IM&R Economic and Market Review Q2 2019

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Economic Review

No longer "patient", Chairman Powell and the Fed kept interest rates unchanged but left the door open to future cuts as eight members are now favoring some additional easing by the end of the year. Powell made the case that a somewhat more accommodative policy has strengthened as a result of trade developments and concerns about global growth.

The US expansion is now officially the longest, breaking the record of 120 months of economic growth from March 1991 to March 2001, according the National Bureau of Economic Research (NBER).

Real gross domestic product (GDP) increased at a robust annual rate of 3.1% in the first quarter according to the Bureau of Economic Analysis. In the fourth quarter real GDP increased 2.2%. Economists project growth to moderate further in the second quarter with the latest Atlanta Fed GDPNow forecast at 1.5%.

The Conference Board Leading Economic Index (LEI) was unchanged in May, following three consecutive increases. While the economic expansion is now entering its eleventh year, the LEI clearly points to a moderation in growth towards 2 percent by year-end says the Director of Economic Research at the Conference Board.

Personal Consumption Expenditures (PCE), the Fed's preferred inflation gauge, remains stubbornly below the Fed's 2% target rate. The broad PCE was up 1.52% from a year earlier while core PCE (less Food and Energy) was up 1.60%.

Pending home sales increased 1.1% May, a positive variation from the minor sales dip seen in the previous month. The National Association of Realtor's chief economist said consumer confidence about home buying has risen and lower mortgage rates create extremely attractive conditions for consumers.

June was the third straight month with slowing manufacturing according to the latest *Manufacturing ISM® Report On Business.* Respondents expressed concerns about US-China trade turbulence, potential Mexico trade actions and the global economy.

Consumer confidence declined in June as households with incomes in the top third more frequently mentioned the negative impact of tariffs. Most of the slippage was in prospects for the national economy, with the unemployment rate expected to inch upward in the year ahead according to the University of Michigan Survey of Consumers.

Financial Markets Review: Domestic Stock Market

Following the best first quarter in 21 years, U.S. stock markets continued to power forward in the second quarter with the Dow and S&P 500 posting their best June in 81 and 64 years, respectively. The Nasdaq Composite recorded its best June in nearly two decades. For the quarter, the S&P 500 advanced 3.79% excluding dividends to 2,941.76. The Nasdaq closed at 8,006.24, up 3.58%. The Dow Jones Industrial Average finished the quarter 2.59% higher to 26,599.96.

Only one of the eleven S&P sectors was negative in the second quarter. The S&P 500 sectors with the highest returns were financials (+8.00%), materials (+6.31%) and information technology (+6.06%). Laggards included energy (-2.83%), health care (+1.38%), and real estate (+2.46%).

Growth stocks continued their domination over value stocks in both the large and small-cap space. The growth style has outperformed value over the past one, three, five and ten years.

The Walt Disney Co. was the strongest holding in the Dow Jones Industrials Average for the quarter jumping 25.77%, followed by Microsoft (+13.97%) and Walmart (+13.29%). Double digit losers were 3M Co (-15.88%), Walgreens Boots Alliance (-12.90%), and Intel (-10.27%).

The best performing S&P industries for the quarter were health care technology (+28.12%), diversified consumer services (22.39%), and construction materials (15.54%). The worst performers were tobacco (-12.65%), independent power and renewable electricity producers (-11.93%) and energy equipment & services (-10.00%).

Looking ahead, fears about slowing growth, volatility, the yield curve, earnings, geopolitics, trade wars, and fragile trade truces will be closely watched. The economic expansion continues to decelerate with manufacturing momentum fading. The Federal Reserve is under increasing pressure to cut interest rates, and any further disappointing data will increase the likelihood of one or more rate cuts in the coming months. The Iran conflict, on-going Brexit mess, and possible further US tariffs on foreign goods add to the list of anxieties.

Against these concerns, Wall Street continues to climb a wall of worry. The accommodative stance of the Fed and other dovish policy makers, low inflation, a strong labor market, reasonable market valuations supported by low interest rates, and a slowing but still growing economy leave markets ready to ride this roller coaster higher in the quarter ahead.

	Total Returns (06/30/19)			Annualized Returns (06/30/19)		
Category/Style	**2nd Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
S&P 500	4.30	18.54	10.42	14.19	10.71	14.70
S&P Midcap 400	3.05	17.97	1.36	10.90	8.02	14.64
S&P Small Cap 600	1.87	13.69	-4.88	11.97	8.41	14.99
Russell 1000 Large Cap Growth	4.64	21.49	11.56	18.07	13.39	16.28
Russell 1000 Large Cap Value	3.84	16.24	8.46	10.19	7.46	13.19
Russell 2000 Small Cap Growth	2.75	20.36	-0.49	14.69	8.63	14.41
Russell 2000 Small Cap Value	1.38	13.47	-6.24	9.81	5.39	12.40

Source: Standard and Poor's, Frank Russell Company

International Stock Markets

The performance of the global manufacturing sector continued to weaken at the end of the second quarter. Production fell for the first time since October 2012, as new orders contracted at the fastest pace in almost seven years and business optimism slumped to record lows.

Pointing out that risks to global growth still tilt to the downside, the International Monetary Fund's (IMF) latest update projects that the global economy will slow to 3.3% this year before returning to 3.6% in 2020.

For the second quarter, the MSCI EAFE Index of developed markets continued to advance gaining 3.68%. Emerging markets, however, struggled with the MSCI Emerging Markets Index returning a paltry 0.20%. The MSCI Frontier Markets Index led this group for the three month period with an increase of 4.69%.

Looking to international stock market indexes, in the Eurozone the Euro Stoxx Index was up 2.42% for the quarter to 375.82. Among key Euro members, France's CAC-40 Index returned 3.52% (in local currency) to 5,538.97. Germany's DAX Index increased 7.58% to 12,398.80 and the UK's London FTSE 100 Index was higher by 2.01% to 7,425.63 as the seemingly endless Brexit saga continued.

Asia-Pacific markets also advanced in the second quarter. In developed markets, Japan's Nikkei stock index edged up 0.33% to 21,275.92, while India's emerging market S&P BSE Sensex index increased 1.87% to 39,394.64. China's stimulus measures were not enough to offset the impact of trade tariffs as the Shanghai Composite Index fell 3.61% to 2,978.88.

The Dow Jones Americas index climbed 3.69% for the quarter to 697.79. Canada's S&P/TSX index increased 1.74% (in local dollars) to 16,382.20 and Mexico's S&P/BMV IPC Index dipped 0.28% to 43,161.17. Brazil's Sao Paulo Bovespa Index jumped 5.82% to 100,967.20.

The dollar weakened 0.60% to 89.58 against world currencies in the second quarter according to the WSJ Dollar Index. The dollar dropped 2.67% against the yen to 107.89 (JPY/USD) and was 1.35% higher versus the euro at $1.137 (USD/EUR).

World Bond Markets

The yield curve remains inverted with the 10 year/3-month Treasury spread at 0.12%. A yield curve inversion is a well-known precursor of a recession. The U.S. 10-year note yield plunged 0.42% to 2.00% at the end of the quarter and the 3 month yield stood at 2.12%. As a result of the yield drop, bond prices rose and the Barclays U.S. Aggregate Bond Index gained 3.08% for the quarter. Likewise, the Barclays Municipal Index gained 2.14% and the Barclays U.S. Treasury TIPS Index added 2.86%. The average money market yield was 2.18% according to the Crane 100 Money Fund Index at the June close.

Yields on most foreign bonds also continued to fall in the second quarter, with the 10-year bond yield sliding below one percent to 0.83% in the U.K. and Canadian 10-year bonds edged down to 1.50%. Yields in Germany and Japan went further into negative territory with Germany down a quarter percent to -0.30%, and Japan lower by 0.07% to -0.14%.

Commodities

After a strong first quarter, commodities as a group moved 0.25% lower in the second quarter to 619.41, as measured by the DJ commodity index.

Lower interest rates and confrontations between the US and China catapulted gold to a six year high as it broke through $1,400 climbing $116.60 (9.02%) for the quarter to end the period at $1,409.70.

Wedged between escalating Mideast tensions and slower growth, crude oil slid 2.77% or $1.67/barrel to $58.47 in the quarter. According to the American Automobile Association (AAA), the national average price of gas ended the three-month period relatively flat at $2.72. Mississippi recorded the lowest prices at $2.32 while California remained the highest at $3.76.

Mutual Funds/Exchange-Traded Funds

According to the Investment Company Institute (ICI), for the 12 months ended May 2019 net mutual fund total assets increased $131 billion to $19.1 trillion, and the number of funds increased by 118 to 8,044. Exchange-Traded Funds (ETFs) gained $175 billion in assets to $3.7 trillion and 141 new funds to a total of 2,033.

MUTUAL FUNDS OVERVIEW AS OF JUNE 30, 2019

	Total Returns		Annualized Returns			
Category	2nd Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
Municipal Bond Interm-Term	2.05	4.84	5.92	2.05	2.99	4.07
Short-Term Taxable Bond	1.47	3.19	4.17	1.96	1.60	2.47
Interm.-Term Taxable Bond	2.83	5.77	7.24	2.09	2.56	3.86
Long-Term Taxable Bond	6.02	13.14	13.05	4.41	5.37	7.77
High Yield Bond	2.26	8.76	6.17	6.30	3.45	7.95
World Bond	2.95	5.43	5.00	2.18	0.58	3.09
Small-Cap Blend	2.19	15.70	-3.74	10.10	5.67	12.70
Mid-Cap Blend	3.00	17.50	2.37	9.96	6.02	12.87
Large-Cap Blend	3.80	17.20	8.19	12.51	8.75	13.24
World Large Stock	3.53	16.46	4.87	11.06	5.95	10.24
Foreign Large Blend	2.95	13.56	-0.08	8.11	2.00	6.39
Natural Resources	0.13	11.84	-8.43	5.54	-2.62	5.38
Real Estate	1.96	18.43	10.52	4.61	7.24	14.53

Source: Morningstar Category Returns, Morningstar, Inc.

Important Definitions and Disclosures

The opinions and material presented are provided for informational purposes only. No person or system can predict the market. Neither asset allocation nor diversification guarantee a profit or protect against a loss. All investments are subject to risk, including the risk of principal loss. There is no assurance that the investment goals and process described herein will consistently lead to successful investing. Asset allocation and diversification do not eliminate the risk of experiencing investment losses. The investment return and principal value of an investment will fluctuate, and an investor's shares, when redeemed, may be worth more or less than their original cost. Funds that invest in stocks of small-cap or mid-cap companies involve additional risks. The securities of these companies may be more volatile and less liquid than the securities of larger companies. Funds that invest in international securities involve special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investment in emerging markets may accentuate these risks. Alternative strategies, including those used in mutual funds, have risks that may substantially increase the potential for loss. Bonds are subject to interest rate risk. Bonds have interest rate risk and credit risk. As interest rates rise, existing bond prices fall and can cause the value of an investment to decline. Changes in interest rates generally have a greater effect on bonds with longer maturities than on those with shorter maturities. Funds that hold bonds are subject to declines and increases in value due to general changes in interest rates. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and/or interest payments.

The information shown does not constitute investment advice and does not consider the investment objectives, risk tolerance or financial circumstances of any specific investor. The information provided is not intended to be a complete analysis of every material fact with respect to any portfolio, security, or strategy and has been presented for educational purposes only. Data obtained from the sources cited is believed to be reliable and accurate at the time of compilation. Nothing contained herein should be construed as a recommendation to buy or sell any individual securities. It should not be assumed that an investment in any of the securities identified was or will be profitable.

The **National Bureau of Economic Research (NBER)** is a private, non-profit, non-partisan research organization whose main aim is to promote a greater understanding of how the economy works. It disseminates economic research among public policymakers, business professionals, and the academic community. **Gross Domestic Product** (GDP) is a measure of output from U.S factories and related consumption in the United States. It does not include products made by U.S. companies in foreign markets. **Real Gross Domestic Product** (real GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). The **Atlanta Fed GDPNow** estimate is a model-based projection not subject to judgmental adjustments. It is not an official forecast of the Atlanta Fed, its president, the Federal Reserve System, or the Federal Open Market Committee. **The Conference Board Leading Economic Index® (LEI)** for the U.S. are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components. **Personal Consumption Expenditures** (PCE) is a measure of price changes in consumer goods and services and consist of the actual and imputed expenditures of households; the measure includes data pertaining to durables, non-durables and services. The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM). The ISM Manufacturing Index monitors employment, production, inventories, new orders and supplier deliveries. A composite diffusion index monitors conditions in national manufacturing and is based on the data from these surveys. The **Federal Reserve System** (also known as the Federal Reserve, and informally as the Fed) is the central banking system of the United States. The Federal Reserve System is composed of 12 regional Reserve banks which supervise state member banks. The Federal Reserve System controls the Federal Funds Rate (aka Fed Rate), an important benchmark in financial markets used to influence the supply of money in the U.S. economy. The **Federal Open Market Committee** (FOMC), a committee within the Federal Reserve System is charged under United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities). The **S&P/Case-Shiller Home Price Indices** are the leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate both nationally as well as in 20 metropolitan regions. The **unemployment rate** percentage of total workforce who are unemployed and are looking for a paid job. Unemployment rate is one of the most closely watched statistics because a rising rate is seen as a sign of weakening economy that may call for cut in interest rate. A falling rate, similarly, indicates a growing economy which is usually accompanied by higher inflation rate and may call for increase in interest rates. Labor force participation rate is the percentage of working age population that is part of the labor force. It is a measure of what proportion of a country's population is employed or actively looking for employment. The index of leading economic indicators is intended to predict future economic activity. Typically, three consecutive monthly LEI changes in the same direction suggest a turning point in the economy. **Inflation** is the rise in the prices of goods and services, as happens when spending increases relative to the supply of goods on the market. Moderate inflation is a common result of economic growth. Hyperinflation, with prices rising at 100% a year or more, causes people to lose confidence in the currency and put their assets in hard assets like real estate or gold, which usually retain their value in inflationary times. **Treasury Yield Curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. **The Michigan Consumer Sentiment Index** was created in the 1940s is conducted by the Survey Research Center and consists of at least 500 telephone interviews posed to a different cross-section of consumers in the continental U.S. each month. The survey questions consumers on their views of their own personal finances, as well as the short-term and long-term state of the U.S. economy. The **International Monetary Fund** is an international organization that was initiated in 1944 at the Bretton Woods Conference and formally created in 1945 by 29 member countries. Each survey contains approximately 50 core questions, and each respondent is contacted again for another survey six months after completing the first one. The answers to these questions form the basis of the index. An exchange-traded fund (**ETF**) is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. Indexes are unmanaged and investors cannot invest directly in an index.

Morningstar Category Returns are composed of the average return for the funds in each Morningstar category over the indicated time period. Categories are defined by Morningstar based on holdings statistics. The category returns are adjusted for survivorship bias, meaning they include all investments even if liquidated, merged or otherwise now obsolete. The returns also include funds that were in a given Morningstar category, but have since changed to another category.

Benchmark Definitions

The **S&P 500 Index** is an index of 500 of the largest exchange-traded stocks in the U.S. from a broad range of industries whose collective performance mirrors the overall stock market. The **Dow Jones Industrial Average** is a widely watched index of 30 American stocks thought to represent the pulse of the American economy and markets. The **NASDAQ** is an index that tracks the cumulative results on a market capitalization basis of all stocks trading in the NASDAQ system. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment. The **S&P SmallCap 600 Index** (S&P600) covers roughly the small-cap range of U.S. stocks, using a capitalization-weighted index. The index covers roughly three percent of the total U.S. stock market. The **S&P MidCap 400 Index** (S&P400) is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the U.S. mid-cap equities sector and is the most widely followed mid-cap index in existence. To be included in the index, a stock must have a total market capitalization that ranges from roughly $750 million to $3.3 billion. The **Russell 1000 Index** is a capitalization-weighted price-only index, which is comprised of 1000 of the largest capitalized U.S.-domiciled companies whose common stock trade in the United States on the New York Stock Exchange, American Stock Exchange and NASDAQ which are included in the Russell 3000 Index. This large cap market-oriented Index is highly correlated with the S&P 500 Index. **Russell 2000 Index** is a market-value-weighted index representing the 2,000 smallest companies in the Russell 3000 index, representative of the U.S. small capitalization securities market. **NAREIT Equity Index** is comprised of real estate investment trusts which own or have an equity interest in rental real estate (rather than making loans secured by real estate collateral). REITs involve risk, including the loss of principal and the possible lack of liquidity. **Morgan Stanley Capital International** (MSCI) All Country World Index (ACWI) is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. **MSCI EAFE Index** is a market capitalization-weighted index of the leading stocks in Europe, Australasia and Far East. Membership of the index is selected by MSCI and designed for leading stocks roughly to match market sector weights. The **MSCI Emerging Markets Index** is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index that consists of indices in 21 emerging economies: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. The **MSCI Frontier Markets Index** provides broad representation of the equity opportunity set while taking investability requirements into consideration within each market. MSCI classifies 34 countries as Frontier Markets, 26 of which are included in the MSCI Frontier Markets Index. The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. The **CAC 40 Index** is a benchmark French stock market index. The index represents a capitalization-weighted measure of the 40 most significant values among the 100 highest market caps on the Paris Bourse (now Euronext Paris). The **DAX Index** is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The **FTSE 100** is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The **DJ Asia-Pacific Index** represents the leading stocks by dividend yield traded in the Asia/Pacific region. The **Nikkei Index** is a stock market index for the Tokyo Stock Exchange (TSE). The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. **S&P BSE Sensex index**, is the benchmark index of the Bombay Stock Exchange (BSE). It is composed of 30 of the largest and most actively-traded stocks on the BSE, providing an accurate gauge of India's economy. The **BM&F Bovespa**, also known as the Sao Paul Stock Exchange, is Brazil's stock exchange. It is the third largest stock exchange in the world by market value with over 500 companies traded on the exchange. The IBOVESPA is an index of about 50 stocks and is the main indicator of the Brazilian stock market's average performance. **S&P/TSX 60 Index** is a stock market index of 60 large companies listed on the Toronto Stock Exchange. Maintained by the Canadian S&P Index Committee, a unit of Standard & Poor's, it exposes the investor to ten industry sectors. **S&P/BMV IPC Index** seeks to measure the performance of the largest and most liquid stocks listed on the Bolsa Mexicana de Valores. The index is designed to provide a broad, representative, yet easily replicable index covering the Mexican equities market. The constituents are weighted by modified market cap subject to diversification requirements. In exchange for greater growth potential, investments in foreign securities can have added risks. These include changes in currency rates, economic and monetary policy, differences in auditing standards and risks related to political and economic developments. The **S&P Global BMI (Broad Market Index)** comprises the S&P Developed BMI and S&P Emerging BMI, is a comprehensive, rules-based index measuring global stock market performance. **Barclays Aggregate Bond Index** is made up of the Lehman Brothers Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Based Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million. The **Barclays Municipal Bond Index** is a market value weighted index of investment grade municipal bonds with maturities of one year or more. The **Barclays Capital U.S. Government Inflation-Linked Bond Index** (U.S. TIPS) measures the performance of the TIPS market. TIPS form the largest component of the Barclays Capital Global Inflation-Linked Bond Index. Inflation-linked indices include only capital indexed bonds with a remaining maturity of one year or more. Treasury notes (T-notes) are intermediate securities with maturities of 1 to 10 years. Denominations range from $1000 to $1 million or more. The notes are sold by cash subscriptions, in exchange for outstanding or maturing government issues, or at auction. **Barclays Capital Global Aggregate ex-U.S. Index** measures the performance of the global bond market, excluding U.S. securities. **Bloomberg Commodity Index:** is a world-production weighted total return index, including reinvested dividends, measuring investor returns from a fully-collateralized commodity futures investment. Due to market fluctuation, the commodities represented by this index may experience loss of invested principal and are subject to investment risk.