MARKET ENVIRONMENT

STRATEGY ASSET MANAGERS

In our first quarter Market Environment commentary we wrote, "Benjamin Graham, the great value investor, stated that in the short run the stock market is a voting machine and in the long run it is a weighing machine." The third quarter started and ended with the market not having made up its mind as the global economy continues to face several unpredictable risks. How far will the trade war escalate? To what sort of outcome will Boris Johnson guide the UK and what quantifiable impact will this have on the EU? How will Middle East tensions, especially with Iran, affect energy prices? And, what sort of conclusion is in store for the rioting in Hong Kong and how will this affect China? With geopolitical, regional political, and economic risks all at the fore the US remained the one notable beacon with an accommodative Fed reducing the federal funds rate by a quarter percent, the second such cut since July. This, of course, contributed to another good quarter for government bonds with U.S. Treasuries returning over 2% in the third quarter.

The S&P ended the third quarter of 2019 roughly where it started. After a difficult summer of 2019, the S&P returned to a bullish mood in September and closed the third quarter with a modest 1.7% gain, leaving the index up 20.6% YTD. Our Global Equity Index was up 19.1% YTD and 1.2% for Q3. The third quarter was marked by continuing trade tensions with China and perceived "positive" and "negative" trade-war news influencing market sentiment. In Europe BREXIT continued to cast uncertainty into the macro picture while the European Central Bank responded to a weaker economic outlook by cutting rates further into negative territory. That being said, our opinion is that with Japan and Europe mired in negative rates and China teetering from the trade war, our status as the one major economy with positive rates will provide support to the market.

Regarding sector performance within the US markets, Utilities (+9.3%), Real Estate (+7.7%) and Consumer Staples (+6.1%) led the field. The worst performers were Energy (-6.3%) and Health Care (-2.3%). Technology and Financials posted respective gains of 3.3% and 2.0%, reversing prior quarter trends as the market experienced a momentary cycling of money flows into value from momentum. Both the 3-month and 2-year vs 10-year yield curves inverted in the third quarter. The jury is still out as to why Technology lagged.

OUTLOOK

The third quarter was led by defensive sectors in the market as slower global economic growth resulted in concerns that a recession might be in the offing for next year. Our market outlook is still mostly positive. With the unemployment rate at record low levels, the consumer continues to show signs of strength. However, we are cognizant of the significant gains that have been realized by the market averages thus far in 2019 and thus our expectations for the balance of 2019 are somewhat muted. Our outlook on the equity markets has been guided by 3 main pillars: accommodative central bank monetary policy, low inflation and interest rates, and strong corporate earnings. The ongoing trade dispute with China is creating some earnings headwinds that may become an impediment to further gains in equities over the near term. A somewhat scarcer earnings environment going forward may result in an added premium being awarded to those companies that can show earnings improvement in a more difficult economic climate. We also believe that it is critical for clients to hold a diversified portfolio as political and economic conditions can change quite rapidly.

Both the ISM manufacturing survey numbers as well as the ISM services survey published recently were substantially weaker than the Street expected. At the same time, the secular forces that have been driving growth in the economy over the course of this expansion should not be underestimated. These seemingly conflicting data points are resulting in a more uncertain environment. We expect that the political noise coming out of Washington D.C and the approaching of the election next year will result in some increased market volatility. We suspect that the businesses will not be as volatile and thus this could create very compelling buying opportunities for our companies in the coming months ahead.