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Quarterly Market Update

Second Quarter 2019

The summary below is for educational purposes only. Please call us with any questions or if you would like to schedule a review or discuss other financial matters.

The Federal Reserve and Trade Keep Investors on Their Toes

The Fed and international trade – these are the two headlines that dominated action in Q2.

Index	Q2 Return*		2019 YTD Return
DJIA[1]	+2.59%		+14.03%
NASDAQ Composite[2]	+3.58%		+20.66%
S&P 500 Index[3]	+3.79%		+17.35%
FTSE Developed ex North America Index[4]	+2.42%		+12.44%
Bond Yields	**Yield as of June 28 & Change***		**Yield as of Dec 31, 2018**
3-month T-bill	2.12%	-0.28%	2.45%
2-year Treasury	1.75%	-0.52%	2.48%
10-year Treasury	2.00%	-0.41%	2.69%
30-year Treasury	2.52%	-0.29%	3.02%
Commodities	**June 28 Price**	**Monthly Change***	**Year end 2018**
Oil per barrel[5]	$58.00	-$2.14	$45.41
Gold per ounce[6]	$1,413.90	+$115.40	$1,279.00

*Sources: U.S. Treasury, MarketWatch, *Quarterly: March 29, 2019 – June 28,2019*

Longer term, profits and profit forecasts are the leading driver of equities. Shorter term, sentiment can be influenced by various factors.

For much of the year, favorable headlines highlighting progress toward a trade deal between the U.S. and China aided equities. In addition, the Federal Reserve shifted gears, no longer talking about gradual rate hikes.

Coupled with modest economic growth, stocks have performed admirably.

In early May, the rally hit a roadblock when the president announced he would impose additional tariffs on China, injecting a new layer of uncertainty into the economic and stock market equation.

An unexpected tweet by the president in early June threatened Mexico with debilitating tariffs. Yet, the peak-to-trough decline in the S&P 500 Index from April 30 thru June 3: a modest 6.8% (St. Louis Federal Reserve data). It's nothing out of the ordinary.

Since 1980, the average annual maximum peak-to-trough pullback for the S&P 500 Index has been 14% (JP Morgan, LPL Research).

But shortly after President Trump threatened Mexico, Fed Chief Powell shifted his stance. No longer was the Fed on hold. Instead, Powell implied the Fed will cut rates if needed, sparking a turnaround and lifting the S&P 500 Index to a new high.

The Economy and Treasury Yields

The steep drop in Treasury yields has surprised nearly everyone – see Figure 1.

In part, yields have fallen in developed nations, which encourages overseas investors to buy into higher-yielding U.S. Treasuries (bond prices and yields move in opposite direction).

Worries about a protracted trade war have increased economic uncertainty, which has encouraged a flight into safer U.S Treasury bonds.

And, odds of a rate cut or cuts this year have gone up significantly (CME Group FedWatch Tool), which also encourages investors to place cash into Treasury bonds.

The Treasury bond market is foreshadowing an economic slowdown and the same could be said from the Conference Board's Leading Economic Index (LEI). But the LEI isn't suggesting the economy will contract this year.

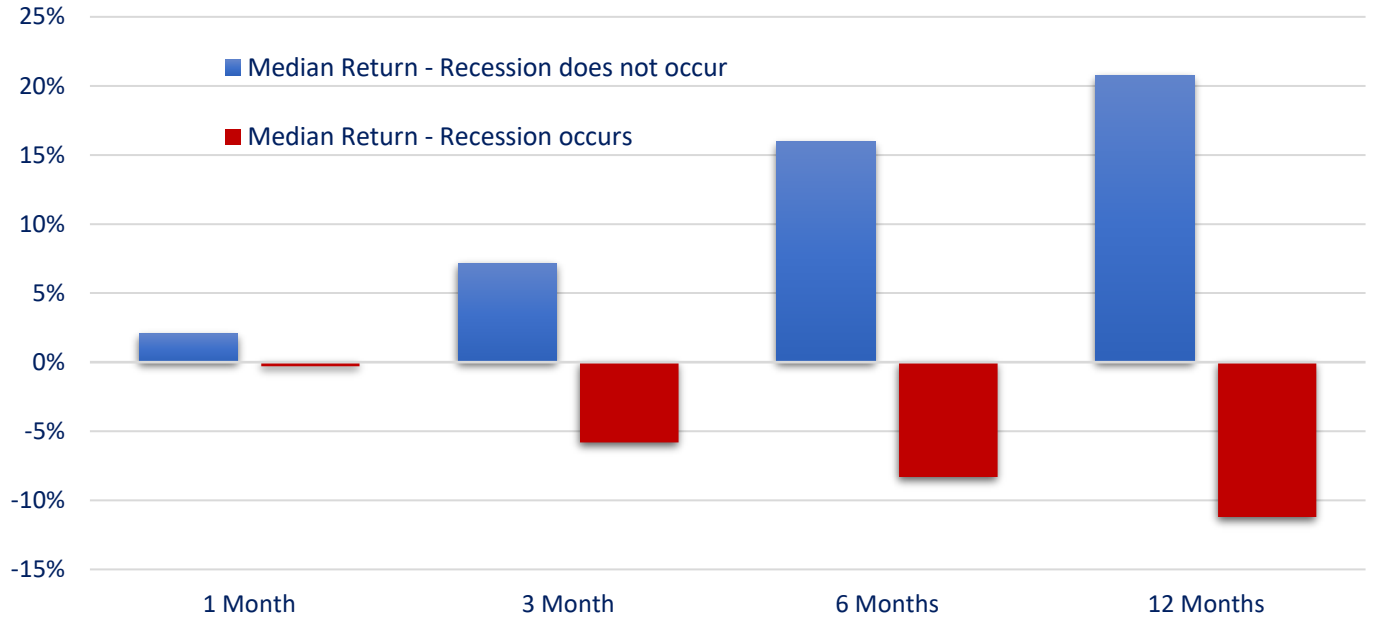
A quick peek at investment grade debt or yields in high-yield debt (junk bonds) aren't suggesting a recession either. If investors expect a steep economic slowdown or recession, yields in junk bonds can spike higher as investors flee shakier firms but that's not happening right now. Investment grade debt can also come under pressure, though we typically see less volatility.

While the rally in stocks during June has not been as broad-based as we might like to see, action in the S&P 500 Index suggests growth isn't about to stall either.

Rate Cuts and Stock Market Reaction

Since 1974, there have been nine rate-cut cycles by the Federal Reserve. Figure 2 illustrates the S&P 500's reaction, from 1-month after to 12-months after the first rate cut in the cycle.

S&P 500 Returns Following the Start of Fed Rate Cuts 1974 - 2007 Fig. 2



Data Source: Barclays, MarketWatch Past performance is no guarantee of future performance

Over the last 45 years, a pattern has emerged, with stocks performing well when the economy side-stepped a recession, such as the mid-1980s, mid-1990s and the late 1990s. And when the economy slid into profit-killing recessions, rate cuts did little to bolster investor sentiment.

Ultimately, steady economic growth has historically been an important ingredient for stock market gains.

[1] The Dow Jones Industrials Average is an unmanaged index of 30 major companies which cannot be invested into directly. Past performance does not guarantee future results.

[2] The NASDAQ Composite is an unmanaged index of companies which cannot be invested into directly. Past performance does not guarantee future results.

[3] The S&P 500 Index is an unmanaged index of 500 larger companies which cannot be invested into directly. Past performance does not guarantee future results.

[4] The Global Dow is an unmanaged index composed of stocks of 150 top companies. It cannot be invested into directly. Past performance does not guarantee future results.

[5] CME Group front-month contract; Prices can and do vary; past performance does not guarantee future results.

[6] CME Group front-month contract; Prices can and do vary; past performance does not guarantee future results.

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- ✓ **Add a name to our mailing list,**
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Please call Chris Hartrich or Eric Rechtin at (314) 394-2354 and we will be happy to assist you!