Investment Update

October 2019 Review and Outlook

After declining in August, domestic equity markets rose in September. The S&P 500 stock index gained 1.87% for the month. The international developed equity markets (MSCI EAFE Index) also rose, with the MSCI EAFE Index up 2.92% for the month. The markets continued to be volatile due to uncertainty around the ongoing trade dispute with China, monetary policy, slowing global economic growth and political uncertainty. The recent impeachment inquiry launched by Congressional Democrats also weighed on markets, fearing it may weaken the President’s trade negotiations with China.

A number of recent data releases continue to suggest economic growth is positive but decelerating in the U.S. In early October, manufacturing and service sector data suggested the domestic economy is slowing. Central banks continue to be accommodative, especially in the U.S. where, as expected, the Federal Reserve reduced its short-term interest rate target at its September meeting. Overseas, the uncertainty regarding Brexit also weighed on global equity markets. As presidential campaign rhetoric accelerates, it may cause volatility to elevate in the near term.

Overall, the domestic economy is currently benefitting from a healthy labor market, low interest rates, and benign inflation. Historically, the combination of these macroeconomic factors, together with the pro-business regulatory philosophy of the Trump administration, has led to a favorable environment for equities.

The consumer sector, which represents approximately 70% of gross domestic product (GDP), has been resilient. We do not expect a recession in the short term given the economy’s current strength. We are actively monitoring several economic indicators such as business confidence, capital spending and employment activity as the risk of a recession has recently elevated. Of course, circumstances can change without notice.

Fixed-income investments lost 0.37% in September, as measured by Barclays Intermediate Government Credit Index. The yield on 10-year Treasury notes rose to 1.68%, up 0.18% since the end of August.

Here is our economic and financial market perspective:

Volatility – We expect volatility to remain elevated due to the level of uncertainty on a number of macro items cited above, especially trade negotiations with China.
Corporate Profits – Third-quarter earnings reports will be a key data point for the markets in the coming weeks. S&P 500 earnings are expected to decline 3.7% according to FactSet. This would be the third consecutive quarter with a decline in year-over-year earnings.

Interest Rates – The yield on 10-year Treasury notes has fallen from 2.69% at year-end to 1.59% in early October. The financial markets now expect the Federal Reserve may cut interest rates two additional times in 2019. The Fed has indicated it will continue to be data dependent and patient.

Consumer Confidence – The Conference Board’s consumer confidence index fell sharply in September to 125.1 from 134.2 the previous month. It was the largest monthly decline in nine months and was partly attributed to the escalation in trade tensions between the U.S. and China. Consumer confidence and sentiment have eroded recently due to uncertainty with tariffs and financial market volatility.

Economic Growth – The most recent report of second-quarter GDP reflected economic growth at 2.0%, down slightly from the initial report of 2.1% and lower from the first quarter’s 3.1% rate. Second-quarter GDP was expected to slow as several recent economic indicators were suggesting a slower economy. The economy is expected to grow approximately 2.0% for the full calendar year 2019.

Employment – Payrolls increased by 136,000 in August. The most recent official unemployment rate fell to 3.5%, which is the lowest reading since December 1969. The longer term employment-growth trend has been at healthy levels, reflecting a growing economy.

Housing – In the most recent report, housing starts increased 12.3% over the previous month. Pending home sales increased 1.6% in August and were up 2.5% over the previous year. The housing market may be benefitting from lower interest rates. We continue to be cautious as this important sector of the economy has moderated over the past year.

Economic and Financial Market Outlook

Economy – Several economic indicators continue to suggest the U.S. economy is decelerating. Importantly, we do not anticipate a recession in the near term, unless the trade war with China significantly escalates. The economy has been led by a resilient and confident consumer sector and strength in employment. Inflation remains at historically low levels, and interest rates continue to be low. Uncertainty regarding the eventual outcome of trade negotiations with China may cause businesses to delay capital expenditures, creating a drag on domestic and global economic growth. Trade negotiations are expected to resume on Oct. 10. It appears that the uncertainty of the tariffs and trade negotiations with China is an issue that will be with us for several months, likely extending after the Presidential election in 2020.

Financial Markets – We expect the markets will continue to be volatile in the short term due to a number of uncertainties, especially the issue of trade and tariffs with China. We’re in a period of the year when markets have generally exhibited volatility. As equity markets have recently sold off, interest rates have fallen. Third-quarter earnings reports and the associated outlooks are likely to be a key determinant of the market’s direction in the near term. We continue to be bullish over the longer term despite increased uncertainty in the near term. Having a well-diversified portfolio should continue to serve investors as we move into autumn.