

LEONARD A. WEISS
SENIOR VICE PRESIDENT, INVESTMENTS
LEONARD.WEISS@RAYMONDJAMES.COM

LOWELL J. WEISS, J.D., CFP®
FINANCIAL ADVISOR
LOWELL.WEISS@RAYMONDJAMES.COM

WEISSWEALTHMANAGEMENT.COM

DJIA: 26,317 | NASDAQ: 7,904*

Markets Resilient Again in Third Quarter Amid Volatility

Markets in the third quarter of 2019 looked surprisingly similar to the second quarter as more U.S.-China trade war uncertainty and a lack of clarity on future interest rate policy caused a sharp increase in volatility in the middle of the quarter, but the S&P 500 remained resilient and ultimately recouped those losses to finish the quarter not far from the new all-time highs established in late July.

The third quarter started strong as news of a “trade truce” between the U.S. and China, which was announced at the G20 meeting in late June, combined with better-than-expected second-quarter corporate earnings to propel the S&P 500 to new all-time highs in July. Also helping markets rally was anticipation of the first interest rate cut by the Federal Reserve since 2008, which became reality on July 31st when the FOMC cut the Fed Funds Rate by 25 basis points.

But that strong start to the quarter was quickly undone in early August thanks to increased tariffs between the U.S. and China (the trade truce was short-lived), uncertainty over future Fed policy, and concerning signals from the bond market regarding economic growth and inflation.

Also, August brought news of recession fears. These fears were stoked by reports of an inverted yield curve and softening in the manufacturing sector. While we don’t think a recession is imminent, news concerning this may keep the market volatile as we begin Q4 2019. October has a history of being a volatile month (though a net positive one) so should be prepared for potential sharp market swings ahead.

The U.S.-China trade truce that was agreed to in late June didn’t last much more than a month as President Trump announced new 10% tariffs on \$300 billion worth of Chinese imports on August 1st, citing a failure by the Chinese to fulfill promises to increase purchases of U.S. agricultural products. Then, in late August, China retaliated by levying various new tariffs on \$75 billion worth of U.S. imports, and President Trump immediately responded by increasing existing tariffs on all \$550 billion of Chinese imports. The tariff tit-for-tat weighed on markets throughout August.

Also pressuring stocks in August was uncertainty regarding U.S. monetary policy. As mentioned, the Fed cut interest rates by 25 basis points on July 31st, but they did not definitively signal more rate cuts were coming, and disappointment from that lack of clear guidance, combined with growing worries over future economic growth, added to the volatility in August.

Finally, a closely watched part of the U.S. Treasury yield curve, the “10s-2s spread,” inverted (meaning that yields on shorter-term notes exceeded those of longer-term notes) for the first time since 2007. This signal has historically preceded a recession by an average of 18 months, although admittedly, it’s not a perfect indicator. Regardless, seeing this signal for the first time in over a decade led to a deterioration in investor sentiment and added to the August volatility.

Despite this trifecta of headwinds, markets again showed impressive resilience in the final month of the quarter, just as they did in the second quarter of 2019.

Early in September, there was improvement in U.S.-China trade relations as President Trump authorized a short delay on the implementation of some of the recently announced tariff increases, and both the U.S. and China agreed to face-to-face meetings in October in another attempt to end the now 18-plus-month trade war. Additionally, the Federal Reserve cut interest rates for a second time on September 18th and clearly signaled more willingness for future cuts if conditions warranted further action.

Finally, after a brief period of being inverted, the yield curve normalized in early September in part due to better-than-expected U.S. economic data and subsequently easing concerns of a future recession.

Due to the improving market fundamentals listed above, the S&P 500 rebounded solidly in September and came close to matching July’s all-time highs, although the initiation of an impeachment investigation by the House of Representatives on President Trump caused a modest pullback late in the month.

In sum, the volatility we witnessed in the third quarter, which remains historically typical, was not surprising due to the numerous macroeconomic uncertainties facing this market and the economy.

But the third quarter was also a reminder that volatility does not automatically mean poor performance. Resilient corporate earnings, stable U.S. economic growth and an accommodative Federal Reserve combined with rising optimism towards U.S.-China trade to offset the volatility and deliver another quarter of positive returns.

Third-Quarter Performance Review – Defensive Sectors Outperform

Major index returns were somewhat mixed in the third quarter as three of the four major indices, the S&P 500, Nasdaq 100 and Dow Jones Industrial Average, finished the quarter with positive returns, while the Russell 2000 saw negative returns. That mixed performance largely reflected the deterioration in U.S.-China trade relations and rising concerns about global economic growth.

By market capitalization, large caps once again outperformed small caps, which is a continuation of the trend witnessed in the second quarter. Large-cap outperformance was partially due to investors reacting to rising future recession fears, as large caps are historically less sensitive to a slowing economy. From an investment

style standpoint, growth outperformed value due to strength in consumer sectors, industrials and large-cap tech.

On a sector level, eight of the 11 S&P 500 Index sectors finished the third quarter with positive returns. But in a departure from the first two quarters of 2019, traditional defensive stock sectors with high dividend yields (like utilities and REITS) handily outperformed. Falling Treasury yields and concerns about future economic growth fueled the outperformance of these higher-yielding sectors.

Sector laggards, meanwhile, were the same as the second quarter. The energy sector experienced negative returns again thanks to further declines in the price of oil and the healthcare sector was pressured by continued political risks via increasing calls for the expansion of government healthcare programs, dubbed “Medicare for all,” and consistent, yet so far unsuccessful efforts by the government to lower the cost of prescription drugs.

US Equity Indexes	Q3 Return	YTD Return
S&P 500	1.70%	20.55%
DJ Industrial Average	1.83%	17.51%
NASDAQ 100	1.29%	23.42%
S&P MidCap 400	-0.09%	17.87%
Russell 2000	-2.40%	14.18%

Source: YCharts

Looking internationally, foreign markets saw negative returns in the third quarter thanks primarily to concerns about global economic growth. Foreign developed markets declined but relatively outperformed emerging markets due to the European Central Bank cutting interest rates and restarting its quantitative easing (QE) program for the first time since September of 2018. Emerging markets, meanwhile, saw moderate declines thanks to concerns about global economic growth, combined with pressures from a stronger U.S. dollar.

Commodities again experienced mixed returns as gold continued to surge and hit fresh multi-year highs while oil declined. Gold rallied in the third quarter thanks to global central bank rate cuts (the Fed and European Central Bank) and an increase in geopolitical tensions (especially with respect to the U.S. and Iran). Meanwhile, oil was volatile last quarter as short-lived geopolitically driven rallies related to the bombing of a Saudi Arabian oil production facility were offset by rising concerns over slowing global economic growth reducing future energy demand.

Switching to fixed income markets, bonds were broadly higher in the third quarter, as we’d expect given global rate cuts, rising concerns about future economic growth, and still subdued inflation readings. The leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) experienced solidly higher returns for the fourth straight quarter.

Looking deeper into the fixed income markets, longer-duration bonds once again outperformed those with shorter durations which is a continuation of what we observed in the first half of 2019 and reflective of a market that is responding to the recent rate cuts and threats of potentially slowing economic growth.

Corporate bonds saw solidly positive returns in the third quarter, although investment-grade bonds handily outperformed high-yield bonds, and that move to higher-quality corporate debt also underscored concerns about future economic growth and corporate earnings.

Fourth-Quarter Market Outlook

Once again, the S&P 500 successfully weathered an increase in volatility this past quarter, as positive current economic fundamentals, interest rate cuts, better-than-expected corporate earnings and renewed hope for resolution on U.S.-China trade helped the S&P 500 maintain strong year-to-date gains.

However, the increase in volatility we saw in May, and again most recently in August, is an important reminder that while markets remain broadly resilient, risks to investment portfolios and the economy need to be carefully monitored. There are still multiple unknowns currently facing investors as we begin the final three months of 2019.

First, the ongoing U.S.-China trade war is clearly the most important influence on the markets. And while there has been rising optimism for some sort of temporary resolution, the fact remains that the U.S. and China still have substantial tariffs in place on imports, with more potentially coming in December. Those tariffs continue to be a headwind on global economic growth, and slowing global growth is a risk to markets that we will continue to watch closely.

Turning to the economy, the outlook remains uncertain. Currently, U.S. economic growth is solid and the envy of the world's developed economies. And, accommodative policy by the Federal Reserve will continue to support that growth. However, Fed rate cuts don't bring guarantees of sustained periods of economic growth, and the ongoing U.S.-China trade war paired with the reappearance of some concerning indicators, such as an inverted yield curve, mean we must remain vigilant in detecting any potential future economic slowdown.

Finally, both domestic and geopolitical dramas require close watching over the coming months. Domestically, the impeachment inquiry of President Trump has the potential to weigh on investor sentiment, while internationally U.S.-Iran tensions are as high as they've been in years, and any conflict between the U.S. and Iran will almost certainly be a negative for stocks, broadly speaking.

Bottom line, U.S. markets were resilient in the third quarter and the performance of most markets year to date remains impressive. However, our experience has taught us that while markets may be resilient, risks still need to be monitored closely, and so we will continue to do so as we have all year.

What happens next with the U.S.-China trade war (will there be a trade truce?), Federal Reserve policy (will the Fed cut rates again in 2019?), and future economic growth (does the yield curve invert again?) will likely determine whether markets maintain, and potentially add to, year-to-date gains—or whether we see similar bouts of volatility like we did in May and August of this year.

We understand that markets always face uncertainties at the start of a new quarter, and we are committed to monitoring these situations and their impact on the markets and your portfolio. Positively, current corporate

and economic fundamentals remain solid, and it is those factors that determine the longer-term path of markets, not the latest political drama or salvo in the U.S.-China trade war.

We understand that volatility, regardless of the cause, can be unnerving, even if it is historically typical. That's why we remain committed to helping you navigate this ever-changing market environment, with a focused eye on ensuring we continue to make progress on achieving your long-term investment goals.

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.

The strong market performance notwithstanding, we remain vigilant towards risks to portfolios and the economy, and 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.

Enclosure #1 – Our first enclosure is the Investment Strategy Quarterly piece from Raymond James. This provides a quick understanding of relevant themes in the investment world. Additionally it provides an economic snapshot as well as a tactical outlook. We like to include this in the Weiss Report as a handy two-page reference.

Enclosure #2 – Our second enclosure is from Brian Wesbury from First Trust Advisors. We like to use his Monday Morning Outlook as an outside piece to see what some economists are saying. Here he talks about the Labor Market and whether the job growth is meaningful.

Enclosure #3 – Our last enclosure comes from our own Leonard Weiss – here he talks about recession fears and how they are portrayed in the media.

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It is not possible to invest directly in an index. The S&P 500 is an unmanaged index of 500 widely held stocks. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. Past performance may not be indicative of future results.

The S&P MidCap 400 provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500, measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

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International investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility.

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Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. 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.

Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and the products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

*Prices of DJIA and NASDAQ as of 10/10/2019

Labor Market Continues to Roar

In spite of all the fear-mongering about a recession, Friday's employment report clearly showed we are not in an economic downturn. The best news in the report was that the unemployment rate fell to 3.5%, the lowest most Americans have seen in their lifetimes.

Even better, the drop in joblessness was broad-based. The Hispanic unemployment rate fell to 3.9%, while the Black unemployment rate remained at 5.5%, both record lows. These figures are much better than in prior business cycles. The lowest Hispanic jobless rate in a prior expansion was 4.8% in 2006; the lowest Black unemployment rate in a prior expansion was 7.0% in 2000.

Workers age 25+ who lack a high school degree have an unemployment rate of 4.8%. This is a group whose jobless rate peaked at 15.8% back in 2010. Remember the new stories suggesting these workers would never find new jobs because of automation? As it turns out, that was bunk.

Some analysts will bemoan the tepid pace of payroll growth in September, but it's important to put the 136,000 jobs gained into context. First, the initial report on September payrolls has fallen short of consensus expectations in ten of the past twelve years. Second, September payrolls have a history of being revised higher. Since the economic expansion started, September has been revised up over the next two months by an average of 48,000, which, if that holds true this year, would put September roughly on par with the average pace of payroll growth seen over the past twelve months.

Remember all the talk a few years ago about how job growth was due to part-time work, not full-time jobs? That was never really true; instead, in our view, it was a case of some analysts letting their (in this case, conservative) political leanings get in the way of sound economic

analysis. But now the story about part-time job growth would be even more absurd. Part-time workers are only 17.1% of all employed workers, versus a peak of 20.1% back in 2010. Since 1980, the lowest part-timer share has been 16.7%, which the economy looks on-track to hit sometime in 2020.

Some analysts are focusing on the fact that average hourly earnings for all private-sector workers were unchanged in September, and are up 2.9% from a year ago, slightly slower than the 3.0% growth in the year ending in September 2018. But average hourly earnings for production and non-supervisory workers (who tend to be lower paid than other workers), rose 0.2% in September and are up 3.5% from a year ago, a clear acceleration from the 3.0% gain in the year ending in September 2018. If you've been hoping that a tighter labor market would help shrink the earnings gap between high- and low-income workers, that finally seems to be happening.

Eventually, the pace of job creation should slow down somewhat as we get a larger share of economic growth from rising productivity, which has accelerated in response to deregulation and lower tax rates. There is a limit to how far unemployment can fall, and how many workers, on average, join the labor force each month. Payroll growth of about 100,000 per month is probably enough to keep the jobless rate at 3.5%; by contrast, payrolls are up 179,000 per month in the past year while civilian employment, an alternative measure of jobs that includes small-business start-ups, is up 183,000.

In the meantime, look for plenty of good news to keep coming from the labor market. And when these unjustified recessions fears fade, long term bond holders are in for a rude awakening.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-7 / 2:00 pm	Consumer Credit– Aug	\$15.0 Bil	\$18.5 Bil		\$23.3 Bil
10-8 / 7:30 am	PPI – Sep	+0.1%	+0.1%		+0.1%
7:30 am	“Core” PPI – Sep	+0.2%	+0.1%		+0.3%
10-10 / 7:30 am	Initial Claims – Oct 5	218K	214K		219K
7:30 am	CPI – Sep	+0.1%	+0.1%		+0.1%
7:30 am	“Core” CPI – Sep	+0.2%	+0.2%		+0.3%
10-11 / 7:30 am	Import Prices – Sep	-0.1%	-0.2%		-0.5%
7:30 am	Export Prices – Sep	-0.1%	0.0%		-0.6%
9:00 am	U. Mich Consumer Sentiment- Oct	92.0	93.7		93.2

INVESTMENT STRATEGY QUARTERLY QUICKVIEW

OCTOBER 2019

THEMES



Trade Like a Dragon, Tweet Like an Eagle

This summer saw rapid escalation in the trade fight between the US and China. Three driving forces of elevated hostility were President Trump's frustration with China's lack of follow through, the trade conflict taking on elements of a battle for primacy in global affairs, and trade issues taking on greater political significance. Some progress remains possible over the next year – particularly on more clear-cut issues such as fentanyl flows or agricultural purchases. We believe a broad-scale deal will continue to be elusive until after the 2020 election, given the complicating factors.



Regarding Recessions

While recessions are inevitable, the economy is never 'due' for one. In other words, the likelihood of entering a downturn does not depend on the length of the expansion preceding it. The yield curve has historically been the single best predictor of recessions and while several points on the curve are currently inverted, there are few signs the overall economy is currently in a recession. Job gains and wage growth have remained strong, and consumer spending (68% of GDP) should provide support for overall economic growth in the near term.



International: Brexit, Tariffs, and Protests, Oh My!

Change is a constant but also can induce uncertainty. Across the UK, Germany, Italy, Hong Kong and many other countries, we are seeing the political, economic and social impacts of an evolving world. These challenges are going to keep on coming in new and varying ways in the 2020s. The challenge for leading politicians and other policymakers is to devise ways to embrace change more as an opportunity than a threat.



In Limbo: How Low Can Interest Rates Go?

Yields around the globe have fallen precipitously in the last year largely as a consequence to struggling global economies and central bank responses. Despite lower interest rates, it is imperative that investors maintain asset allocation discipline. Individual bonds can provide consistent income, predictable cash flow, and greater preservation of principal. These features hold true at any interest rate level.



Sending the Right Signals?

The US Treasury market is one of the most liquid and efficient debt markets in the world and investor activity and preferences therein provide important insights into the economic outlook and inflation expectations. To wit, a collapse in global yields, together with a massive rally in the benchmark 10-year US Treasury note, is indicative of a significant global economic slowdown and muted inflation.

For more information, refer to the full [Investment Strategy Quarterly](#).

Economic Snapshot

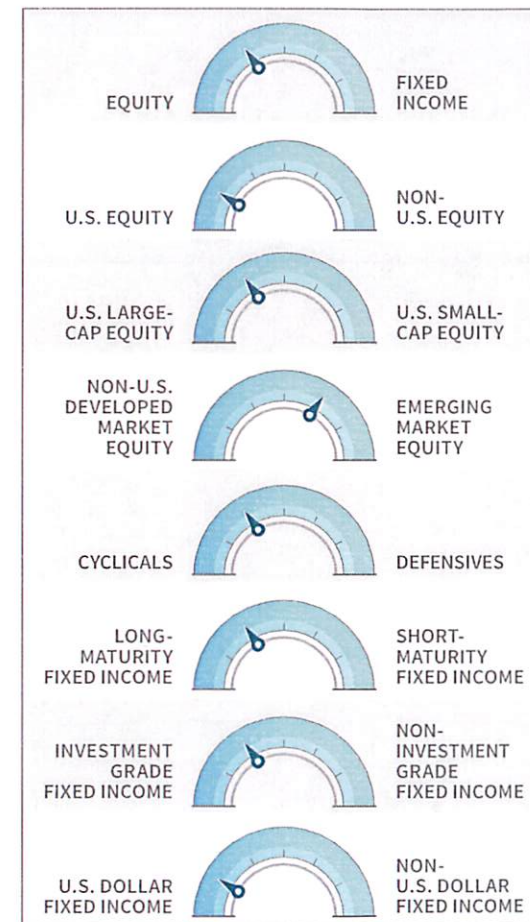
Economic Indicator

FAVORABLE	EMPLOYMENT
	CONSUMER SPENDING
	HOUSING AND CONSTRUCTION
	THE DOLLAR
NEUTRAL	GROWTH
	BUSINESS INVESTMENT
	MANUFACTURING
	INFLATION
	MONETARY POLICY
	LONG-TERM INTEREST RATES
	FISCAL POLICY
	REST OF THE WORLD

From Scott Brown, Ph.D.,
Chief Economist, Equity Research

Tactical Outlook

(3-9 months)



The tactical asset allocation outlook above reflects the Raymond James Investment Strategy Committee's recommendations for current positioning. Your financial advisor can help you interpret each recommendation within this material relative to your individual asset allocation policy, risk tolerance and investment objectives.

INVESTMENT STRATEGY QUARTERLY QUICKVIEW

OCTOBER 2019

Capital Markets Snapshot

EQUITY	AS OF 9/30/2019*	3Q 2019 RETURN**	12-MONTH RETURN
DOW JONES INDUSTRIAL AVERAGE	26,916.83	1.83%	1.73%
S&P 500 INDEX	2,976.74	1.69%	2.15%
NASDAQ COMPOSITE INDEX	7,999.34	0.18%	0.58%
MSCI EAFE INDEX	1,889.35	-1.00%	-4.26%
RATES	AS OF 9/30/2019	AS OF 6/30/2018	AS OF 9/30/2018
FED FUNDS TARGET RANGE	2.25-2.50	2.25-2.50	2.00-2.25
3-MONTH LIBOR	2.11	2.32	2.40
2-YEAR TREASURY	1.63	1.73	2.81
10-YEAR TREASURY	1.69	2.00	3.05
30-YEAR MORTGAGE	3.65	3.80	4.57
PRIME RATE	5.00	5.50	5.25
COMMODITIES	AS OF 9/30/2019*	3Q 2019 RETURN**	12-MONTH RETURN
GOLD	\$1,489.90	5.41%	25.10%
CRUDE OIL	\$54.07	-7.53%	-26.18%

*Price Level
**Total Return

Sector Snapshot

	SECTOR	S&P WEIGHT
OVERWEIGHT	INFORMATION TECHNOLOGY	21.8%
	HEALTH CARE	13.8%
	COMMUNICATION SERVICES	10.5%
EQUAL WEIGHT	FINANCIALS	13.1%
	CONSUMER DISCRETIONARY	10.0%
	INDUSTRIALS	9.3%
	ENERGY	4.6%
	REAL ESTATE	3.2%
UNDERWEIGHT	CONSUMER STAPLES	7.4%
	UTILITIES	3.5%
	MATERIALS	2.7%

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ALTERNATIVE INVESTMENTS involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements. There is no guarantee that any of the alternative strategies listed will be successful or that they will prevent loss.

INDEX DESCRIPTIONS: Please note that all indices are unmanaged and investors cannot invest directly in an index. An investor who purchases an investment product which attempts to mimic the performance of an index will incur expenses that would reduce returns. Standard & Poor's 500 (S&P 500): Measures changes in stock market conditions based on the average performance of 500 widely held common stocks. Represents approximately 68% of the investable U.S. equity market. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The MSCI EAFE (Europe, Australia, Far East) index is an unmanaged index that is generally considered representative of the international stock market. The returns noted do not include fees and charges which will affect an investor's return.

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Recession Fears Possibly Overblown?

By: Leonard Weiss

I would not be the first person to write that stock market volatility is tied to the emotions of greed (optimism) and fear (pessimism). In this piece, I'd like to drill down on the recent spate of media coverage concerning if/when the next recession will start, and what would trigger it.

While it is possible to worry our way into a recession, the overwhelming majority of economic reports I follow have maintained the positive momentum present in the last two years. The economy is doing very well.

Remember, a recession is confirmed when the GDP is reported negative for two consecutive quarters (six months). Last quarter's GDP growth was 2%, so we can't be in a recession now and I think not for several quarters to come.

The media is usually misguided on the topic. Some of us say that economists "have successfully predicted 7 of the last 2 recessions"! This media push has been so one sided, I wonder what the media's real motive is in pushing a certainty that cannot be successfully forecast.

Below are a few samples of the coverage from the last few weeks:

"RECESSION FEARS HIGHEST IN 8 YRS" BofA-ML

"WHY EVERYONE'S WORRIED ABOUT A RECESSION AGAIN"- Vox

"PARTS OF AMERICA MAY ALREADY BE FACING RECESSION"- The Economist

"HOW THE RECESSION OF 2020 COULD HAPPEN"- NY Times

And my favorite:

"A SELL-OFF WORSE THAN DECEMBER CAN ARRIVE IN A WEEK, SAYS ANALYST WHO IS PREDICTING A 'LEHMAN-LIKE' DROP" - CNBC

Whatever the media's motive, all of these doom and gloom stories may be a positive for investors.

The fact of the matter is that when pessimism rises it helps a bull market. It's called the "Wall of Worry". Pessimism leads investors to reduce stock holdings. This is usually seen as equity outflows from mutual funds and ETFs in favor of bonds and cash. We saw much of this in Q2 of this year. Professionals were scratching their heads on why a segment of investors were leaving the stock market while it's rising. This can be viewed as some investors acting on their pessimism.

After these large outflows, the equity markets went to new highs in July. Those who sold missed the subsequent run to new highs, and these assets will probably come back into equities albeit at higher prices than when they were sold.

On August 23rd, the DOW dropped 800 points, and the media had a field day using the decline as a bellows for their narrative. But they didn't report just four trading days later the DOW had recovered all the loss, even though one of the four days was down (-170 Aug 27th). For some reason the drop was more important than the rise!

This piece was written on September 9, 2019. The DOW is approximately 475 points higher than the closing price the day before the 800 point decline. Yet, not much media coverage of a market within inches of its all-time highs at this time.

We say again: pessimism fuels a bull market. As long as pessimism rises, even 10 years past the last bottom, I think the bull market can extend itself. One way to see this pessimism is looking at the weekly report on investor sentiment in the American Association of Individual Investors (AAII). In their reading Friday September 6th, there were two bears for each bull. By many measures, pessimism abounds.

But one day, everyone will be euphoric with an up market, stock tips given by Uber/Lyft drivers, and a sense that the market can go up forever. Think 1999. This would be a great cause of concern.

Sir John Templeton, one of the most prolific investors of the last century noted:

"Bull markets are born in pessimism, grow on skepticism, mature on optimism and die in euphoria".

You can decide what phase we're in at this time.