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Investment Commentary

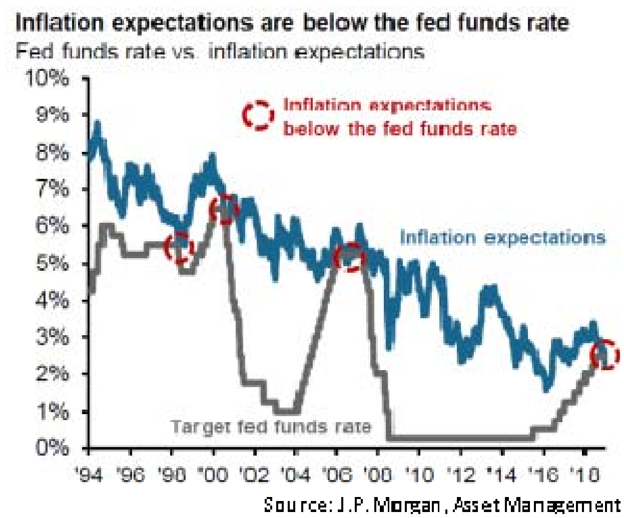
2nd Quarter, 2019

Below you will find our investment commentary for the most recent quarter. We hope you find it informative and will consider our investment services in the future. If you have any questions or concerns about the market or your investment portfolio, please call our office to schedule a meeting or conference call.

Economic Review & Outlook

Economists are once again predicting GDP growth will slow in the second quarter of 2019, an eerie similarity to the calls for Q1 GDP slowing growth which ultimately proved to be incorrect. At the end of March, expectations were for Q1 growth to register around 1.5%, but ultimately ended up growing around 3%. What can you say other than the resilient U.S. economy keeps on charging ahead!! As for Q2 expectations, the Wall Street Journal survey of more than 60 economists has consensus expectations at 1.6% for Q2 growth as the quarter comes to an end. We will wait and see if their predictions this quarter are any more accurate than last quarter.

What is most interesting is it appears the Q2 slowdown forecast is being taken much more seriously as the Federal Reserve is already feeling pressure to cut interest rates. Many economists are arguing for multiple rate cuts over the coming months to battle the ongoing trade war issues. They also point to falling inflation expectations as justification to begin this process. A recent chart released by J.P. Morgan illustrates this argument perfectly. As you can see, the target Federal Funds rate is now above long-term inflation expectations, leading many to suggest the Federal Reserve should cut interest rates immediately. This hasn't happened since prior to the credit crisis, which lends support to economists suggesting a rate cut is exactly what the economy needs to stave off another recession. The Federal Reserve chose to forego a rate cut during the June meeting, but expectations have been as high as 90% that a rate cut is coming in July. The second half of the year should be a very interesting one when it comes to monetary policy.



The possibility of a second half slowdown is not isolated to the U.S. According to Gluskin Sheff, 92% of the 37 countries they track have seen a decline in their proprietary leading economic indicator from year ago levels. They note many of the largest countries such as the U.S., Germany, United Kingdom, Japan, are in the midst of their largest year-over-year declines in many years. This suggests the stakes are high regarding the ongoing trade negotiations and will be a key variable in determining where the global economy heads in the second half of the year.

While no one would suggest a trade war is good for economic growth long term, the one industry that may be seeing a nice boost in the short-term is the housing market. We have previously commented on how important the housing market is to the U.S. economy and how there are multiple signs in the first half of 2019 that things may be slowing. Sales have been declining in multiple major metropolitan areas, listing for homes in many markets are increasing rapidly, reduced asking prices have been observed and you have even seen bidding wars in many of the hottest areas dissipate. According to real estate brokerage Redfin's most recent housing report, "the volume of home sales has been declining in major metros for almost a year and the number of homes for sale is soaring in some of the hottest markets." While the housing market isn't 100% tied to interest rates, lower mortgage rates will surely provide a cushion to these alarming reports. With mortgage rates having dropped nearly a full percentage point since the year began, the summer season could see a nice turnaround as potential buyers rush in to make sure they lock in lower rates.

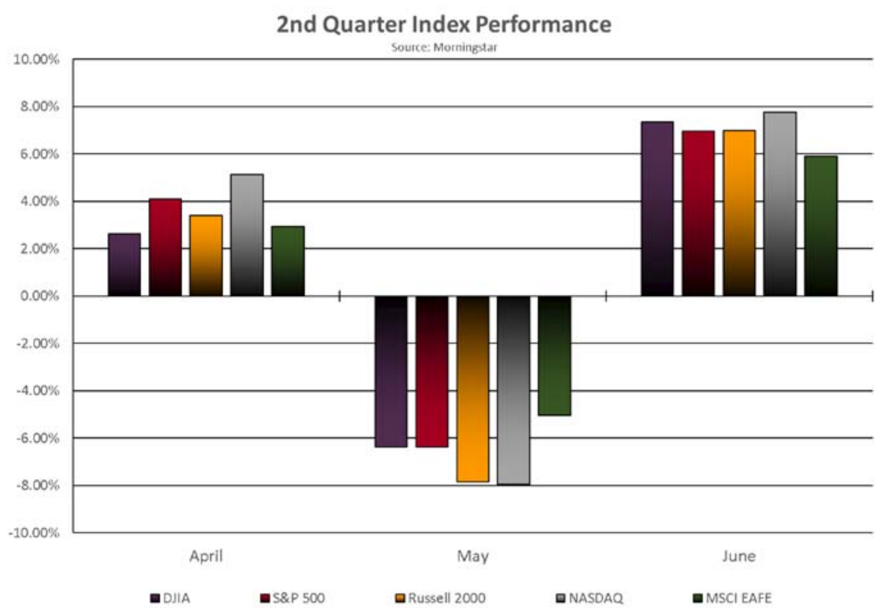
Bond Market Review & Outlook

Coming off a down year in 2018, many investors were frustrated by the performance of their bond investments. We have heard stories of retail investors choosing to remove all bonds from their investments and instead use money market instruments for the conservative portion of their portfolio. Through the halfway market of 2019, investors who made that call are probably regretting that move. The benchmark Barclays Aggregate Bond Index has returned 6.1% through the first six months of the year. With even the highest yielding money market funds paying just over 2% annually, traditional bond investors have made five times the return of money market investors so far this year. For bond investors willing to take on more credit risk, high yield bonds as measured by the Bank of America High Yield Index are up 10.1% in 2019. Thus, after a disappointing 2018 where money market funds outperformed nearly every asset class, this year money market funds are at the bottom of the pack. Keep this in mind come January of next year when the urge to invest in whatever ends up doing this best this year begins creeping into your mind.

The dilemma for bond investors at the present time is the flatness of the yield curve. What this refers to is the yield difference between investing in 2-year Treasury Notes versus 10-year Treasury bonds is a mere 0.25% as of June 30th. To make this point very clear, this means you can loan the U.S. government money for 10 years instead of 2 years and it will only get you an extra 0.25% per year. Wow!! Why anyone would do that might be on the top of your mind right now?

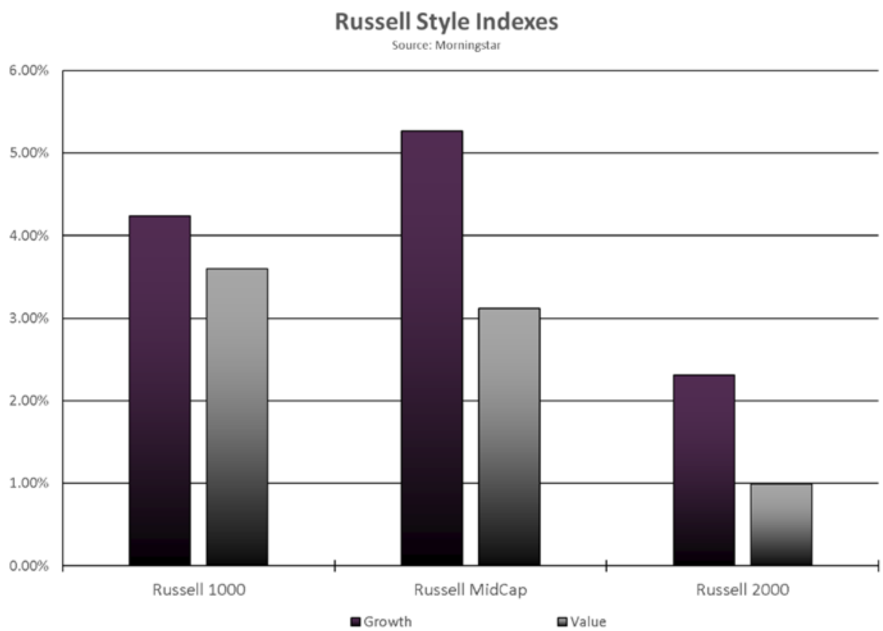
The conundrum exists as a result of what we discussed earlier in our economic outlook. Investors are expecting the Federal Reserve to cut interest rates over the next couple of months, suggesting short term interest rates are artificially high at the present time. If you agree with this outlook, purchasing longer dated bonds now before the Federal Reserve cuts interest rates could be a good move. From our perspective we simply want to remind investors that timing the bond market is just as difficult as timing the stock market. We have tremendous confidence in our bond managers to navigate this very unique time and will accordingly defer to their expertise when it comes to positioning their portfolio. Investors who thought they could outsmart the bond market are already well behind this year in terms of performance, so our advice is to stay the course and let the bond portion of your portfolio do its job by not tinkering with it just because we are in a flat yield curve environment.

Stock Market Review & Outlook



You might have expected stocks to struggle in an environment where economic growth is slowing and the Federal Reserve is considering cutting interest rates. Quite the contrary. If there is one thing investors have become acutely aware of over the past ten years it would be that the stock market typically responds positively to even the slightest hint of easier monetary policy. This time was no exception. After initially struggling in May due to escalating tariff concerns, investors pushed stocks to all-time highs in June when it became apparent the Federal Reserve would likely take action to stem these concerns. For the quarter, the DJIA and S&P 500 returned 3.2% and 4.3%, respectively. Small caps were up as well, rising 2.1% as measured by the Russell 2000. Technology stocks continued to remain market leaders, evidenced by the strong 3.6% return in the NASDAQ composite. International stocks rebounded some during the quarter as the MSCI EAFE returned 3.7%, in line with the other major indexes. So, despite the heightened volatility over the past six months, investors who have been able to control their emotions remain very satisfied.

As one would expect, growth stocks continue to dominate value stocks in the midst of a runaway bull market. You can see this trend held true for all market capitalization segments from the Russell Style Index chart. In general, larger companies outperformed smaller ones as investors' appetite for the mega cap names continues to show no signs of waning. This thirst for large cap stocks pushed the S&P 500 to its best first six month start to a calendar year since 1997.



Despite the sense of comfort most investors have at the present time, at some point portfolio declines will last longer than a couple months. Being prepared for this inevitable outcome by embracing this eventual reality is what separates successful long-term investors from those who often panic when financial market concerns arise. One of the most commonly cited phrases in the investment world is, "you can't time the market." Over the past year a diversified portfolio of anywhere between 75% stocks and 25% stocks has essentially delivered an identical return. However, the difference in volatility between the two has been extreme with a nearly 15% drop at one point for the 75% stock portfolio, but barely more than a 5% drop for the 25% stock portfolio. The takeaway for investors should be to not try and time the market, but instead pick a strategy in line with your risk tolerance. Over time, stocks have historically been one of the best performing assets classes available to investors, but there have been many multiyear periods of frustration for investors. Prepare yourself now by creating a portfolio with volatility you can handle.

No one can predict with absolute certainty what is in store for investors in the second half of 2019. Stocks could move materially higher if any of the current concerns regarding the trade war, housing market, interest rates, or corporate earnings improve. Conversely, any of these could take a turn for the worse and sink financial markets. The most successful long-term investors already have a plan in place to deal with either of these outcomes. As always, we cannot thank you enough for entrusting us with the responsibility to navigate your financial well-being during these uncertain economic times.

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