Investment Update

2019 Third Quarter Update

October, 2019

Review: Despite an increase in market volatility, the S&P 500 managed to generate a positive return of +1.7% in Q3 2019. Similar to Q2, the market declined when US-China trade tension escalated and then recovered when signs of a possible détente emerged. Recent re-escalation of trade tensions is leading to further concerns about weakening global growth and resulted in a sharp rally in the bond market in August, with the Barclays Aggregate Index finishing the quarter up 2.3%. The Federal Reserve cut interest rates twice by 0.25% in both July and September, and the market anticipates another cut by year end as the Fed continues a "midcycle adjustment" to extend the US economic expansion.

Period	3Q19	2Q19	1Q19	2018
S&P 500	1.7%	4.3%	13.6%	-4.4%
MSCI EAFE[1,2]	-1.0%	4.0%	10.1%	-13.4%
MSCI Emerging Markets[2]	-4.1%	0.7%	10.0%	-14.3%
Barclays U.S. Aggregate Bond	2.3%	3.1%	2.9%	0.0%
Barclays Municipal Bond	1.6%	2.1%	2.9%	1.3%

[1]Europe, Australia, Far East

[2]MSCI returns are in U.S. Dollars

Earnings Growth Has Driven the Market Higher Over the Past Year

On a year-to-date basis, the S&P 500 is up over 20%, and almost all of that return has been driven by multiple expansion—i.e., higher valuation as measured by Price/Earnings. However, it is important to remember that most of that return was simply a recovery of the 13.5% decline in Q4 2018, which, as discussed in previous Investment Updates, was largely a function of messaging and policy actions of the Fed. Similarly, even though multiple expansion is responsible for driving most of the year-to-date return, the S&P 500 forward P/E multiple is actually down from a year ago. By extension, this means that earnings growth has been positive, albeit at a slower pace than 2018.

The chart on the next page illustrates the volatility resulting from the Fed and US-China trade tension over the past year. The Fed's more accommodative stance makes it less likely that we see another Fed-driven decline in the near term. The key question at this point is whether economic growth will be robust enough to drive continued earnings growth going forward.

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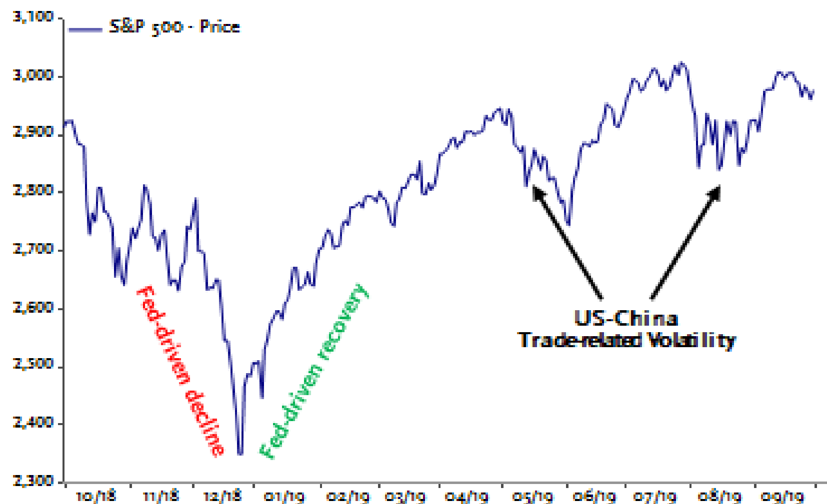

Outlook: To date, US economic data still appear to be healthy, particularly at the consumer level. While we recognize that some consumer data can lag, we are encouraged by a few other indicators that have tended to lead in prior economic cycles. For example, both truck freight volumes and consumer debt delinquency are not showing signs of a slowdown or distress. One potential area of caution that we continue to monitor closely is in durable goods orders, where growth—excluding Transportation, which has been impacted by the Boeing 737 MAX issues—has decelerated versus 2018 yet is still positive. This deceleration is most likely explained by the uncertainty and increased costs associated with the US-China dispute.

We continue to monitor economic growth outside the US as well as the impact of stimulus efforts in China and Europe. International data have been less encouraging than what we have seen in the US, which leads us to believe that if stimulus efforts are unsuccessful at reinvigorating growth, we could see a repeat of 2015-16, where weaker international economic growth led to a slowdown in US industrial growth.

Given these current dynamics, we believe that trade policy and global central banks will continue to be the primary drivers of market moves in the near future. On those fronts, October promises to be an important month, with US-China trade negotiations expected to resume and a possible rate cut by the Fed at their month-end meeting.

Strategy: We continue to prefer domestic equities in the near term given the better economic conditions in the US. In fixed income, due to further declines in yields during the quarter, we continue to see more value in shorter maturities.