Market Summary

2Q 2019

The equity and fixed income markets are sending conflicting messages about the health of the economy. Equity markets, at least in the U.S., are approaching all-time highs and valuations appear slightly elevated, suggesting optimism about the future. However, the recent strength in bond markets and decline in interest rates suggest a flight-to-safety that usually only occurs during periods of pessimism.

A return to normal market relationships between stocks and bonds would suggest that either rates could rise again if the economy remains strong, or that stocks will fall as the economy weakens. We won't try to guess which market is correct in the short term. Investors should instead focus on their long-term investing goals. In equities, that means focusing on the subset of high-quality companies trading at attractive valuations based on their long-term (five to 10 year) earnings prospects. For bond investors, that means avoiding the temptation to reach for yield, and instead focusing on capital preservation.

Equities

The S&P 500 Index was up 4.3% during the second quarter and has returned 18.5% year-to-date. The quarter was volatile as the S&P 500 rose 4.1% in April, dropped 6.4% in May, and jumped 7.1% again in June. The market was especially reactive to uncertainty related to ongoing trade discussions between the U.S. and China. Equity markets sold off as trade talks took a negative tone, only to bounce back after the Federal Reserve indicated its willingness to ease off its rate hikes at least partially in response to concerns over trade. It is likely, in the short term, that the market will remain sensitive to unpredictable headlines and tweets related to trade talks.

The S&P Energy sector dropped 2.8% during the quarter but every other sector generated positive returns. Financial stocks were up 8%, while the technology sector returned 6.1%. The healthcare and real estate sectors were also relative laggards during the quarter but still eked out positive returns of 1.4% and 2.5%, respectively.

Many of the trends seen over the past several years persisted during the quarter. For example, value stocks continue to lag their growth counterparts. The Russell 1000 Value Index returned 3.8% during the quarter and 16.2% year-to-date, while the Russell 1000 Growth Index returned 4.6% and 21.5% during the same time periods.

Non-U.S. stocks also continue to lag domestic stocks. The MSCI EAFE Index rose 3.7% during the quarter, while the MSCI Emerging Markets Index gained 0.6%. Through the first half of 2019, the MSCI EAFE returned 14.0%, while the MSCI Emerging Markets Index returned 10.6%. Valuations continue to appear attractive for non-U.S. stocks relative to domestic equities, but much of the difference is due to variations in sector composition. For example, non-U.S. developed market indexes tend to include more exposure to slower-growing or cyclical industries, while U.S. equity markets emphasize faster-growing technology-driven firms.

Over the long term, equity returns will continue to depend on both underlying earnings growth and valuations. According to FactSet, analysts are predicting relatively modest 2.6% earnings growth for the S&P 500 in calendar year 2019, resulting in a forward price-to-earnings ratio for the Index of 16.9 times forward earnings, which is slightly above the 10-year average of 14.8 times earnings. Given the expectation of relatively slow earnings growth and elevated valuation levels, there is a higher likelihood of more modest returns over the coming years.

Fixed Income

Interest rates moved lower across the yield curve during the quarter, resulting in higher bond prices and decent returns for fixed income strategies. Two-year Treasury rates declined 0.53% to 1.74%, while 10-year Treasury rates fell 0.41% to end the quarter at 2.0%. The decline in rates came as market participants showed concern over potentially slowing economic growth, which caused the Federal Reserve to reverse course from their previously telegraphed intention to continue raising interest rates.

At the beginning of 2019, the market was pricing in multiple rate hikes by the Federal Reserve. However, six months later, at the end of the second quarter, the Fed futures market was implying a nearly 100% probability of a rate cut during the July FOMC meeting, with some investors expecting as much as a 0.50% cut. The rapid change in sentiment shows why it is extremely difficult to make investment decisions based on short-term economic trends.

The Bloomberg Barclays U.S. Aggregate Bond Index returned 3.1% during the quarter, while the Bloomberg Barclays U.S. Corporate Bond Index returned 4.5%. The Bloomberg Barclays Municipal Bond Index returned 2.1% during the quarter. Lower-quality bonds continued to generate decent returns as the Bank of America Merrill Lynch U.S. High Yield Index returned 2.6% during the quarter.

Commodities

Commodities were a mixed bag during the quarter. The Bloomberg Commodity Index declined 1.2% in large part due to oil prices falling from around $62 to as low as $51 per barrel of West Texas intermediate oil, before ending the quarter at $58 per barrel.

Gold prices fared much better than oil, and the LBMA Gold Price Index rose 8.8% during the quarter.

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Sources: MorningStar and Federal Reserve Bank of St. Louis

Important Information:
The **Standard & Poor's 500 Index**, often abbreviated as S&P 500, is an American stock exchange market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.
The **Russell 1000 Growth Index** is a broadly diversified index predominantly made up of growth stocks of large U.S. companies.
The **Russell 1000 Value Index** is a broadly diversified index predominantly made up of value stocks of large U.S. companies.
The **Russell 2000 Index** is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index. The index is maintained by FTSE Russell, a subsidiary of the London Stock Exchange Group.
The **Russell Microcap Index** measures the performance of the microcap segment of the U.S. equity market. It includes 1,000 of the smallest securities in the Russell 2000 Index based on a combination of their market cap and current index membership and it also includes up to the next 1,000 stocks.
The **MSCI EAFE Index** is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. and Canada.
The **MSCI Emerging Markets Index** is an index designed to measure equity market performance in global emerging markets.
The **Bloomberg Barclays US Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.
The **Bloomberg Barclays US Corporate Bond Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.
The **Bank of America Merrill Lynch High Yield Bond Index** tracks the performance of below-investment-grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.
The **Bloomberg Barclays U.S. Municipal Index** covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.
The **LBMA Gold Price Index** is the global benchmark for unallocated gold and silver delivered in London.
The **West Texas Intermediate (WTI)** oil, also known as Texas light sweet, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content.
Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements.

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