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INVESTMENT STRATEGIES

Clear Direction in a Complex World

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Quarterly Insights – July 2019

In sharp contrast to the quiet, steady gains of the first quarter, stock market performance in the second quarter was one marked by volatility. The S&P 500 logged a 4% gain in April thanks to solid first quarter corporate earnings report and ended April near new all-time highs.

Volatility returned in the first week of May, however, as The United States raised tariffs on $200 billion in Chinese goods from 10% to 25% following the collapse of U.S.-China trade negotiations. The news caught investors by surprise as reports previously implied a U.S.-China trade deal was close to being finalized, and stocks dropped sharply in reaction. Moreover, Federal Reserve Chairman Jerome Powell implied the Fed was not as open to an interest rate cut as investors anticipated. That combination of factors weighed on markets throughout May and the S&P 500 fell to its lowest levels since early March.

However, in June the stock market was able to find support and rebound strongly as there was progress across the two main sources of volatility in the second quarter, U.S.-China trade and future Fed interest rate policy. First, at the June 19th meeting, the Federal Reserve reversed course from May and signaled an interest rate cut is likely in 2019, perhaps as early as July. That shift helped to re-validate market expectations of lower interest rates in the near future, and stocks rebounded strongly on that expectation. Second, President Trump and Chinese President Xi Jinping agreed to meet at the recently held G20 meeting, and the result of the meeting was a trade "truce" of no new tariffs while trade negotiations resume.

In sum, despite the market volatility and macroeconomic uncertainty, the underlying fundamentals for the economy and the markets remain generally solid, and investors are now anticipating the first Fed rate cut in over a decade as well as an extended "truce" in the U.S.-China trade conflict—both of which should be further supportive of the stock market. So, while we should prepare ourselves for more historically typical volatility, the outlook for markets remains generally positive as we begin the second half of the year.

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Second Quarter Performance Review

Despite the uptick in volatility in the second quarter, U.S. stock market performance still resembled that of the first quarter as rising hopes for Fed rate cuts and a U.S.-China trade truce resulted in broad gains across most market segments and sectors.

By market capitalization, large caps outperformed small caps, which is a reversal from the first quarter. Large cap outperformance was partially due to investors reacting to underwhelming economic data, as large caps are historically less sensitive to a potentially slowing economy. Increased hopes for a U.S.-China trade truce in late June also helped large caps outperform as they have more exposure to global trade. From an investment style standpoint, growth again outperformed value mostly due to another quarter of strong returns by tech and consumer discretionary stocks.

On a sector level, 10 of 11 S&P 500 Index sectors finished the second quarter with positive returns; however, consumer staples and the financial sectors were the notable outperformers. Consumer staples were driven higher by solid earnings and investors' desire for some insulation from a loss of economic momentum and trade uncertainty, while financials benefitted from rising expectations for a Fed rate cut and the late-quarter steepening of the yield curve.

The energy sector, meanwhile, experienced negative performance in the second quarter mainly because of declines in the price of oil. The healthcare sector also lagged the S&P 500 thanks to rising political risks via increasing calls to eliminate private health insurance and the expansion of government healthcare programs.

US Equity Indexes	Q2 Return	YTD Return
S&P 500	4.30%	18.54%
DJ Industrial Average	3.21%	15.40%
NASDAQ Composite	4.25%	21.85%
S&P MidCap 400	3.05%	17.97%
Russell 2000	2.10%	16.98%

Source: Morningstar (As of June 28th 2019)

Looking internationally, foreign markets also had positive returns for the second quarter, but once again underperformed the United States. Foreign developed markets outgained emerging markets due to several factors, including less sensitivity to volatility in foreign trade relations, a stronger dollar (for most of the quarter) and rising hopes for more stimulus from the European Central Bank. Emerging markets, meanwhile, were restrained by concerns about global economic growth and pressures from a mostly stronger U.S. dollar. However, a late-quarter decline in the dollar coupled with rising U.S.-China trade optimism helped emerging markets register a slightly positive gain for the quarter.

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International Equity Indexes	Q2 Return	YTD Return
MSCI EAFE NR USD (Foreign Developed)	3.68%	14.03%
MSCI EM NR USD (Emerging Markets)	0.61%	10.58%
MSCI ACWI Ex USA NR USD (Foreign Dev & EM)	2.98%	13.60%

Source: Morningstar (As of June 28th 2019)

Commodities saw mixed returns for the quarter, as gold surged to a multi-year high while oil declined. Gold rallied in the second quarter due to multiple factors including rising expectations for Fed rate cuts, an increase in geopolitical tensions (especially with respect to the U.S. and Iran) and the late-quarter declines in the U.S. dollar. Oil, meanwhile, was volatile last quarter as short, sharp geopolitically driven rallies were offset by rising concerns about declining demand and potential oversupply as U.S. oil production hit another record high in the second quarter.

Commodity Indexes	Q2 Return	YTD Return
S&P GSCI (Broad-Based Commodities)	-1.42%	13.34%
S&P GSCI Crude Oil	-2.85%	26.95%
LBMA Gold Price	7.09%	9.66%

Source: Morningstar (As of June 28th 2019)

Switching to the fixed income markets, performance largely reflected investors' expectations for future Fed rate cuts, and that was positive for the broad bond markets. The leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized more positive returns in the second quarter as rising anticipation of future rate cuts, combined with worries about economic growth and increased geopolitical concerns sent bond indices decidedly higher in the second quarter.

Looking deeper into the fixed income markets, longer-duration bonds outperformed those with shorter durations during the second quarter, which is a continuation of what we observed in the first quarter and reflective of a market that is forecasting future rate cuts and slower economic growth.

Corporate bonds, both investment grade and high yield, again outperformed government bonds in the second quarter thanks to a better-than-expected earnings season, and the rising expectations for a future Fed rate cut. Both investment grade and high yield bond funds again posted strong returns.

US Bond Indexes	Q2 Return	YTD Return
BBgBarc US Agg Bond	3.08%	6.11%
BBgBarc US T-Bill 1-3 Mon	0.62%	1.22%
ICE US T-Bond 7-10 Year	3.53%	6.84%
BBgBarc US MBS (Mortgage-backed)	1.96%	4.17%
BBgBarc Municipal	2.27%	5.11%
BBgBarc US Corporate Invest Grade	5.37%	11.94%
BBgBarc US Corporate High Yield	2.55%	10.84%

Source: Morningstar (As of June 28th 2019)

Third Quarter Market Outlook

Markets were impressively resilient in the second quarter and registered gains despite deterioration in global economic activity and renewed uncertainty with U.S.-China trade. But, experience has taught us not to become complacent just because markets have been resilient, and we think that's again appropriate as we start the second half of the year.

Reductions in interest rates by the Federal Reserve, while welcome, are not a panacea for the U.S. and global economies. And as we start the third quarter, we face macroeconomic uncertainty on multiple fronts.

First, the U.S.-China trade situation remains delicate and very uncertain, and until there is a final agreement on a new U.S.-China trade pact, that lack of clarity will act as a headwind on economic growth and likely create temporary periods of volatility like we experienced in the second quarter.

Looking at the global economy, growth metrics underwhelmed in the second quarter, although the impact on global stocks was muted by rising market expectations of more stimulus from global central banks, including the Fed. But, if we see further deterioration in global and U.S economic indicators, that will also likely be a source of elevated volatility across markets.

Additionally, there are several unsettled geopolitical situations that must be monitored, including Brexit (the deadline is October 31st), North Korea (relations are still unsettled despite the recent Trump/Kim meeting) and Iran (the chances of a U.S.-Iran military conflict are as high as they've been in years).

Finally, while the Federal Reserve has signaled it will begin to reduce interest rates in the coming months, the situation remains very fluid, and if the Fed does not meet market expectations by cutting rates, that will cause short-term volatility.

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It remains unclear how, or when, these events will be resolved, and what those implications will be for markets. Yet as 2019 has shown us so far, uncertainty is not, by itself, enough to offset the still-strong fundamentals in the U.S. economy and corporate America. Corporate profits and Employment are still strong in the United States. Put more generally, markets always face uncertainties, but over the long term, it is core economic and corporate fundamentals that drive market returns—not the latest sensational headlines.

At Zick Whitted Taub Investment Strategies, our years of experience in all types of markets (calm and volatile) have taught us that successful investing remains a marathon, not a sprint. Therefore, it remains critical to stay invested, remain patient, and stick to a plan. That’s why we’ve worked diligently with you to establish a personal allocation target based on your financial position, risk tolerance, and investment time horizon.

We thank you for your ongoing confidence and trust. Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment. Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

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Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transitions costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Commodities' investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuation even during periods when prices overall are rising. There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices generally rise.
Barclays Aggregate Index is comprised of the Government/Corporate, the Mortgage-Backed Securities and the Asset-Backed Securities indices.
The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ
The NASDAQ Composite is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market.
The Russell 2000 Index is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index.
The Russell 2000 index is an unmanaged index of small cap securities which generally involve greater risks.
MSCI EAFE (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 21 developed nations.
MSCI Emerging Markets Index is designed to measure equity market performance in 23 emerging market countries. The index's three largest industries are materials, energy, and banks.
The MSCI ACWI (All Country World Index) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. As of June 2007 the MSCI ACWI consisted of 48 country indices comprising 23 developed and 25 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indices included are: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea,

Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

S&P GSCI Crude Oil is an index tracking changes in the spot price for crude oil.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies.

LBMA Gold Price refers to the London Bullion Market Association (LBMA) Gold Price.

S&P GSCI (Broad- Based Commodities) is a leading measure of general price movements and inflation in the world economy.

Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index is composed of fixed-rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase.

The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility and Finance, which include both U.S. and non-U.S. corporations.

The Barclays Capital US Aggregate Index is an unmanaged market value weighted performance Benchmark for investment-grade fixed rate debt issues, including government, corporate, asset backed, and mortgage backed securities with a maturity of at least 1 year.

The **Bloomberg Barclays US Mortgage Backed Securities (MBS) Index** tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

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Holding investments for the long term does not insure a profitable outcome. Investing involves risk and you may incur a profit or loss regardless of strategy selected, including diversification and asset allocation. Past performance is not indicative of future results.

Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. The companies engaged in the communications and technology industries are subject to fierce competition and their products and services may be subject to rapid obsolescence. Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors. International investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility. Currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising. Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

Investing in emerging markets can be riskier than investing in well-established foreign markets.
Investing involves risk and investors may incur a profit or a loss.
Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.
The prices of small company stocks may be subject to more volatility than those of large company stocks.
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Future investment performance cannot be guaranteed, investment yields will fluctuate with market conditions.
The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With
1,136 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Long-term Corporate Bonds are debt obligations of the issuing corporation.
U.S. government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term (less than one year) obligations of the U.S. government.
High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of a portfolio.
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