Weekly Capital Market Comments

May 31, 2019

NORTHEAST | SEQUOIA PRIVATE CLIENT GROUP

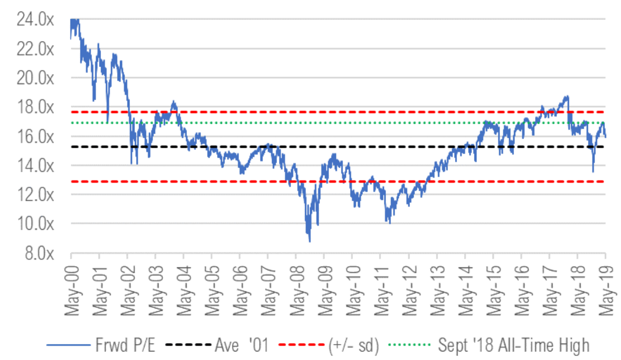
King of the Blind Squirrels

Weekly Review

Equity markets were lower again this week (Thurs-Thurs), while a flight to quality bid up bonds. Global equity markets continue to digest uncertainty surrounding slowing global growth (oil down over 5%), heightening US trade tensions (now with Mexico), as well as political angst in the Middle East, Venezuela and the UK. The S&P was down 1.1% for the week, but still stands higher by 12% YTD. The NASDAQ was off 0.8% for the week and is higher by 14% YTD. Bonds were mostly higher over the last 5 trading days, except for HY, which was down 0.1%. Interestingly, Growth was the best performing (still negative) Style, while Value continues to lag, especially MidCaps – driven by downside in Retail, Energy and Minerals. Across Style groupings, Communications and Financial Services outperformed, while Energy and Utilities lagged. Long-duration bond positions led fixed-income indices, and even TIPs had a solid week. **This is something we continue to watch; even as inflation prospects seem tame, the inverted curve together with potential upward price pressures from a global tariff policy may make inflation-protected securities more attractive.** Safe haven assets were for bid this week; Gold was higher by over 2% and the US 10yr is now down below 2.2%.

Like a one-eyed man in the land of the blind, we feel as though we are the king of our domain, given our recent market prognostication. But as another saying goes, "Even the blind squirrel finds a nut once in a while." We have not yet decided which maxim best describes our recent market call. **And quite frankly, it really doesn't matter. What is paramount at this point, is where do we go from here, and how should clients best position their portfolios?**

Exhibit 1: Historical P/E Ratios



Source: NEPCG and FactSet

Last night, a POTUS tweet indicated that the US would impose a 5% tariff on all imports from Mexico effective June 10, 2019, increasing every month thereafter by 5 percent until a 25% levy is reached. This latest round of tariffs is intended to drive the Mexican government to get more involved in stemming the illegal inflow of aliens through its country on their way to the US. Sectors most impacted include autos, agriculture and other consumer goods. At the same time, US-Sino trade tensions are not going away. Not only has China reportedly "readied a plan" to restrict the sale of rare earth metals to the US but are also planning a list of foreign companies/organizations/individuals viewed as "unreliable" for having harmed Chinese companies' interests.

We continue to assert that the S&P will have difficulty breaching a 17x handle on the next-12 months earnings – a resistance level has held up strikingly well since 2014, except for the period directly following the passing of the Tax Cuts and Jobs Act of 2017. **But at what point do markets bounce?** We have a hard time believing that we test the mid-13x multiples we experienced in late December. For one, we have already rolled off nearly six months of challenging earnings results, and markets typically discount 12-18 months out. So even if economic headwinds caused by China (or any number of other real or perceived threats) take deeper root in the US economy or investor sentiment, we believe equity markets will soon begin to look to 2020 earnings. Further, we believe that the fixed-income market – while clearly flashing bright yellow – is not experiencing a similar back up in yields as it did in late 2018. **So as we sit here today, after digesting yet another week of capital market and geopolitical theatrics, we can envision the S&P trading down to our observed long-term average of roughly 15x-15.5x, which would put the S&P at roughly 2,625 (off 6% from here**), assuming no deterioration to earnings, of course. However, if say, we

	Domestic Indices	1Week
1	BBgBarc US Government TR	0.5%
2	US Inter Gov Bd TR Bond	0.4%
3	BBgBarc US Agg Bond TR	0.3%
4	BBgBarc Municipal TR USD	0.3%
5	BBgBarc US MBS TR	0.2%
6	ICE BofAML US High Yield TR	-0.1%
7	NASDAQ Composite PR	-0.8%
8	Russell 2000 TR	-1.0%
9	NYSE Composite PR	-1.0%
10	S&P 500 TR	-1.1%
11	DJ Industrial Average TR	-1.2%
12	S&P MidCap 400	-1.3%

	Style Stratification	1Week
1	US Mid Growth	-0.1%
2	US Small Growth	-0.2%
3	US Growth	-0.3%
4	US Large Growth	-0.4%
5	US Mid Core	-1.0%
6	US Mid Cap	-1.1%
7	US Market	-1.1%
8	US Large Cap	-1.1%
9	US Core	-1.5%
10	US Large Val	-1.6%
11	US Large Core	-1.6%
12	US Mid Val	-2.2%

	Sector Stratification	1Week
1	US Commun Svc Capped	-0.3%
2	US Financial Services	-0.4%
3	US Technology	-0.5%
4	US Basic Materials	-0.6%
5	US Industrials	-0.7%
6	US Cyclcl Sup Sec	-0.8%
7	US Consumr Cyclcl	-0.9%
8	US Snstve Sup Sec	-0.9%
9	US Healthcare	-1.5%
10	US Real Estate	-1.8%
11	US Dfnsve Sup Sec	-2.0%
12	US Consumr Dfnsve	-2.3%
13	US Energy Capped	-2.8%
14	US Utilities	-3.3%

	Bond Indices	1Week
1	US Lng Gov Bd TR Bond	1.5%
2	US Lng Core Bd TR Bond	1.2%
3	US Lng Corp Bd TR Bond	0.8%
4	US TIPS TR	0.8%
5	US Gov Bd TR Bond	0.6%
6	US Corp Bd TR Bond	0.5%
7	US Core Bd TR Bond	0.5%
8	US Inter Gov Bd TR Bond	0.4%
9	BBgBarc Municipal TR USD	0.3%
10	US Inter Corp Bd TR Bond	0.3%
11	US Inter Core Bd TR Bond	0.2%
12	US Shrt Gov Bd TR Bond	0.2%
13	Mortgage TR Bond	0.2%

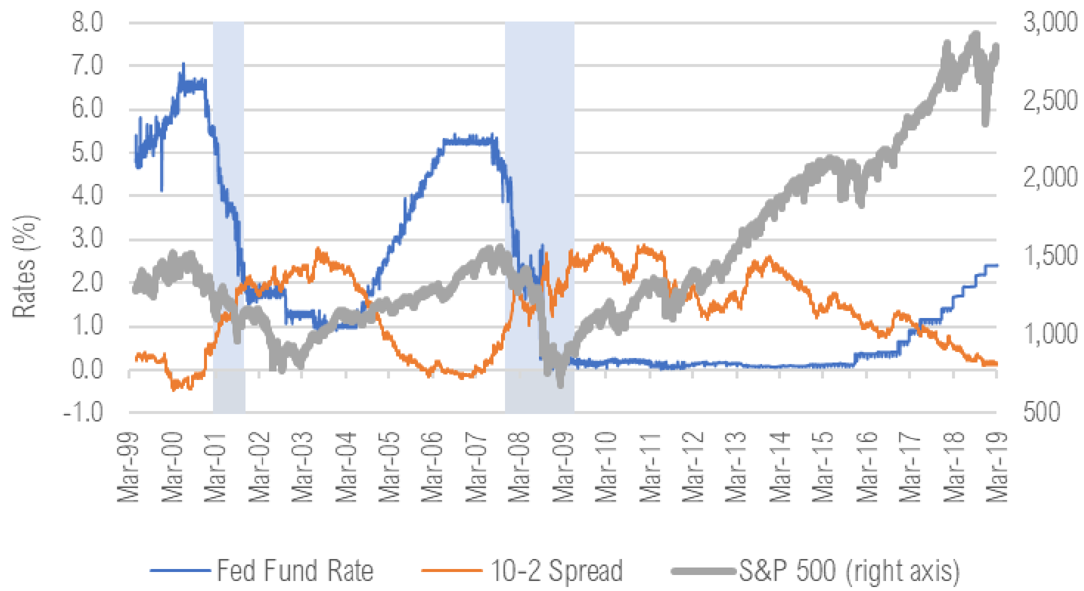
	International Markets	1Week
1	MSCI EM Latin America PR USD	3.7%
2	SSE Composite PR CNY	1.6%
3	MSCI EM PR USD	1.0%
4	MSCI EM PR LCL	1.0%
5	FTSE 100 TR GBP	-0.1%
6	Euronext Paris CAC 40 NR EUR	-0.2%
7	MSCI Europe PR LCL	-0.4%
8	FSE DAX TR EUR	-0.4%
9	MSCI World Ex USA PR LCL	-0.5%
10	MSCI Japan PR LCL	-0.5%
11	MSCI Europe NR USD	-0.6%
12	MSCI World ex USA NR USD	-0.7%
13	MSCI Pacific NR USD	-0.8%
14	MSCI Pacific PR LCL	-0.8%

Source: Morningstar.com

get a 10% downside to earnings over the next 12-months, we could see the S&P trading down another 10%, to roughly 2,500. But we believe for this to happen, recession fears and speculation need to morph closer to reality. Finally, we can't help but remind investors the tile from our March 29, 2019 note entitled, "***Be Careful What You Wish For***," whereby we cautioned investors that a Fed cut is not the panacea for a slumping market and slowing economic back drop, but rather could be the catalyst that pushes us into recession and causes additional market sell-off. In Exhibit 2, we illustrate that it was **not until the yield curve inverted AND the Fed began cutting rates, that we soon entered into recession, but not before a more severe market retracement.** From our perspective, it is like the Fed "saying Uncle" and finally acknowledging an environment whereby lower rates are needed to keep the economy alive.

We'd love to hear your thoughts.

Exhibit 2: Be Careful What You Wish For



Source: NEPCG and FactSet