

## WEALTH MANAGEMENT

May 31, 2019

### What Happened in the Markets?

- US stocks fell to end the week, as the S&P 500 retreated 1.3% to close at 2,752. The other two major US averages were also lower on the day. The NASDAQ Composite dropped 1.5%, while the Dow Jones Industrial Average gave up roughly 350 points, or 1.4%.
- Equities continued their month-long pullback on Friday, closing at their lowest levels since March. Trade tensions remain a top-of-mind concern for investors, and an unexpected US announcement imposing 5% tariffs against Mexico in ten days opened up a new front in the ongoing conflict. The risk-off tenor translated into further gains for US treasury bonds. Finally, the recent re-inversion of the 10-year and 3-month portion of the yield curve has sparked concerns that the bond market is signaling an economic slowdown on the horizon.
- Nine of the 11 S&P sectors finished the session in the red. Real Estate (+0.8%), Utilities (+0.4%), and Health Care (-0.8%) outperformed on the day, while Communication Services (-2.0%), Energy (-1.6%), and Technology (-1.6%) lagged the broader market.
- Treasuries continued their recent rally as yields fell along the curve. The benchmark 10-year yield settled around 2.14% as of the 4 p.m. equity market close, retesting levels last seen in the fall of 2017. The prices of Brent (-3.6%) and WTI (-5.9%) Crude oil fell on the day, as trade fears weighed on commodities. It was WTI's worst day of 2019. The US dollar depreciated against its major peers as measured by the US Dollar Index, while the price of gold jumped 1.3%.

### Catalysts for Market Move

US equities closed lower on the day, as the S&P 500 dropped 1.3% and finished near the session lows. More than 75% of stocks in the index were negative on the day. Among the major US benchmarks, losses were steepest in the tech-heavy NASDAQ Composite, which fell 1.5%. The Dow lost 1.4% by comparison. Looking at investing styles, value stocks were roughly on par with growth based on the Russell 1000 Value and Growth indices. Large-cap stocks were also relatively in line with small-caps, as measured by the Russell 2000 and Russell 1000 indices. Defensive stocks led cyclicals by around 2.4%, reflecting the risk-off sentiment of the session. Outside the US, European benchmarks ended their session broadly lower with the Euro Stoxx 50 Index dropping 1.1%. The Japanese Nikkei fell 1.6% in overnight trading.

A dreary May for stocks concluded on Friday, as US equities finished at their lowest levels in almost three months. Conflict between the US and its trading partners continues to dominate investor concerns, as new US tariff threats were unexpectedly issued late Thursday evening. In the latest sign of escalation, the President announced a 5% tariff rate on all goods imported from Mexico, set to be implemented on June 10. The level will increase by a further 5% each following month dependent upon the administration's satisfaction that the Mexican government is tackling immigration issues at the US southern border. Auto manufacturers and firms that have supply chain exposure to Mexico were among the hardest hit on the day. With Beijing and Washington seemingly far away from a trade deal, tariff escalation on additional fronts should add to market uncertainty looking forward. The negative trade development, combined with recent weakness in economic data, helped send the S&P 500 further below closely-watched technical levels, specifically its 200 day moving average – a bearish sign for stocks. While equities have pulled back, bonds have rallied. US treasuries are at their highest levels since September of 2017, with prices having risen as yields have fallen. The spread between the 10-year and 3-month treasury yields also re-inverted for the third time in 2019, and is the most negative since 2007. Many investors traditionally view a yield curve inversion as a sign of increasing recession risk.

The S&P 500's down day marked the sixteenth 1%+ move of 2019, and the seventh in which stocks fell. The VIX Index, a forward-looking measure of S&P 500 volatility, finished just below 19 as of the equity market close. US equity valuations have come down, but still appear to be underpricing the risks of higher inflation, pressures to corporate margins, and a slowdown in capital spending. The combination of high valuations, underappreciated risks to corporate profits, and escalating geopolitical uncertainty suggests to us that market volatility will remain elevated in the coming months. The S&P 500 Index is currently up 9.8% year to date, while the NASDAQ Composite has gained 12.3%, and the Russell 2000 Index has risen 8.7%. Both the S&P 500 and NASDAQ have fallen from their recent all-time highs, and are now roughly 7-9% below those levels. This sell-off has eased pressure slightly on valuations, lowering the S&P 500's consensus forward price-to-earnings multiple from its 17.5x value earlier this month to 15.7x currently.

### The Global Investment Committee's Outlook

The market environment in 2018 was one of the most challenging for equity investors since the Financial Crisis, with every region and most stocks delivering negative returns. Unusually, bonds and alternative investments simultaneously fared poorly, reducing the effectiveness of asset allocation in balancing out the losses with some gains. In sharp contrast with how 2018 ended, 2019 began with a sharp and broad rally across the majority of risk asset classes. Beginning in January, the dramatic pivot by the Federal Reserve to embrace a patient policy approach helped ease financial conditions and improve market sentiment. Overall, the GIC expects 2019 will be a better year than 2018 both in terms of absolute returns and the breadth of those returns. However, with significantly more good news currently priced into markets, the GIC advises caution as US equity valuations remain full and earnings forecasts may have further to fall. While the GIC remains overweight equities relative to fixed income, it believes international stocks, particularly emerging markets, may offer the most upside going forward. Within fixed income, the GIC remains underweight corporate credit, and prefers high-quality short-duration bonds as a proxy for cash, which it will look to deploy throughout 2019 as opportunities arise. It also recommends a moderate allocation to long-duration Treasuries as a defensive portfolio hedge against the risk of a future equity or credit market correction.

Market data provided by Bloomberg.

**Dow Jones Industrial Average (DJIA):** A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.

**Euro STOXX 50 Index:** Provides a blue-chip representation of supersector leaders in the Eurozone.

**Hang Seng China Enterprises Index:** This is a free-float-adjusted, capitalization-weighted index of the "H" shares, which are shares of mainland China companies that trade in Hong Kong.

**NASDAQ Composite Index:** A broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.

**Russell 1000 Growth Index:** measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

**Russell 1000 Value Index:** measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

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**Russell 2000 Index:** measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

**S&P 500 Index:** The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks.

**US Trade-Weighted Dollar Index:** A weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that circulate widely outside the US.

**VIX:** This is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 Index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30-day period.

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Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies. **Technology stocks** may be especially volatile.

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