

Quarterly Market Review

No “Debate” Fed-Induced June Rally Lifts 2Q Equity and Bond Performance

2Q 2019

Dovish Shift in Fed Policy Drives Strong Equity and Fixed Income Performance; Dollar Weakens

Quarterly Highlights

- Trade war escalates; U.S. raises tariffs on \$200 billion from 10% to 25% and threatens additional tariffs on \$300 billion of imported Chinese goods.
- The probability of two or three 2019 Fed rate hikes rises to 93% and 60%, respectively.
- U.S. unemployment rate (3.6%) declines to the lowest level since 1969.
- The pace of home price gains (+2.5% YoY) slows to the lowest level since August 2012.
- Theresa May resigns as Brexit process continues.
- China’s manufacturing PMI falls into contraction territory for the first time in four months.
- The amount of negative yielding global debt rises to the highest level (\$13 trillion) on record.
- U.S. 10-year Treasury yield falls to lowest level in two years. 10-year German bund hits record low.
- The Barclays Aggregate Index posts its best quarter (+3.1%) since 3Q11.
- S&P 500 posts the best start to a year (+18.5%) since 1997; Info Tech leads.
- European equities outperform global equities for the first time in seven quarters.
- U.S. dollar falls for the first time in five quarters; gold rises to a five-year high.

Economy | Fed Attempts to Shift Policy to “Insurance” Rate Cut.

- The advanced reading of **1Q19 GDP** (+3.1% Quarter-over-Quarter (QoQ)) was revised lower from the seasonally strong preliminary first quarter reading (+3.2% vs. +1.1%, the average of the previous 10 1Q readings). While personal consumption was revised modestly higher (to +1.2% QoQ from +1.1% QoQ), it remained weak from a historical perspective.
- **The Fed** left interest rates unchanged at the June FOMC meeting. The Fed left its 2019 median rate forecast unchanged, but Chair Powell highlighted that the Fed would “act as necessary” to extend the expansion. The futures market is currently reflecting a 60% probability of three or more rate cuts in 2019.
- **June ISM Manufacturing** (51.7) remained in expansionary territory (a level above 50) for the 32nd month but declined for the third consecutive month. While both the production and employment subsectors improved, the decline in the headline index was driven by the new orders component which declined to the lowest level since December 2015.
- **The U.S. added 75k jobs** in May, marking the 104th consecutive month of job gains (the longest streak on record). **Wage growth** (+3.1% year-over-year (YoY)) remained near cyclical highs and the unemployment rate (3.6%) remained at the lowest level since 1969.

- **Jobless claims** rose modestly (to +227k) for the second consecutive month, but continue to remain near historically healthy levels.
- **Headline inflation** (+1.8% YoY) slowed for the first time in three months due to slowing transportation costs. **Core CPI** (+2.0% YoY) slowed to the lowest level since February 2018.
- **Consumer confidence** (121.5) declined for the first time in three months and fell to the lowest level since September 2017. The Expectations Index declined to its lowest level in five months.
- **Core retail sales** (ex. food, autos and gas, +0.3% Month over Month (MoM)) rose for the third consecutive month, but at a slower pace than the 10-year historical average (+2.7% vs. +3.3% YoY).
- **Housing data** was mixed as existing home sales (+2.5% MoM) and permits (+0.7% MoM) were positive, while new home sales (-7.8% MoM) and housing starts (-0.9% MoM) declined. The pace of home price gains (S&P Case Shiller Home Price Index: +2.5% YoY) slowed to the lowest level since August 2012.
- **China’s Manufacturing PMI** (49.4) fell into contraction territory (a level below 50) for the first time in four months.
- **Euro Zone Manufacturing PMI** (47.6) remained in contraction territory for the fifth straight month. Euro zone economic sentiment (103.3) declined to the lowest level since April 2016.

Fixed Income | Broad Fixed Income “Jumps” on Rising Fed Rate Cut Expectations.

- The **Bloomberg Barclays U.S. Aggregate Index** (+3.1% QoQ) rallied for the fourth consecutive quarter and posted its best quarterly gain since 3Q11. Fixed income was supported by a decline in sovereign bond yields, as trade uncertainty, concerns surrounding global growth, and rising expectations for global monetary policy easing pushed yields lower.
- **U.S. Investment-Grade bonds** (+4.5% QoQ) rallied for the third time in four quarters and posted the second best quarter over the past 10 years. The rally in investment grade was led by the industrials (+4.8%) and utilities (+4.7%) sectors.
- **Emerging Market bonds** (+3.8% USD QoQ) rallied for the second consecutive quarter. Despite continued uncertainty surrounding U.S. and China trade, EM bonds rallied on falling global sovereign yields and rising expectations for future Fed rate cuts.
- **International sovereign bonds** (G7 ex U.S., +3.4% QoQ) posted their best monthly gain in five quarters as the decline in global sovereign yields and weakness in the dollar supported the asset class.
- **TIPS** (+2.5% QoQ) rallied for the second consecutive quarter but underperformed nominal Treasuries (+3.0% QoQ) for the second time in three quarters.
- **High-yield bonds** (+2.5% QoQ) rallied for the fourth time in the past five quarters. Despite volatility intra-quarter as a result of energy weakness and continued uncertainty surrounding trade, high-yield spreads narrowed modestly (-14 bps) to 377 bps during the second quarter.
- **Municipals** (+2.1% QoQ) rallied for the third consecutive quarter. All three municipal sectors (high yield +2.7%, revenue +2.3% and general obligation +2.1%) were in positive territory in 2Q19.

Equities | Fed Policy Wins in “Tug-of War” With Trade Uncertainty.

- **Global equities** (MSCI AC World, +3.8% USD QoQ) rallied for the second consecutive quarter. Despite uncertainty surrounding global trade and slowing global economic momentum (which spurred a 5% decline intra-quarter), global equities rallied due to rising expectations for monetary policy easing from global central banks.
- **European equities** (MSCI Europe ex UK, +6.4% USD QoQ) rallied for the second consecutive quarter and outperformed global equities for the first time in seven quarters. While slowing economic momentum continues to weigh on the asset class, Europe outperformed global equities on a relative basis due to a delay in U.S. auto tariffs.
- **U.S. Large-Cap equities** (S&P 500, +4.3% QoQ) rallied for the second consecutive quarter and posted the best start to a year since 1997. While an escalation in trade rhetoric was a headwind, rising expectations for Fed rate cuts supported U.S. equities.
- 10 of 11 **S&P 500 sectors** were positive in 2Q19 with only Energy (-2.8% QoQ) in negative territory.
- **U.S. Small-Cap equities** (Russell 2000, +2.1% QoQ) rallied for the second straight quarter but lagged large cap for the third time in four quarters.
- **Japanese equities** (MSCI Japan, +1.0% USD QoQ) rallied for the second consecutive quarter in part due to the delay in U.S. auto tariffs.
- **EM equities** (MSCI EM, +0.7% USD QoQ) rallied for the second straight quarter but underperformed developed markets (MSCI EAFE USD +4.0% QoQ) by the widest margin in four quarters.
- Within EM, **Asia** (MSCI Asia ex JP, -0.6% USD QoQ) underperformed **Latin America** (MSCI LATAM, +4.6% USD QoQ) for the third time in four quarters.

Commodities | Gold “Boosted” by Muted Dollar and Fed Dovishness.

- The **Bloomberg Barclays Commodity Index** (-1.8% QoQ) declined for the fifth time in the past six quarters as broad commodities were pressured by the escalation in trade uncertainty between the U.S. and China and slowing global economic momentum.
- The **U.S. Dollar Index** (-1.2% QoQ) declined for the first time in five quarters. Despite rising intra-quarter to the highest level in two years, the U.S. dollar declined due to rising expectations for future Fed rate cuts and narrowing interest rate differentials.
- The **Bloomberg Industrial Metals Index** (-7.8% USD QoQ) declined for the third time in four quarters. Industrial metals, led by copper (-7.6% QoQ) declined due to the escalation in trade rhetoric between the U.S. and China and slowing demand concerns.
- The **Bloomberg Energy Index** (-5.1% QoQ) declined for the second time in three quarters. Despite continued geopolitical risks (bombing of oil tankers in the Strait of Hormuz) and the elimination of Iranian export waivers, crude oil (-2.8% QoQ) declined as concerns over future oil demand rose amidst slowing trade and economic momentum.
- The **Bloomberg Softs Index** (-0.9% QoQ) declined for the fifth time in the past six quarters.
- The **Bloomberg Precious Metals Index** (+6.5% QoQ) rallied for the second time in three quarters and posted the best quarter since 1Q17. Gold (+8.9% QoQ) led the rally and rose to a five-year high as falling global sovereign yields, rising expectations for Fed rate cuts and slowing economic momentum supported the asset.
- The **Bloomberg Grains Index** (+7.7% QoQ) posted the best quarterly gain since 2Q15 led by a sharp gain in wheat (+15.2% QoQ).

Figure 1: Rising Expectations for 2019 Rate Cuts

Expectations for two or three 2019 Fed rate cuts rose to 93% and 60%, respectively.

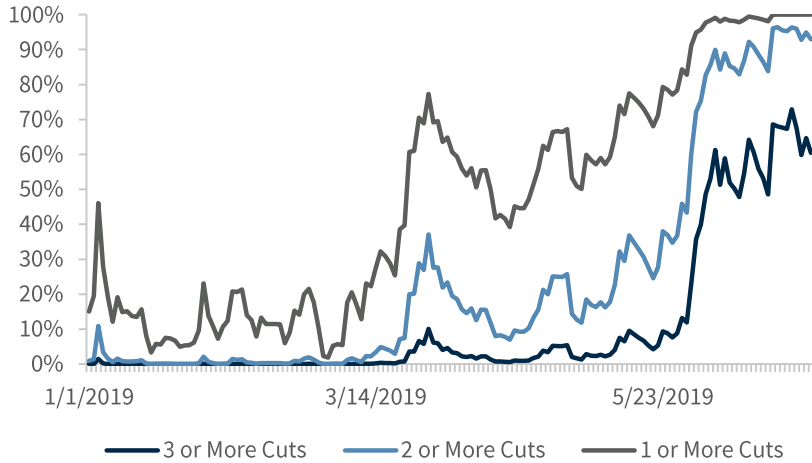


Figure 2: Cyclical Sectors Led the Way in 2Q

Cyclical sectors led the strong rally in the second quarter.

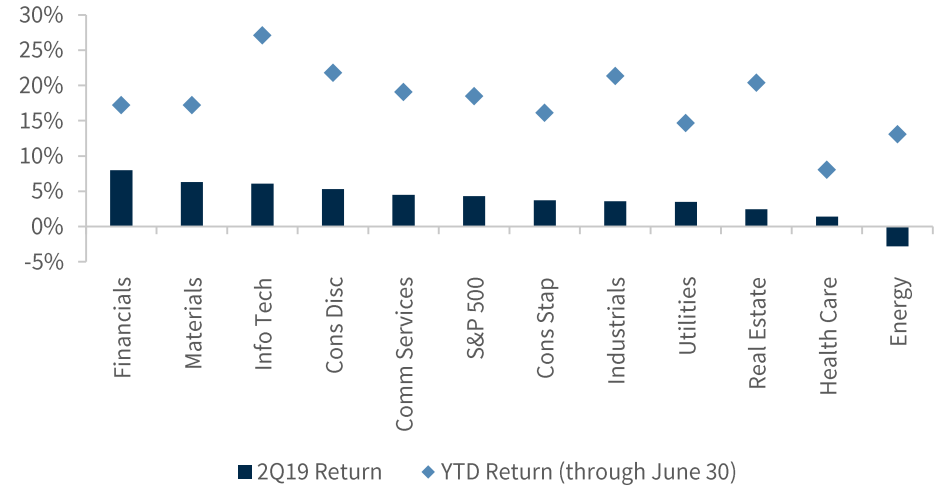


Figure 3: Treasury Yields Hit Multi-Year Low

The 10-year Treasury yield declined to its lowest level since September 2016 due to rising expectations for Fed rate cuts, slowing global economic momentum, and heightened trade uncertainty.



Figure 4: Gold Rises to Multi-Year High

Gold rose to a five-year high and broke the key \$1400/oz level on the back of falling global sovereign yields, muted inflation, and rising expectations for Fed rate cuts.



Fixed Income | Investment Grade Leads Broad 2Q Fixed Income Rally

	June	2Q19	YTD	1 Year	3 Year	5 Year	10 Year
U.S. Investment Grade	2.8%	4.5%	9.9%	10.7%	3.9%	4.1%	6.1%
EM Bonds	2.7%	3.8%	9.4%	11.0%	5.0%	4.6%	7.7%
International Bonds	3.3%	3.4%	4.7%	4.4%	-0.3%	0.3%	1.8%
U.S. Aggregate	1.7%	3.1%	6.1%	7.9%	2.3%	2.9%	3.9%
Treasuries	1.5%	3.0%	5.2%	7.2%	1.3%	2.5%	3.0%
TIPS	1.5%	2.5%	5.2%	4.7%	1.9%	1.4%	2.9%
High Yield	1.9%	2.5%	9.9%	7.5%	7.5%	4.7%	9.2%
Municipals	0.5%	2.1%	5.1%	6.7%	2.6%	3.6%	4.7%

Commodities & FX | Precious Metals Shine Again

	June	2Q19	YTD	1 Year	3 Year	5 Year	10 Year
Gold	7.8%	8.9%	10.3%	12.7%	2.3%	1.4%	4.3%
BBG Precious Metals	7.1%	6.5%	5.9%	5.2%	-2.2%	-2.2%	2.5%
U.S. Dollar Index	-1.7%	-1.2%	0.0%	1.6%	0.1%	3.8%	1.8%
BBG Commodity Index	2.5%	-1.8%	3.8%	-8.9%	-3.6%	-10.0%	-4.2%
Crude Oil (WTI)	9.3%	-2.8%	28.8%	-21.1%	6.6%	-11.1%	-1.8%
BBG Energy Index	3.8%	-5.1%	9.3%	-16.2%	-1.9%	-18.9%	-12.3%
Copper	2.8%	-7.6%	3.1%	-8.5%	7.3%	-3.3%	1.8%
BBG Industrial Metals	1.9%	-7.8%	3.5%	-13.0%	4.9%	-3.8%	-0.9%

S&P 500 Sectors | Financials Lead Broad Rally in 2Q19

	June	2Q19	YTD	1 Year	3 Year	5 Year	10 Year
Financials	6.7%	8.0%	17.2%	6.3%	16.4%	10.6%	13.1%
Materials	11.7%	6.3%	17.3%	3.2%	10.4%	5.4%	11.4%
Information Technology	9.1%	6.1%	27.1%	14.3%	26.2%	18.5%	18.6%
Consumer Discretionary	7.8%	5.3%	21.8%	10.2%	16.7%	14.0%	19.7%
Communication Services	4.3%	4.5%	19.1%	13.7%	0.6%	5.3%	9.8%
Consumer Staples	5.2%	3.7%	16.2%	16.4%	4.8%	8.4%	12.8%
Industrials	7.8%	3.6%	21.4%	10.4%	12.5%	9.3%	15.6%
Utilities	3.3%	3.5%	14.7%	19.0%	8.0%	10.0%	12.2%
Real Estate	1.8%	2.5%	20.4%	16.8%	6.9%	9.7%	17.2%
Health Care	6.6%	1.4%	8.1%	13.0%	10.8%	10.6%	15.5%
Energy	9.3%	-2.8%	13.1%	-13.2%	0.2%	-5.5%	5.0%

Equities | Large Cap Outperforms Small Cap in 2Q

	June	2Q19	YTD	1 Year	3 Year	5 Year	10 Year
Russell 1000 Growth	6.9%	4.6%	21.5%	11.6%	18.1%	13.4%	16.3%
S&P 500	7.0%	4.3%	18.5%	10.4%	14.2%	10.7%	14.7%
Russell 1000	7.0%	4.2%	18.8%	10.0%	14.1%	10.5%	14.8%
Russell 1000 Value	7.2%	3.8%	16.2%	8.5%	10.2%	7.5%	13.2%
Russell 2000 Growth	7.7%	2.7%	20.4%	-0.5%	14.7%	8.6%	14.4%
DJ Industrial Average	7.2%	2.6%	14.0%	9.6%	14.1%	9.6%	12.2%
Russell 2000	7.1%	2.1%	17.0%	-3.3%	12.3%	7.1%	13.4%
Russell 2000 Value	6.4%	1.4%	13.5%	-6.2%	9.8%	5.4%	12.4%

International Equities (in USD) | DM Outperforms EM in 2Q

	June	2Q19	YTD	1 Year	3 Year	5 Year	10 Year
MSCI Europe ex UK	7.4%	6.4%	17.8%	4.3%	10.9%	2.8%	7.9%
MSCI LATAM	6.2%	4.6%	12.9%	18.9%	11.2%	-0.4%	2.6%
MSCI EAFE	6.0%	4.0%	14.5%	1.6%	9.6%	2.7%	7.4%
MSCI AC World	6.6%	3.8%	16.6%	6.3%	12.2%	6.7%	10.7%
MSCI Japan	3.8%	1.0%	8.0%	-3.8%	8.4%	4.8%	6.1%
MSCI UK	5.0%	0.9%	13.0%	-2.0%	7.0%	-0.2%	6.9%
MSCI EM	6.3%	0.7%	10.8%	1.6%	11.1%	2.9%	6.2%
MSCI Asia ex JP	6.7%	-0.6%	10.8%	-0.2%	11.8%	5.1%	8.2%

Key Asset Class Levels

	June	2Q19	Start of Year	1 Year	3 Year	5 Year	10 Year
S&P 500	2,942	2,942	2,507	2,716	2,036	1,961	919
DJIA	26,600	26,600	23,327	24,216	17,410	16,852	8,438
MSCI AC World	523	523	456	502	386	428	245
S&P 500 Dividend Yield	2.04	2.04	2.32	2.06	2.33	2.09	2.47
1-3M T-Bills (Cash, in %)	2.09	2.09	2.39	1.86	0.25	0.01	0.16
2YR Treasury Yield (in %)	1.74	1.74	2.50	2.52	0.61	0.43	1.11
10YR Treasury Yield (in %)	2.00	2.00	2.69	2.85	1.46	2.53	3.50
30Yr Treasury Yield (in %)	2.53	2.53	3.02	2.98	2.28	3.36	4.30
EURUSD	1.14	1.14	1.14	1.16	1.11	1.36	1.41
Crude Oil - WTI (\$/bbl)	59	59	45	73	48	106	69
Gold (\$/oz)	1390	1390	1281	1251	1318	1320	941

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This index is similar to other trade-weighted indexes, which also use the exchange rates from the same major currencies. Bloomberg Barclay Commodity Index is a commodity group sub index of the Bloomberg CTR. The index is composed of futures contracts on crude oil, heating oil, unleaded gasoline and natural gas. It reflects the return on fully collateralized futures positions and is quoted in USD. Bloomberg Industrial Metals Index is composed of futures contracts on aluminum, copper, nickel and zinc. It reflects the return of underlying commodity futures price movements only. It is quoted in USD. Bloomberg Softs Index is a commodity group sub index of the Bloomberg CI. It is composed of futures contracts on coffee, cotton and sugar. It reflects the return of underlying commodity futures price movements only and is quoted in USD. Bloomberg Precious Metals index is a commodity group sub index of the Bloomberg CI. It is composed of futures contracts on gold and silver. 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Sources for Charts: Bloomberg, FactSet

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INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863

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