

October 8, 2019

What Happened in the Markets?

- US stocks fell on Tuesday, with the S&P 500 off 46 points or 1.6%, to close at 2,893. The S&P 500 has now rallied 15.4% year to date (price return), but sits 4.5% below July's all-time high.
- Trade tensions were widely cited as the culprit for today's move lower in equities, with a flurry of US / China headlines crossing the wires throughout the session, ahead of this week's meeting in Washington between trade negotiators from both countries. Outside of trade, market concerns around slowing US economic data remain in the forefront, and some de-risking ahead of 3Q earnings season which begins in earnest next week may have also contributed to today's weakness.
- All 11 S&P sectors fell during the session. Real Estate (-0.5%) and Consumer Staples (-0.9%) were relative outperformers on the day, while Financials (-2.0%) and Healthcare (-1.8%) lagged the broader market.
- Outside of equities, market action was similarly downbeat. Treasuries rallied across the curve, though front-end rates moved more sharply than long-end rates, driving a slight steepening in the yield curve (as measured by the spread between 10-year rates and 2-year rates, the former of which settled near 1.53% as of the 4 p.m. equity market close). The Dollar was modestly higher, while gold rallied nearly 1% during the session to close back above \$1,500 / ounce.

Catalysts for Market Move

It was a turbulent session on Wall Street Tuesday, with the S&P 500 dropping 1.6% to close at 2,893. Stocks opened the day sharply lower following several headlines overnight suggesting tensions between the US and China were rising ahead of a meeting this week between trade negotiators from the two countries. Early afternoon trading saw equity markets partially recover some of these losses, a rally that appeared to be sparked by comments made by Federal Reserve Chair Jerome Powell suggesting the Fed would soon announce an expansion to its balance sheet "for reserve management purposes." However, as new headlines emerged in the final hour of trading that brought focus back to US / China relations, stocks sold-off sharply into the close with the S&P 500 finishing the day at its low for the session.

While focus will remain on trade ahead of this week's meeting between high-level US and China officials in Washington D.C., as well as the Federal Reserve and interest rates ahead of its late-October meeting, expect markets to also pay close attention to fundamentals as third-quarter earnings season heats up in the coming weeks. With economic data looking mixed at best, and uncertainty on several fronts remaining elevated, any weakness in earnings reports or guidance could weigh on markets still trading near all-time highs. 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 16.5x 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 has seen a sharp and broad rally across 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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International investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies. **Investing in foreign emerging markets** entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks. **Investing in currency** involves additional special risks such as credit, interest rate fluctuations, derivative investment risk, and domestic and foreign inflation rates, which can be volatile and may be less liquid than other securities and more sensitive to the effect of varied economic conditions.

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.

Treasury Inflation Protection Securities' (TIPS) coupon payments and underlying principal are automatically increased to compensate for inflation by tracking the consumer price index (CPI). While the real rate of return is guaranteed, TIPS tend to offer a low return. Because the return of TIPS is linked to inflation, TIPS may significantly underperform versus conventional U.S. Treasuries in times of low inflation.

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

Alternative investments may be either traditional alternative investment vehicles, such as hedge funds, fund of hedge funds, private equity, private real estate and managed futures or, non-traditional products such as mutual funds and exchange-traded funds that also seek alternative-like exposure but have significant differences from traditional alternative investments. The risks of traditional alternative investments may include: can be highly illiquid, speculative and not suitable for all investors, loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized, absence of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than open-end mutual funds, and risks associated with the operations, personnel and processes of the manager. Non-traditional alternative strategy products may employ various investment strategies and techniques for both hedging and more speculative purposes such as short-selling, leverage, derivatives and options, which can increase volatility and the risk of investment loss. These investments are subject to the risks normally associated with debt instruments and also carry substantial additional risks. Investors could lose all or a substantial amount of their investment. These investments typically have higher fees or expenses than traditional investments.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Investing in commodities entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. **Physical precious metals** are non-regulated products. Precious metals are speculative investments, which may experience short-term and long term price volatility. The value of precious metals investments may fluctuate and may appreciate or decline, depending on market conditions. If sold in a declining market, the price you receive may be less than your original investment. Unlike bonds and stocks, precious metals do not make interest or dividend payments. Therefore, precious metals may not be suitable for investors who require current income. Precious metals are commodities that should be safely stored, which may impose additional costs on the investor. The Securities Investor Protection Corporation ("SIPC") provides certain protection for customers' cash and securities in the event of a brokerage firm's bankruptcy, other financial difficulties, or if customers' assets are missing. SIPC insurance does not apply to precious metals or other commodities.

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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