October 2, 2019

## What Happened in the Markets?

- US stocks extended Tuesday's losses on the second day of fourth-quarter trading, as the S&P 500 dropped 1.8% to close at 2,888 – its lowest level since August. The session saw 95% of names in the index post negative returns. The S&P is now 4.6% below its July 26 all-time high.
- Wednesday's market action appeared to be a continuation of the anxiety seen on Tuesday. While there was little to point to in the way of new catalysts, investors continued to grapple with weak economic data out of the US, which had previously been looked to as an exception to slowing global economic growth. Major European indices dropped roughly 3% on the day, as "safe-haven" assets continued to gain.
- All 11 S&P sectors fell on the day. Real Estate (-0.5%), Utilities (-1.3%), and Communication Services (-1.4%) outperformed the broader market, while Technology (-2.0%), Financials (-2.1%), and Energy (-2.6%) lagged.
- Rates were lower on the day with the biggest move seen on the short end of the curve as Treasuries gained broadly. Ten-year yields moved to 1.60% as of the 4 p.m. equity market close, and 30-year yields remained close to 2.09%. Gold rose for a second straight day, trading around $1,500 per ounce as investors sought "safer" areas of the market. The dollar fell slightly against major global currencies as measured by the US Dollar Index.

## Catalysts for Market Move

Equity markets extended their slide to a second day as concerns mounted over slowing global growth, though US stocks finished well off their lows. Investors continued to digest poor manufacturing data from the US which, up to this point, has been looked to as a relative exception to recent economic weakness seen around the world. The down move in stock prices following the softer data suggests that investors have started to price the fact that the US economy may be more susceptible to global economic woes than previously thought. A payrolls report for September did little to assuage market anxiety. Although the 135,000 jobs added roughly met the consensus estimate, the figure is down from a peak of 234,000 in January and suggests a declining trend. European stocks also faced steep declines on Wednesday after data out of Germany pointed to a deep contraction in the manufacturing sector. Major European indices fell roughly 3%, with the steepest losses seen in the UK where the FTSE 100 dropped 3.2%. Brexit drama continued there today, as Prime Minister Boris Johnson issued an ultimatum to the EU to accept his compromise solution, threatening that the UK will leave without a deal otherwise. The PM presented his plan to avoid a hard border in Ireland, addressing one of the major sticking points in discussions with the EU. Talks remain in progress ahead of the October 31 deadline.

Even with the two-day sell-off, the S&P 500 still sits just 4.6% below July's record high. With the backdrop of Fed uncertainty, US-China trade concerns, and a decelerating economic and earnings growth outlook, equity markets may seem too sanguine. But outside of US stocks, markets seem to be showing more concern: Gold has rallied and sits near a six-year high. Ten-year Treasury rates have fallen roughly 0.5 percentage points since July and are near their lowest levels in three years. The 3-month/10-year Treasury curve remains inverted, which has historically been a negative harbinger for growth.

While in recent weeks market attention has been consumed by US-China trade developments and questions over the Fed's next move, 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 appears to have been roughly flat in 1H19, a dramatic slowdown that still does not appear fully priced into the index, which trades at nearly 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 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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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.

**Asset allocation and diversification** do not assure a profit or protect against loss in declining financial markets.

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