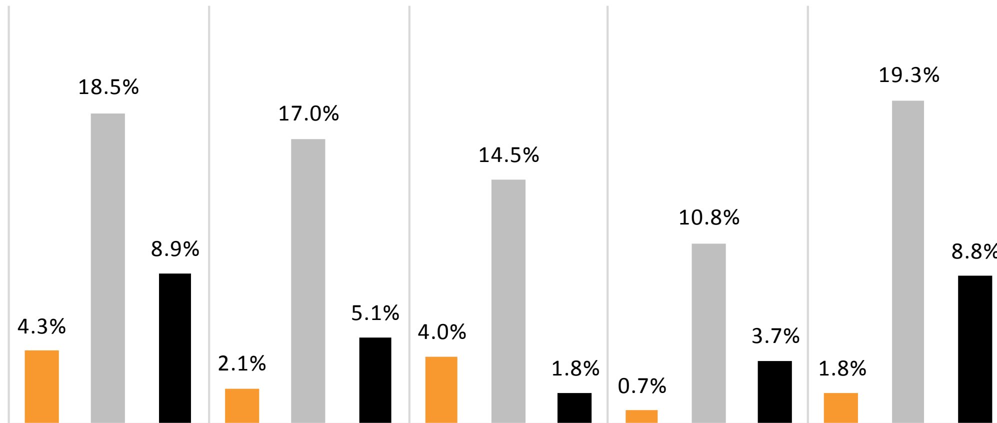
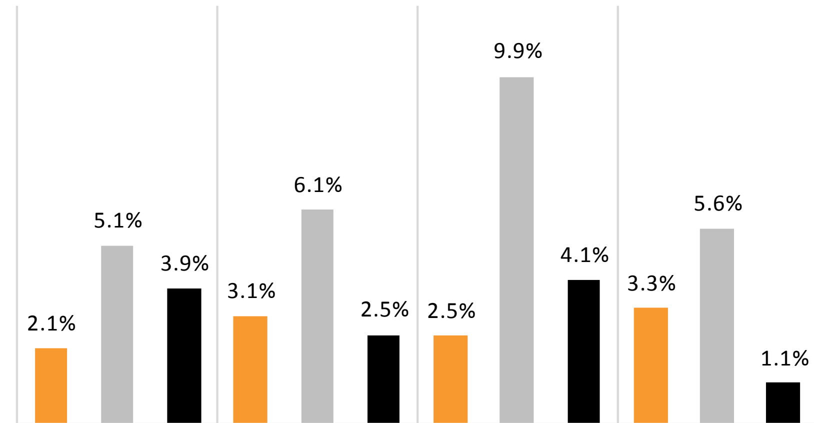
2Q'19 Market Review

EQUITY MARKETS ■ 2Q'19 ■ YTD ■ 5 Yr Avg. **FIXED INCOME MARKETS**





US LARGE CAP | US SMALL CAP | DEVELOPED INTERNATIONAL | EMERGING MARKETS | REITS | US MUNI | US AGG | US CORPORATE HIGH YIELD | GLOBAL AGG

- 2Q'19(Q2) finished with positive returns across all major risk asset classes. Although returns were strong, the Fed indicated stimulus may be coming for the second half of 2019 as ongoing trade tensions and weaker economic data highlight future risks.
- **Large cap** equites were up +4.3% in Q2, finishing off the best first half of the year for the S&P 500 index since 1997. As for valuations, the index is at an inflection point, trading at 16.7x fwd EPS, which is higher than historical average of 16.2x.
  - **Financials** were the top performing S&P 500 sector, up +8.0% for Q2, while **Energy** was the worst performer, down -2.8% for Q2.
  - Regarding Q2 sector valuations, **Financials** appear to be the most attractive sector trading at only 11.9x fwd EPS, vs. the 20-year average of 12.6x. **Utilities** appear to be one of the most expensive sectors, trading at 18.8x fwd EPS vs. the 20-year average of 14.3x.
- **Small caps** have experienced a rare historical divergence over the LTM, down -3.3% vs. large caps up +8.9%. Even though small caps finished up +2.1% for Q2, the relative underperformance to large caps highlights potential opportunity for the asset class.
- **International** equities only marginally trailed the S&P 500 for Q2, up +4.0%. **Emerging market** equities, however, faced continued headwinds from the trade war and were up only +0.7% in Q2. A resolution to the trade dispute between China and the US likely would have the largest positive impact on emerging markets equities.
- **REITs** were up +1.8% in Q2, but the asset class has had the best returns of all risk assets YTD up 19.3%, 0.8% better than the S&P 500.

- While every major fixed income asset class was positive for Q2, in mid-May, the same time equity markets pulled back, the yield on 10-year treasury notes dropped below the yield on 3-month treasury bills (yield curve inversion). Since then, the yield curve has remained inverted, leading investors to worry of an impending recession and hoping the Fed will proactively lower rates to attempt to orchestrate a "soft-landing" recession.
- Despite signals of slowing growth and volatile Fed policy, fixed income markets have had a very strong start to the year, led by the **US Agg**, which generated the best quarterly return in nearly eight years, up +3.1% in Q2.
- Municipal bond supply has continued to come in below historical norms while demand has remained robust. The **US Muni** index returned +2.1% for Q2, which on an after-tax basis, still exceeded the returns seen in taxable bonds.
- Global economic concerns around slowing manufacturing data, political and social unrest in emerging market economies, Italy's austerity pressures, and Japan's stubbornly weak inflation have prompted global central banks to follow the Fed's accommodative path, leading to strong returns in the **Global Agg,** up +3.3% for Q2.

Sources: Zephyr StyleADVISOR

Market conditions and trends will vary. Past performance is no guarantee of future results. Investments cannot be made in an index

Underlying indices are S&P 500® Index, Russell 2000® Index, MSCI EAFE, MSCI Emerging Markets Index, FTSE NAREIT All Eq REITs Index, Barclays Municipal Bond Index, Barclays U.S. Aggregate Bond Index, Barclays U.S. Corporate High Yield Bond Index and the Barclays Global Aggregate Bond Index.

2Q’19 Integrated Topic of Interest

Yield on the 10-year Treasury note

WSJ

TREASURYS

A 10-Year Treasury Yield Below 2% Is Something Almost Nobody Saw Coming

Yields at multiyear lows reflect the difficulties central bankers face in normalizing monetary policy after a decade of unusually easy money

Analyst predictions from January

End of June

End of 2019

4.0%

3.5

3.0

2.5

2.0

Actual yield

Jan. 2019 April July Oct.

“It is difficult to make predictions, particularly about the future.” – Mark Twain

- From 2015 to 2017, the Fed raised rates one time each year. In 2018, however, the Fed raised rates every quarter. The focus on recent data at the end of 2018 led the consensus Wall Street economist to forecast that rates were headed higher in 2019, and in some instances, much higher.
- What has happened since was something no “expert” predicted. The chart to the left highlights forecasts vs. reality, and it shows that the closest economist prediction was the 10-year Treasury note at 2.5% at the end of 2Q’19. While the chart to the left only shows the actual yield (the black line) through mid-June, the 10-year Treasury note closed Q2 at 2.0%, 50bps lower than the lowest economist prediction.
- It is important to remember that even the smartest economists often get forecasting wrong. When experts do successfully predict a macro-event, history shows their track record thereafter tends to be less than lackluster. The following are just a few of many notable examples of initial forecasts that were correct yet failed to correctly forecast subsequent events.
  - Technical analyst guru Robert Prechter, who successfully predicted the 1987 market crash, has since been wrong more than he has been right.
  - Famed Goldman Sachs strategist, Abby Joseph Cohen, was an early forecaster of the 1990s bull market who remained bullish well after the dot-com crash lost her clients substantial wealth.
  - Peter Schiff, strategist at Euro Pacific Capital, was one of the few who correctly predicted a crash in real estate in 2007. He also expected the economic turmoil to “last, not just quarters but years.” He simultaneously predicted that as a result, gold would skyrocket to $5000 by 2013. All of which ended up being wrong.

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Sources: https://www.wsj.com/articles/some-investors-had-hunch-yields-were-about-to-fall-11560072600; *WSJ Survey of Economists (predictions); Tullett Prebon (actual)*