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2019 Second Quarter Commentary

As we face the second half of the calendar year, we should be thankful for a very strong beginning. Both the equity and bond markets had strong performances. The US stock market, as defined by the S&P 500 Index, was up 18.25%, continuing the strong rally it began in late December from the year end lows. The US Bond market, as defined by the Bloomberg Barclays Aggregate Bond Index, was up 5.98%, as US interest rates on the 10 year US Treasury fell to below 2%.

Yet, the market's performance hasn't been without its share of volatility. Probably the number one factor affecting overall market volatility has been the ongoing saga of negotiating a deal on trade with China. As our Washington policy analyst, Ed Mills, has pointed out, negotiating a trade deal is easy until you begin talking about technology transfer and market access. These are two major issues that need to be dealt with and are part of the off again, on again drama that we get from the process.

Another factor adding to volatility is that President Trump has elected to use the threat of tariffs as part of negotiating with other countries and markets such as Mexico and the EU. These tactics cause uncertainty among corporate executives who run multinational corporations, making it hard to predict earnings. This uncertainty ultimately translates into uncertain earnings expectations which often translates into price volatility.

More recently analysts have become worried again about the inversion of the US Treasury yield curve. This happens when the yield on the 10 year US Treasury is lower than the yield on overnight lending rate. Many analysts suggest that this foreshadows a recession. The event of an inverted yield curve has got many analysts suggesting that there is a need for the Federal Reserve (Fed) to lower its short term overnight rate. Speculation of a rate cut has helped both equity and bond prices rally in recent weeks.

It is our opinion that 10 year US Treasury yield has declined because of increased purchasing from overseas, and that the call for the Fed to lower rates is more about weakening the US dollar against the Euro then worries about a US recession. A weaker US dollar is needed to offset a weakening Euro as the ECB is continuing to provide support to the European economies.

Fears of a US recession, concerns about a US-China deal, and possible recession in Europe continue to create volatility for stocks. We expect corporate earnings this quarter to be in line with expectations, but that forward looking statements will be uncertain due to ongoing trade concerns. Adding to the confusion on trade, we are in the beginning stages of the US Presidential election cycle. Another political issue involves the EU which recently held elections for the European Parliament which governs the European Commission and the ECB. We continue to await final resolution on the new leadership in Europe and the ECB as well as plans for Brexit. Our conclusion is that we will likely see more volatility ahead.

Economic activity in the US continues to grow. Unemployment is low and we are not seeing significant wage growth or inflation. It is unlikely that the US will move from growth to recession while in a full employment phase. Furthermore, we remain on the forefront of energy independence and we are growing onshore manufacturing both of which support further US economic growth. The repatriation of capital has had a positive effect on stock prices through buybacks and mergers as well as laying the groundwork for increased capital expenditures by corporate America. We expect that ultimately corporate and government spending will continue to support growth in the US.

Now that portfolio values have recovered it is an excellent time to review your comfort with volatility. Think back to how you felt during the recent drop in May. Were you nervous about the drop in values? Did you sell assets and move to cash, or want to? These are important questions to consider as your comfort with volatility is important to how we build and maintain your portfolio. It's important that your investment plan is aligned with your personal goals as well as your risk tolerance. Periods of volatility such as we've recently experienced often provide for a re-evaluation of risk tolerance. Have your goal or time horizons changed over the past year? Have there been events in your life that will change your outlook?

It's important to review your overall asset allocation and to evaluate whether your portfolio is still positioned appropriately. Now is a good time to make decisions about adjustments and rebalancing that may be needed to realign your portfolio.

Sincerely,

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