PENNIALL PERSPECTIVE
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Market Review

Interest rates. Trade Talks. Inflation Fears. Political Events. International Developments. During the past year, every one of these events have influenced stock and bond prices. So, when you hear that the financial markets are reacting to the news once again, it should come as no surprise.

However, we know volatile markets can be unnerving, so we thought we would put all these events into perspective with…

The Tao of Wealth Management[1]

The path to success in many areas of life is paved with continual hard work, intense activity, and a day-to-day focus on results. However, for many investors who adopt this approach to managing their wealth, that can be turned upside down.

The Chinese philosophy of Taoism has a phrase for this: *"wei wu-wei."* In English, this translates as "do without doing." It means that in some areas of life, such as investing, greater activity does not necessarily translate into better results.

In Taoism, students are taught to let go of things they cannot control. To use an analogy, when you plant a tree, you choose a sunny spot with good soil and water. Apart from regular pruning, you let the tree grow.

This doesn't mean that we should always do nothing. In fact, insights from financial science suggest you should direct your investment efforts to the things you can control. These include taking account of your own preferences and sensitivities when choosing investment strategies, diversifying your allocation to moderate the ups and downs, being mindful of the impact of fees, and exercising discipline when emotions threaten to blow you off course.

Successful investing requires taking actions that can have a positive impact on the outcome. For instance, to maintain their desired asset allocation, investors should regularly rebalance their portfolio by reallocating money away from strongly performing assets – selling high to harvest gains, buying low when things become inexpensive.

But rebalancing is a disciplined, premeditated activity based on each person's circumstances. It contrasts with the "busyness" of reflexively following investment trends and chasing past returns promoted through financial media. Look at the person who fitfully watches business TV or who sits up at night researching stock tips. That sort of activity is likely counter-productive and can add cost without any associated benefit. With investing, constantly tinkering with an allocation does not perfectly correlate with success.

Now, while that makes sense, many people struggle to apply those principles because the media tends to look at investing through a different lens, focusing on today's news, which is already priced in, or on speculating about tomorrow. Guesswork can surely be interesting. But is it relevant to your long-term plan? Probably not.

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1 Adapted from The Tao of Wealth Management by Jim Parker, published on the Dimensional Funds Website

People caught up in the day-to-day may constantly switch money managers based on past performance, or attempt tactical changes in their allocation, or respond in a knee-jerk way to news events that turn out to be noise.

Again, the assumption underlying these approaches is that if you put more effort into the external factors and adjust your position constantly, you will get better results. Unfortunately, people may end up earning poorer long-term returns from trading too much, chasing past performers, or attempting to time the market. Ultimately, that's just another reminder of the potential benefits available to disciplined investors who stay focused on what they can control.

As the ancient Chinese proverb says: "By letting it go, it all gets done. The world is won by those who let it go. But when you try and try, the world is beyond the winning."

Market Updates

While you ponder on the philosophy of Taoism, below are some of the high and low points of the quarter as related to the major market sector. See Exhibit 1 for a summary of key benchmark performance.

On Stocks

The month of July started the quarter off on a positive note around the world – in fact, it was the best month for US markets since January. The positive momentum was not sustained through August & September as market results were mixed in the latter two months of the period.

For the quarter as a whole, looking at broad market indices, the US outperformed non-US developed and emerging markets during the quarter. US outperformance also applied to real estate investment trusts (REITs). While developed markets outside the US underperformed the US, in dollar terms, they outperformed emerging markets during the quarter. As a whole, emerging markets posted negative returns for the quarter.

In terms of currency, the Canadian dollar and the Swiss franc appreciated over 1.5% vs. the US dollar, but the Japanese yen and Australian and New Zealand dollars all each depreciated more than 2%. In emerging markets, most currencies depreciated against the US dollar. The Turkish lira fell over 20%, but the Mexican peso appreciated more than 5%.

On Bonds

Interest rates increased in the US during the third quarter. The yield on the 5-year Treasury note rose 21 basis points (bps), ending at 2.94%. The yield on the 10-year Treasury note increased 20 bps to 3.05%. The 30-year Treasury bond yield rose 21 bps to 3.19%.

On the short end of the yield curve, the 1-month Treasury bill yield increased 35 bps to 2.12%, while the 1-year Treasury bill yield rose 26 bps to 2.59%. The 2-year Treasury note yield finished at 2.81% after an increase of 29 bps.

In terms of total return, short-term corporate bonds gained 0.71%, while intermediate-term corporates returned 0.80%.

Short-term municipal bonds declined 0.11%, while intermediate-term munis dipped 0.06%. Revenue bonds (–0.16%) performed in line with general obligation bonds (–0.14%).

On Commodities

The Bloomberg Commodity Index Total Return declined 2.02% in the third quarter. The energy complex led performance. Heating oil gained 5.63%, and Brent oil returned 5.21%.

On the Economy

The ongoing dialogue on global trade captured most financial headlines during the quarter. There were some positive headlines in relation to this topic, the most notable was the new trade deal between the US, Mexico and Canada (USMCA), yet concerns around trade and a potential trade war continued to concern investors.

As of this writing, despite statements from the IMF (International Monetary Fund) that disruptions of long standing trade agreements could have an impact on growth if not resolved quickly, no real resolution to "tarrifgate[2]" has materialized. While the impact of continuing a tit-for-tat policy on tariffs between China and the US could be negative, projections from the IMF do not have us pointed toward the "R"-word.

In fact, the Federal Reserve was confident in the strength of the economy and raised short-term rates again, which they are projecting to do several more times. One can debate this policy as well, but the reality remains that the Federal Reserve sees improving economic conditions such that they feel it is necessary to continue raising rates. Only the lens of history will tell us how well this policy was executed.

Exhibit 1. Third Quarter 2018 Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q3 2018	**STOCKS**				**BONDS**	
	7.12%	**1.31%**	**-1.09%**	**-0.03%**	**0.02%**	**-0.17%**
Since Jan. 2001						
Avg. Quarterly Return	2.0%	1.5%	2.9%	2.6%	1.1%	1.1%
Best Quarter	16.8% **2009 Q2**	25.9% **2009 Q2**	34.7% **2009 Q2**	32.3% **2009 Q3**	4.6% **2001 Q3**	4.6% **2008 Q4**
Worst Quarter	-22.8% **2008 Q4**	-21.2% **2008 Q4**	-27.6% **2008 Q4**	-36.1% **2008 Q4**	-3.0% **2016 Q4**	-2.7% **2015 Q2**

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]).

[2] See our Blog post from August 16, 2018 – *"Tariffgate" & Tuning Out the Noise*