider this cycle's expansion is clearly testing physical limits. Not since the turn of the millennium when so many market indicators similarly ran "better and better" have our contrarian instincts begun to rattle. And as hard as it may be to suggest a dark cloud for the silver lining of record low unemployment, the very real demographic limits set by falling immigration and lower birth rates is already raising labor costs. In addition, without corporate capital investment to build and sustain productivity, capacity constraints could pressure profits as well. This can make for hard choices, a reallocation of resources and management time, and require real talent. All in, the appetite for stocks could reasonably pause.

We think that an echo of these approaching limits is seen in the rising frequency of political car pile-ups on the economic expressway (Trade Wars; Budget Impasses; Monetary and Fiscal Loggerheads; and Tax, Anti-trust and Regulatory wrangles). We take these as measures that hard changes are evolving to reset the longer-term imperatives and benefits that drove globalization over the last generation. And while some of the coming changes will involve undesirable outcomes, likely far more will offer great opportunities as well. Ultimately, we expect that despite pulls to the contrary, the U.S. will recommit to building a new century as it has in the past, based on open, fair, and competitive markets with a leading role for private capital.

For now, we see total portfolio returns trending along the 5% annual center point of balanced Investment Plans. We believe this represents a better basis for assessing your needs than doe-eyed optimism. If you would like to discuss these matters further, please feel free to call.

Warmest Regards,

James W. Mersereau, CFA, CIC
President

Daniel A. Kane, CFA, CIC
Managing Director

In compliance with Rule 204-2(a) of the Investment Advisors Act of 1940, we hereby offer our current Form ADV Part II as filed with the Securities and Exchange Commission through notice of its public posting on our website (www.carderockcapital.com). The Securities Exchange Commission's Investment Adviser Public Disclosure database can be accessed at their website (www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx). With reference to Rule 206(4)-2 Carderock urges you to compare the information on your statement with the statements received from your custodian. Please call if you have any questions.

Random Gleanings

"(Paul) Volker, born in 1927, opened his eyes to the world of the gold dollar, fixed exchange rates, and a balanced federal budget. He died in an age of the fiat dollar, floating (or manipulated) exchange rates and a trillion-dollar boomtime deficit. The former Federal Reserve chairman cut an almost diffident figure. His shambling posture, cheap suits, budget cigars, even the unassuming title of his 2018 memoir – *Keeping At It* - gave no hint at the vast powers he wielded during his eight years at the head of America's central bank, or his courage to bear up under the abuse he suffered for turning the screws to kill the Great Inflation. He was an old-fashioned, sound-money Democrat whose instinct in the matter of interest rates was to defer to the judgment of the market. He had a proper respect for the undesirable side effects of ultra-low interest rates. Certainly his 20% federal funds rate triumphed over high inflation, and the absence of a fast depreciating dollar surely fueled the great financial booms of the 1980's and 1990's. James Grant, "*Exit, A Humble Giant*", **Grant's Interest Rate Observer**, 12/13/2019.

"The stock market is making new highs; the yield curve has returned to a positive slope and the U.S. economy is growing. Yet Federal Reserve Bank credit, the sum of the Fed's earning assets, is expanding at a three-month annual rate of 22.2%. Repos are loans secured by Treasury bills and bonds, and as no collateral could be safer, no rates should be duller. But like the bank president who drives his Cadillac into the country club swimming pool, repo is showing a whole new personality. We find no plausible explanation other than to suggest the remote cause of the comprehensive problems is the substitution of an administered benchmark money rate for a market determined rates." James Grant, "*Monetary New Year's Party*", **Grant's Interest Rate Observer**, 11/15/2019.

"China has spent decades growing stronger and richer. It already senses that only one country – America – can defy Chinese ambitions with any confidence. Its leaders have a bleak world view in which might makes right, and it is a fairy tale to pretend that universal rules bind all powers equally. Increasingly, they can imagine a day when even America ducks a direct challenge, and the global balance of power shifts forever. Chinese officials say that America failed to educate workers, allowed inequalities to yawn and never built social safety nets to help victims of globalization – and is now scapegoating China for those ills. Chinese officials want to avoid confronting America for now, but increasingly, America is seen as an obstacle to China's rise, and that means trouble looms." "*400-pound Rivals"*, **The Economist**, 1/04/2020.

'Taxes are not for everybody else to contribute. They are for us. They enable government to create a civilized society, and one the protects us when others might do us harm. They provide the funds to educate us, insurance against illness and they foster better economic performance while absorbing some of the inevitable shocks. If voters are unhappy that public services are not up to scratch, politicians should tell the truth and seek a consensus around the fact that all need to pay more. The alternative is to keep pretending that tax is largely a matter for others. All parties have chosen this latter, expedient option. But we should recognize that this route ends with a general unwillingness to pay for valued public services, harming us all." Chris Giles, "Taxes Cannot be Something That Other People Pay", Financial Times, 11/21/2019.

"No one predicted 2019. The biggest surprise was the direction of interest rates which really pumps up equity valuations way ahead of earnings momentum. And I think 2020 is more of a year of reckoning. We have two problems: We have a labor force that isn't growing fast enough and capital fixed investment which has decelerated for 4 straight quarters. There are many people who will say in the next few weeks that the easy money has been made. Except I don't recall many people in January 2018 talking about the easy money through 2019 and the year to come. I think the challenge last year was the (maintaining) the courage to stay invested. You had excuse after excuse, reason after reason thrown in your face to abandon this rally. Consider Mickey Mantle's saying, 'I never knew the game of baseball was so easy until I entered the broadcasting booth', and then ask how courageous do you need to be in 2020? I think you need to be very careful. I don't think this continues like it has, and eventually, the fundamentals will drag down the market. Last year, all the global (negatives) knocked the market down, but the drop-in interest rates pushed it back up. We'll have corporate growth, but not like last year. Tome Keene, Jon Ferro and **Robert Albertson**, "*2020 To Be the Year of Reckoning*", **Bloomberg Surveillance**, January 2, 2020.

CARDEROCK
CAPITAL® MANAGEMENT, INC.

SHORT TAKES
December 31, 2019

RESULTS

The **S&P 500 index** rose **9.1%** for the 4th Quarter and **31.5%** for 2019.

Stocks:

Size: – Large Cap Stocks continued its outperformance on both Small and Mid-Cap Stocks during the 4th Quarter.

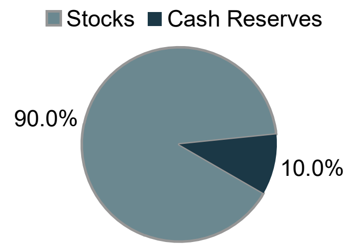
S&P 500 Large-Cap 9.1%, S&P 400 Mid-Cap 7.1%, S&P 600 Small-Cap 8.2%

U.S. Economic Sectors: – S&P 500 Index Sectors with Ranges from: –

4th Qtr. - Healthcare (14.99%) to **Energy** losing **(-6.3%)**

1 Year (2019) - Technology (48.0%) to **Energy (7.6%)**

Carderock Equity Target Allocation

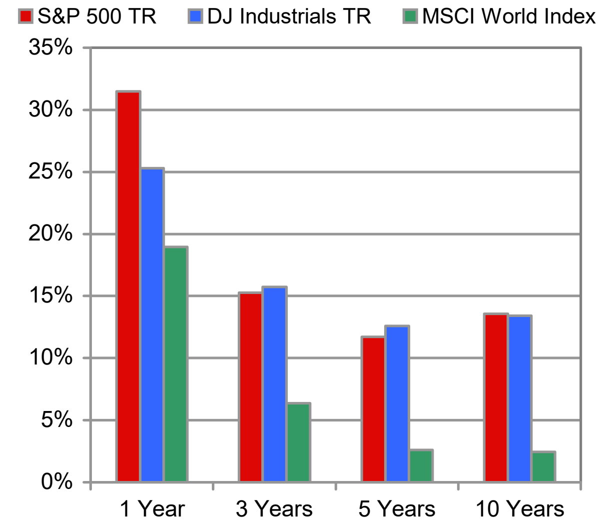


Bonds –High Yield Bonds outperformed Investment Grade Bonds for the period. as the Interest Rate Yield curve continued to flatten throughout the period.

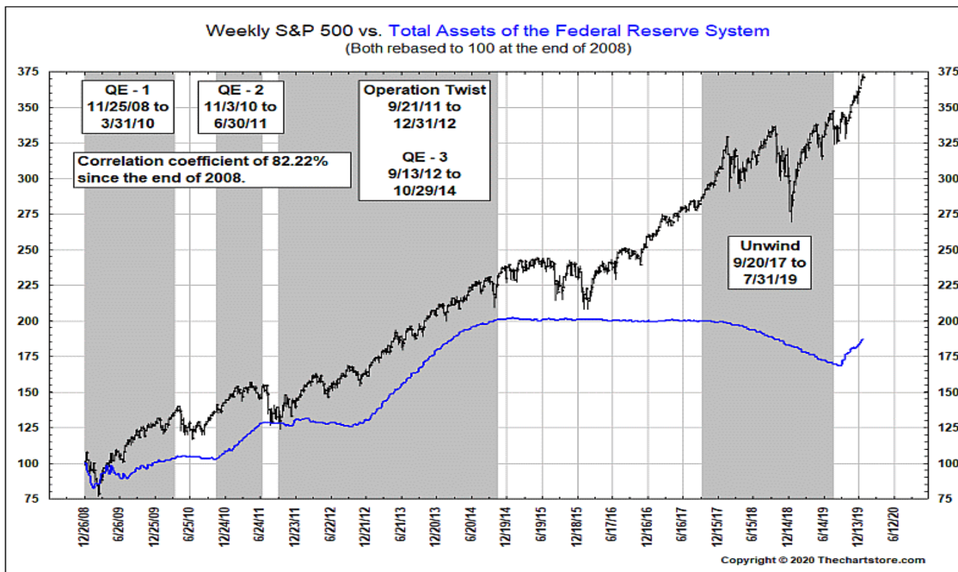
Bond Indexes and Performance	**4th Qtr.**	**1 Yr. (2019)**
➢ Lipper Short-Int. U.S. Govt. Index:	**0.2%**	**3.7%**
➢ Lipper Short-Int. Municipals Index:	**0.8%**	**4.5%**
➢ iShares iBoxx **(LQD)** Inv. Grade Corp. Bond Index:	**1.5%**	**17.1%**
➢ iShares iBoxx **(HYG)** High Yield Corp. Index:	**2.5%**	**14.2%**

Source: Lipper, FactSet and Blackrock

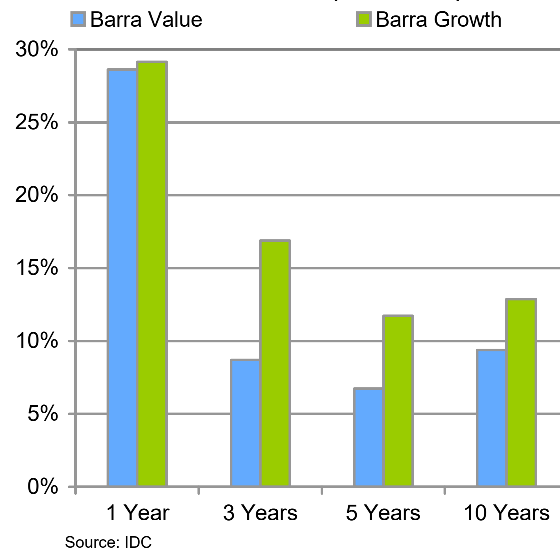
Global Stock Market Annualized Performance (12/31/2019)



Correlation – Federal Reserve Balance Sheet to S&P 500 Index



Growth vs. Value Style Annualized Performance (12/31/2019)



Investment Grade Bonds

What Has Changed?

Triple-B bonds continue to make up more than 50% of the investment grade market

Share of BBBs in investment-grade bond index

Source: Bloomberg Barclays