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Market Commentary

July 2019

THE MARKET

The S&P 500 reached a new all-time high on July 26th pushing its gains for the year to over 20%, which is the best performance during the first seven months of the year since 1997.[1]

The markets continued their growth in 2019 with the S&P 500 increasing another 1.31% in July, the DJIA climbing another 0.99%, and the NASDAQ finishing the month up 2.11%.

However, due to the strengthening dollar, commodities and international/emerging markets ended the month down. MSCI ACWI ex US which represents both developed and emerging market countries (excluding the United States) finished the month down 1.21% and the Bloomberg Commodities Total Return Index finished the month down 0.67%. The Barclays Aggregate Bond Index ended the month of July relatively flat.

Overall, the above-mentioned asset classes are all positive for the year as seen in the chart below.

ASSET CLASS	July*	2019 YTD*
S&P 500	1.31	18.89
DJIA	0.99	15.16
NASDAQ	2.32	23.99
MSCI International ACWI ex USA Net Real time	(1.21)	12.23
SPDR Barclays Aggregate Bond (SPAB)	(0.03)	4.70
Bloomberg Commodities TR	(0.67)	4.36

*Percent change as of July 31st, 2019 | Source (2)

In a rare occurrence, both equities and fixed income are having a great year.

2019 marks just the 10th time since 1980 that both the S&P 500 and long-term treasuries are up more than 5% to start the year.[3] (note: SPAB is used as a proxy for long-term treasuries when investing in fixed income). Gains occurring in both equities and fixed income during the same period is seen as unusual. When bond prices rise, their yields decrease, which is usually an indicator that an economic slowdown is ahead so one would normally pull back on their equity exposure and vice versa. However, uncertainty surrounding interest rates and what the Federal Reserve will do has led to positive performance in both stocks and bonds this year. Equity investors are still optimistic that the recovery will continue, while fixed income investors are a little more weary. Thus, causing investors to place money in both stocks and bonds.

SPEAKING OF INTEREST RATES

Investors had to wait until the last day of the month for the Federal Open Market Committee (FOMC) meeting to see whether the Fed would cut interest rates or not, and if so, by how much.

As discussed in last month's commentary, it was not a foregone conclusion that rates would be cut, but there was the strong possibility. Before diving into the outcome of the July 31st FOMC meeting, it is helpful to understand why the Fed decides to increase or decrease rates.

For the last 11 years, the Fed has either stood pat on interest rates or decided to increase them, which is seen as tightening monetary policy. Following the 2007 – 2009 Financial Crisis, the Fed cut rates to 0% in December of 2008, where they remained there for seven years.[4]

When interest rates are low, it means that it is cheaper to borrow money (for example, taking out a car loan is more appealing at 2% than at 10%). The reason for low rates is to stimulate the economy and encourage consumer spending. The federal funds rate is the rate at which banks and credit unions lend money to other depository institutions overnight. Rates on credit cards and home equity lines of credit are cheaper, along with rates on mortgages and other loans. In the same way, companies can borrow money cheaper and invest those funds to grow their business.

Both consumer and business spending increases which leads to economic growth. With the economy having experienced quite the recovery, since December of 2015, the Fed has slowly increased rates to a more normalized level in order to stabilize inflation or to slow the rapid growth of the economy. With the S&P 500 hitting an all-time high in July of 2019, many people are wondering why the rates are being cut? Even though the economy is healthy, it isn't behaving as expected with inflation and market-determined interest rates still lower than anticipated.[5] A rate cut would help to normalize both market-determined rates and inflation.

When all was said and done...

The Fed announced a 0.25% decrease of interest rates to a target range of 2.00 – 2.25%.[6] This is the first decrease since December of 2008.

Many investors, including the White House, thought that this should have been somewhat of an all or nothing rate change. Either don't cut rates at all or cut rates by 0.50% or more to signal that this would only be a one-time decrease.

The 0.25% rate cut left the remainder of the year up for interpretation and comments by the Fed Chair, Jerome Powell, which only seemed to confuse investors even more. Throughout his post-meeting press conference, he claimed that the rate cut was a mid-cycle adjustment and that future rate cuts were not a sure thing. These comments caused a quick decline in the stock market. He followed that up by later backpedaling in the same press conference which quickly caused the market to increase and recover the losses that it just incurred.[7]

This volatility during the short-term time frame of a press conference shows just how volatile the stock market can be with rate uncertainty. Overall, due to the non-transparent Fed, we believe investors can expect more market volatility in the month of August with a slightly bullish outlook on equities.

IN INTERNATIONAL NEWS

European Central Bank, Brexit, and China uncertainty dominate headlines

On July 2nd, Christine Lagarde was nominated as the new president of the European Central Bank (ECB) and she will be leaving her current position of director of the International Monetary Fund (IMF).[8] The ECB is the central bank of the 19 European Union countries that have adopted the euro. The IMF is an international organization headquartered in Washington, D.C., consisting of 189 countries with the goal of promoting economic global growth and financial stability, encouraging international trade, and reducing world poverty. The announcement of Lagarde's change in roles is arguably the biggest change in leadership for the international financial system in decades. Lagarde will leave the IMF in good shape having taken on a broad range of issues, while her task with the ECB will be a tall one. The European environment calls for someone not only with technical skills but with the political wherewithal to navigate the course. Can the ECB stabilize the European economy?

CHRISTINE LAGARDE

Boris Johnson was elected as Prime Minister of the United Kingdom on July 23rd following Theresa May's resignation.[9] Brexit led to May's resignation and it will undoubtedly be the focus of Boris' early months in office. He has taken a pro-Brexit stance and has been quoted as saying a Brexit deal will be reached "do or die" by the October 31st deadline. This could mean the U.K. leaves the European Union without a deal in place, although that is not the ideal scenario and is unlikely. Johnson could also bypass parliament. Regardless, Johnson is a brash figure and how he handles Brexit will matter overseas and here at home in the United States.

BORIS JOHNSON

U.S.-China trade talks remained stable with the two countries in a truce for most of July. However, on July 31st, face to face negotiations between China and the United States did not lead to a deal.[10] The topics of focus were forced technology transfer, intellectual property rights, non-tariff barriers and agriculture. Negotiations are expected to continue in September. However, Trump announced new tariffs on Chinese goods to start the month of August which led to China devaluing its currency on August 5th. The market did not react kindly to the news from China. Expect a more detailed update on the situation in next month's commentary.

MAINTAIN A DISCIPLINED APPROACH

With all the uncertainty surrounding interest rates, Brexit, US-China trade talks, and market volatility, it is wise to make sure that you maintain a disciplined investment approach.

Maintain the asset allocation that resulted from your risk tolerance questionnaire. It is never encouraged to try and time the market by pulling out funds based on news flashing across the television. Those are impulse decisions and often lead to underperformance in your account.

While it may make sense to increase or decrease your risk tolerance at times, please don't hesitate to consult a financial professional in order to make sure your investments are aligned with your goals and risk tolerance.

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[1] https://fortune.com/2019/07/29/there-have-been-two-times-in-history-stocks-have-been-this-expensive-1929-and-2000/

[2] https://www.investing.com/indices

[3] https://www.cnbc.com/2019/06/26/in-a-rare-occurrence-both-stock-and-bonds-are-having-a-great-year.html

[4] https://www.usatoday.com/story/money/2019/07/30/federal-reserve-why-does-fed-lower-interest-rates/1861483001/

[5] https://www.wsj.com/articles/why-the-fed-is-cutting-rates-when-the-economy-looks-good-11564392600

[6] https://www.federalreserve.gov/monetarypolicy/fomcpresconf20190731.htm

[7] https://www.wsj.com/articles/jerome-powells-off-the-cuff-approach-leaves-investors-on-edge-11564995600

[8] https://www.cnbc.com/2019/07/02/imfs-christine-lagarde-nominated-for-top-job-at-european-central-bank.html

[9] https://www.cnbc.com/2019/07/23/boris-johnson-who-is-the-new-uk-pm.html

[10] https://www.foxbusiness.com/economy/us-china-trade-war-timeline-latest-stock-reaction

*Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations for the respective strategies are shown gross of fees. If fees were included returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations. Unlike an actual performance record, they do not reflect actual trading, liquidity constraints, fees and other costs. Also, since the trades have not actually been executed, the results may have under- or overcompensated for the impact of certain market factors such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. Returns will fluctuate and an investment upon redemption may be worth more or less than its original value. Past performance is not indicative of future returns. An individual cannot invest directly in an index.