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Quarterly Commentary

After a very strong Q1 performance, equities continued to rise in Q2 with the S&P 500 up an additional 5%. This brings 2019 S&P 500 performance up above 18%!

We believe a more realistic perspective comes from recognizing that equities have risen a more modest 12% over the past 18 months, taking into consideration last year's decline. Over this time frame, valuations and price to earnings multiples are relatively flat; instead, equity returns have risen in tandem with underlying earnings growth. We expect this to continue given a long-term perspective.

So, why such strong performance so far this year as opposed to 2018 when earnings were much stronger? We believe that global central banks were more focused on achieving monetary tightening goals in 2018 and were slow to address a decelerating global economy. However, the ongoing trade negotiations with China (and briefly, Mexico) raised the downside global economic risk perceptions and contributed to the pivotal easing of monetary policies in Europe, China and the US. The Fed has dramatically reversed its policy this year with respect to both quantitative tightening and interest rate policy expectations. US investors now expect 2 or 3 rate cuts this year rather than rate hikes. All this actual and expected monetary stimulus has boosted markets and has bought the global economy some time for China and the US to come to terms on trade.

There have now been many US economic indicators (jobs, purchasing manager surveys, transport volumes) that indicate an actual slowdown in US economic activity. Part of this slowdown is just a normalization after a strong 2018; however, most is likely due to the uncertainties of tariffs and conducting business in today's environment. Business decisions are in flux, affecting inventories, supply chain management and customer relationships. The Huawei controversy widely impacts US technology and transport companies. US trade negotiation tactics have put into question long-held trading norms, which in turn have slowed trade activity.

Barring a surprise trade agreement from the US and China, we would expect companies to downplay their expectations for the balance of the year when they begin to report Q2 earnings over the next several weeks. We also expect the Fed to be reticent in pursuing rate cuts which may also disappoint investors. We're also cognizant of the rising geopolitical uncertainties particularly with Iran.

Longer term, we believe that the market is signaling that the US and China will reach an agreement. We think this is the most material determinant of equity returns for the rest of the year; and, an agreement would signal a return to normalcy within the global trade environment. While we wait, we are happy that our client portfolios are collecting dividend yields higher than the overall market.

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