Market Performance

Stocks continued to perform exceptionally well in the second quarter despite continued trade tensions and slowing global growth. The S&P 500 Index advanced 4.30% in the quarter, bringing the year-to-date return to a robust 18.54%. Small stocks, as measured by the Russell 2000 Index, lagged the S&P 500 but still advanced 16.98% for the year to date. Growth stocks continued to outperform value stocks with growth returning 21.49% versus 16.24% for value for the year to date. Foreign stocks continued to underperform the S&P 500 with developed markets advancing 14.03% in the first half of 2019 and emerging markets returning only 10.58%.

The 10-year U.S. Treasury bond yield continued its descent during the quarter as the yield fell from 2.42% at the end of the first quarter to 2.00% at the end of the second quarter. Slowing global growth rates and well contained inflationary trends have significantly aided fixed-income returns. The strongest returns in the fixed-income market have come from emerging market debt (advancing 10.60% for the year to date) and high yield (up 10.12% year to date). The Bloomberg Barclays U.S. Aggregate Bond Index advanced 6.11% and municipal bonds returned 5.09% through the first half of the year.

Interest Rates

The federal funds rate was 2.40% at quarter end compared to the 10-year U.S. Treasury yield of 2.00%. This has resulted in the well published yield curve inversion.

U.S. Treasury Yield Curve

Data is obtained from Factset, Federal Reserve and J.P. Morgan Asset Management and is assumed to be reliable. Data presented is through June 30, 2019. Past performance is no guarantee of future results.

Despite President Trump’s jawboning of the Federal Reserve, the bond market’s message is that the Fed needs to reduce short-term interest rates. At least a quarter point cut possibly in late July or September seems almost a certainty at this point. We are hopeful that a modest cut may actually steepen the curve somewhat and eliminate the current inversion or at least flatten the curve out. Sustained inversions can have a negative impact on future economic growth.

Trade Tensions

Trade tensions around the globe involving China, Mexico and the European Union continued to escalate during the quarter. President Trump and Chinese President Xi appear to have called a truce for the time being with no further tariff escalations and some reductions in Huawei purchase restrictions in exchange for some unspecified agricultural purchases from China. We expect Chinese trade issues to continue to drag on at least through year end and perhaps longer. It is very difficult to estimate how much of a drag on global growth this has created over the last year, but it certainly hasn’t helped. Importantly, most of the negative impacts of these trade issues have been felt by agriculture and manufacturing industries globally. In the U.S., these are much smaller parts of the economy compared to the service and consumer sectors. The longer this dispute lasts the more companies will adjust their factories and supply chains accordingly so they are less impacted by this friction.

2020 Presidential Election

The Presidential election in 2020 is starting to have an impact on some sectors already. Health care, in particular, has been hurt by Democratic candidates’ proposals of “Medicare for all” and the elimination of private insurance. The election will certainly create headwind noise over the next year plus, but we will wait and see what, if any, impact this has on the health-care and/or technology sectors.
International Markets

Foreign economies continued to struggle to grow in the first half of 2019. German industrial activity is at or near a recession and the U.K.’s Brexit continues to create uncertainty. Ten-year yields in France, Germany, Japan, Netherlands and Switzerland are all negative, reflecting weak growth in Europe.

Global Earnings

Earnings Per Share, Local Currency, Next 12 Months, Jan. 2006 = 100

A trade resolution between the U.S. and China would certainly help German exports and provide some improvement to European growth. Although Chinese growth rates have moderated, the transition from investment and export-led growth to the consumer is continuing unabated.

Chinese Economic Growth

Chinese Real GDP Contribution Year-Over-Year % Change

Corporate growth rates in the U.S. grew modestly in the first quarter and we still believe S&P 500 earnings can advance in the mid single-digit range in 2019. Investors weren’t rewarded for outstanding earnings growth in 2018 (+20% growth) with the S&P 500 declining over 4%. Corporate margins have not fallen apart in 2019 and this has caused stock returns to catch up to actual earnings growth. Returns from here will be driven by prospects for continued earnings growth into 2020.

As always, we will invest your capital in high-quality companies that we believe will prosper over the long haul. We thank you for your trust and continued confidence in these more volatile times.

The S&P 500® Index is a market capitalization weighted index which includes 500 of the largest companies in leading industries of the U.S. economy. Growth stocks are represented by the Russell 1000® Growth Index which is a market capitalization-weighted index of growth-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. Value stocks are represented by the Russell 1000® Value Index which is a market capitalization-weighted index of value-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. Developed international markets are represented by the MSCI® EAFE Index which is a free float-adjusted market capitalization index that measures developed foreign market equity performance, excluding the U.S. and Canada. Emerging markets are represented by the MSCI Emerging Markets Index which is a free float-adjusted market capitalization index tracking the equity performance of global emerging markets. Municipal bonds are represented by the Bloomberg Barclays U.S. Municipal Index which covers the U.S. dollar-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds. The Bloomberg Barclays U.S. Aggregate Bond Index is a market value weighted index that tracks the daily price, coupon, pay downs and total return performance of fixed-rate, publicly placed, dollar-denominated and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. Performance is calculated on a total return basis with dividends reinvested. High yield is represented by the ICE BofAML U.S. High Yield Index which tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market. Emerging market debt is represented by the JPMorgan Emerging Markets Bond Index Global which is a benchmark index for measuring the total return performance of international government bonds issued by emerging market countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements.

This report is based on the assumptions and analysis made and believed to be reasonable by Advisor. However, no assurance can be given that Advisor’s opinions or expectations will be correct. This report is intended for informational purposes only and should not be considered a recommendation or solicitation to purchase securities. Past performance is no guarantee of future results.

Data is obtained from Factset, MSCI, Standard & Poor’s, Thomson Reuters and J.P. Morgan Asset Management and is assumed to be reliable. The earnings chart uses MSCI indices for all regions/countries, except for the U.S., which is the S&P 500. All indices use IBES aggregate earnings estimates. MSCI Europe includes the eurozone as well as countries not in the currency bloc, such as Norway, Sweden, Switzerland and the U.K. (which collectively make up 47% of the overall index). Data presented is through June 30, 2019. Past performance is no guarantee of future results.

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Douglas S. Foreman, CFA is Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has approximately 33 years of investment experience.

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