Broadleaf Partners, LLC

Our 2019 Investment Playbook   January 15, 2019

At the end of each year, we like to look back on the year that was and consider what we got right, what we got wrong, and what we might have learned in the process. We then turn our attention to the year to come, hoping that by putting our thoughts in writing, we'll gain greater clarity on the factors that might drive our investment returns in the future.

We share these thoughts with you, our clients and friends, in the hope that you gain a better understanding of the influences that may drive our investment decisions in the coming year. As always, these decisions are fluid and may change with the circumstances, but are also made with a longer term perspective and intent to drive superior investment returns over time.

We appreciate your continued confidence in our approach and interest in our work!

Looking Back

In our *2018 Investment Playbook*, we made three general observations on the economy, the financial markets, and politics in general. What follows is an italicized summary of each opinion from last year's Playbook along with our comments and assessment of what actually came to pass.

<u>The Economy</u>

"The tax cuts will be beneficial to GDP growth in 2018 and beyond. Will it be the kind of stimulus that reignites the animal spirits and excesses common to the 80's and 90's? We're not so sure, but at the very least, it will help. Many expect a lift of .3-.5% in GDP growth because of the changes, and we would tend to agree with that assessment. The Fed will likely raise rates 2-3 more times, but as a whole, interest rates will remain low and GDP in the 3-3.5% range."

The tax cuts were helpful in boosting GDP growth, but not to such an extent that animal spirits were reignited. Third quarter GDP was at the higher end of our forecasted range, but the Fed hiked rates more than we had expected; four times in total.

<u>The Markets</u>

"We believe investors may once again be pleasantly surprised by the market's returns in 2018. While some are already making comparisons of today to prior bubbles, we think we're early in the process, likely more 1996 than 1999. A correction of some sort in 2018 is

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certainly possible and perhaps even likely, but the higher free cash flow generation prospects associated with lower taxes represents support to market valuations and a clear buy signal should any correction occur. Put simply, corporate America has more options, and that is of value."

The markets performed quite well through the third quarter, but did correct in the fourth quarter, bringing full year returns for most indices into negative territory. (The Broadleaf Growth Equity Portfolio was positive, however.) While the tax cuts helped mitigate risks associated with trade and higher interest rates for most of the year, communication missteps from the Fed in early October pushed things out of balance, and heightened fears of recession surfaced by year end.

<u>Politics</u>

"In spite of the victory on the tax front, we're under no delusion that the political environment will see a return to normal. It won't. The rise of Facebook and social media has democratized the news and journalism industry, giving everyone both a voice and a megaphone. But as with all major innovations, new freedoms and progress have their downsides. Our brains will either become increasingly numb to the dopamine-induced rushes of fake and "un" newsworthy news, or we'll succumb like addicts, needing ever escalating levels of half truths and absurdity to get through the day."

The political environment remains divisive, and Facebook was justly the subject of intense scrutiny by governments around the globe. Though we still believe social media provides value, there are clearly issues of privacy and decency that must be resolved over time. The rise of social media has heightened competition for eyeballs, making most sources of media take cues from "reality TV" which was launched over a decade ago (hardly real) or perhaps even the National Enquirer from the 1980's. Let's hope that this is a passing fancy and that time heals all wounds.

Looking Forward – Our 2019 Playbook

Following the same format, what are our thoughts on the economy, the markets, and politics for 2019?

<u>The Economy</u>

While we believe the economy will slow in 2019, we do not believe there will be a recession. In 2012 and 2015, the rest of the world caught a cold, led by weakness from China. The same pattern appears to be occurring today, but similar to the prior two periods, we don't believe the weakness will prove powerful enough to cause a domestic recession. We believe U.S. GDP growth should be 2-2.5% in 2019, assuming the Fed puts additional hikes on pause.

The Markets

The markets experienced significant volatility in 2018, both early in the year and then at the end. We believe the Fed has hiked rates enough and that they are now very close to the neutral level, that which is neither stimulative nor contractionary to the economy as a whole. As such, we don't believe many, if any, additional rate hikes will be necessary in 2019. Inflation remains tame and employment is very solid.

Advancements in artificial intelligence and other technologies should enable the neutral rate to stay lower for longer as almost all industries in the economy remain immensely competitive and thus wage pressures generally restrained, even at high rates of employment. Along with the continued benefits of lower tax rates, a milder Fed, progress with trade talks, and fading recessionary fears should set the markets up for excellent results by the end of 2019. Successful stimulus efforts from China's central bank would also help assuage global growth concerns. We would fade traditional safe havens and invest with innovators, those that can and will grow in spite of the economy.

Politics

There will not be an end to the divisiveness. President Trump believes he was put in office to shake up the Washington establishment, and like him or hate him, he will continue to do so, even if it costs him a second term.

We believe a trade deal with China will ultimately be achieved in 2019, but enforcing it may prove to be the larger issue. Intellectual property laws haven't kept China from violating them in the past and we wouldn't expect a new trade agreement to change behavior without adequate and consistent enforcement. Although we suspect President Trump will reach a trade deal with China, he will likely be vigilant in enforcing it, meaning the trade risks won't soon dissipate.

This business is never easy, but it's always an intellectual challenge worth pursuing. May God bless you abundantly in the coming year, even if it comes in ways you don't expect!

Kindest Regards,

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