

August 26, 2019

### What Happened in the Markets?

- US equities rose on Monday as the S&P 500 gained 1.1%. All three of the major US averages were positive on the session, with the tech-heavy NASDAQ (+1.3%) leading the way. The day's gains leave the S&P 500 just 4.9% below the July 26 all-time high.
- Stocks advanced to start the week as markets gained on a more optimistic trade outlook from the White House. Despite turmoil last Friday and several conflicting news stories over the weekend, the President contended at the G7 Summit in France on Monday that the chances of a US-China deal are better now than at any time in the last year. While the market seemed to appreciate the upbeat tone, it remains to be seen whether the two sides will meaningfully reengage in discussions after several weeks of icy relations.
- All 11 S&P sectors were up on the session. Communication Services (+1.5%), Technology (+1.4%), and Utilities (+1.2%) outperformed on the day, while Materials (+0.3%), Energy (+0.5%), and Industrials (+0.7%) lagged the broader market.
- Yields moved slightly higher across the curve on Monday, with the 10-year Treasury yield settling near 1.54% and the 30-year yield hovering close to 2.04% as of the 4 p.m. equity market close. Outside of rates, crude oil prices fell 0.5%+, while the US dollar was modestly stronger, with the US Dollar Index rallying 0.4%. Gold was relatively flat on the day and remains above \$1,500 / ounce.

### Catalysts for Market Move

US stocks moved higher on Monday as rhetoric around trade discussions between the US and China struck a more positive tone, improving investor sentiment and reigniting hope that a deal between the world's two largest economies may be possible. At the G7 Summit in France on Monday, the President commented that the chances of a US-China agreement are better now than at any point in the last year. The optimism from the White House comes following a tumultuous trading session last Friday that saw stocks fall almost 3% after China imposed retaliatory tariffs on US farm products and automobiles. In response, the White House raised existing tariffs on \$250 billion of Chinese imports from 25% to 30% beginning October 1, and said new tariffs on \$300 billion of goods will be 15% instead of the previously announced level of 10%. This seemed to matter little on Monday as investors shifted their focus to the positive tone out of Washington.

After Monday's up-move, the S&P 500 sits 4.9% below last month's record high. With the backdrop of Fed uncertainty, continuing US-China trade concerns, and a decelerating economic and earnings growth outlook, we remain cautious. Though US stocks have held up reasonably well, other markets seem to be showing more concern. Gold, a perceived "safe-haven" asset, has rallied to six-year highs and remains above \$1,500 / ounce. Ten-year rates have fallen more than 0.5% in the past month and 30-year rates remain near all-time lows.

While in recent weeks market attention has been consumed by US-China trade developments and Fed uncertainty, deteriorating fundamentals also warrant monitoring. After two years of S&P 500 companies posting double-digit profit growth in 2017 and 2018, earnings per share for the index appear to have been roughly flat in 1H19, a dramatic slowdown in profit growth that still does not appear fully priced into the index, which trades at more than 16.4x consensus forward earnings estimates. We expect markets to remain volatile over the coming weeks and months, as US equities appear to be underpricing the risks of inflation, corporate margin compression, and a slowdown in capital spending. Uncertainty surrounding the Federal Reserve's next move could also weigh on markets. All this is occurring against a backdrop of ongoing trade tensions, which have the potential to negatively impact corporate confidence and investment, and could, in turn, serve as a further headwind to growth. As a result, we continue to suggest investors remain patient before putting fresh capital to work.

### 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 stocks appear fully valued 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 potential 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.

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

**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.

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The value of **fixed income securities** will fluctuate and, upon a sale, may be worth more or less than their original cost or maturity value. Bonds are subject to interest rate risk, call risk, reinvestment risk, liquidity risk, and credit risk of the issuer. **High yield bonds** are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. **Duration**, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates. Generally, if interest rates rise, bond prices fall and vice versa. Longer-term bonds carry a longer or higher duration than shorter-term bonds; as such, they would be affected by changing interest rates for a greater period of time if interest rates were to increase. Consequently, the price of a long-term bond would drop significantly as compared to the price of a short-term bond.

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**Yields** are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

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