Trumbower Financial Advisors, LLC
3rd Quarter 2019
Investment Market Commentary

Trade and Treasuries Trigger Turbulence

It was a tumultuous quarter that upended several entrenched financial market trends. Initially, US stocks soared on the wings of the first Fed Funds rate cut since December 2008. Equities peaked in July but cratered in August as the trade spat escalated, US factory activity contracted and preliminary 2019 job statistics revised down. Treasury yields collapsed under a surge of demand and visions of rate cuts.

Plans for reviving the China trade talks (now in progress) and remarkably robust consumer spending sparked a partial recovery in September. Investors refused to be daunted by prospects for duller 3rd quarter corporate earnings or recession forecasted by the inverted yield curve. They dramatically reversed a decade long preference for Growth, aka Momentum stocks, in favor of Value. Large, Mid and Small Cap US Value stocks outperformed Growth by 2.11%, 1.05% and 3.6%, respectively, during Q3. Is this the beginning of a cyclical rotation or a short-term reaction to global uncertainty?

Volatility also characterized sector leadership. Energy was the worst performer in July and August but catapulted near the top in September. Utilities, another Value sector, also performed well in August and September after a poor showing in July. Growth sectors, including Tech and Consumer Discretionary were leaders in July and laggards in September.

Appetites for yield continued to send global bond prices higher and rates lower. Yield on the 10-year UST fell from 2.03% to 1.67% in Q3, a -17.73% drop. It touched down at 1.47% in early September, the lowest since 2016. The 30-year Treasury followed suit dipping to a record low of 1.91%. While total returns to existing long-bond holders mushroomed, the 30-year Treasury is now a pretty risky security. Future upside potential is negligible but the price could fall by 20% when rates head back toward 3%.

The yield curve (3 mo/10yr) has remained obstinately inverted since May and didn't budge when the Fed lowered rates at the short end twice by a total 50 bps. The current situation stands in stark contrast to Q3 2018

(Continued on page 2)

Selected Benchmark and Category Average Returns

Large Cap Equity

Benchmark Indx & Category Average*	(Total Return) 3rd Q 2019	12 Mos.
S&P 500 Growth	0.72	3.25
Large Cap Gr Avg	-0.64	2.18
S&P 500 Value	2.83	5.56
Large Cap Val Avg	1.50	1.84
S&P 500 Index	1.70	4.25
Large Cap Blnd Avg	1.36	1.87

Mid Cap Equity

Benchmark Indx & Category Average*	(Total Return) 3rd Q 2019	12 Mos.
S&P MC 400 Growth	-0.61	-2.53
Mid Cap Gr Avg	-1.85	2.49
S&P MC 400 Value	0.44	-2.44
Mid Cap Val Avg	0.67	-1.86
S & P 400 Index	-0.09	-2.49
Mid Cap Blnd Avg	0.38	-1.55

Small Cap Equity

Benchmark Indx & Category Average*	(Total Return) 3rd Q 2019	12 Mos.
Russell 2000 Growth	-4.17	-9.63
Small Cap Gr Avg	-4.65	-7.85
Russell 2000 Value	-0.57	-8.24
Small Cap Val Avg	-0.81	-9.18
Russell 2000	-2.40	-8.89
Small Cap Blnd Avg	-1.48	-8.04

International Equity

Benchmark Indx & Category Average*	(Total Return) 3rd Q 2019	12 Mos.
MSCI EAFE	-1.71	-4.27
Intl Equity Avg	-1.28	-3.26

* **Category average** calculated using *Morningstar Direct*. Fund universe screened to include funds that meet the following criteria:

- **A.** M-Star Category consistent with designated asset class and management style.
- **B.** M-Star Style Box consistent with designated management style.
- **C.** Fund's Objective consistent with asset class.
- **D.** Excludes Index Funds.

We have not independently verified *Morningstar* data.

3rd Quarter Equity Market Results

	3rd Qtr. % Chg.	12-mo. % Chg.
S&P 500	1.70	4.25
S&P 400	-0.09	-2.49
Nasdaq	0.18	0.52
Russ 2000	-2.40	-8.89
MSCI EAFE	-1.71	-4.27
MSCI Emg Mkt	-4.25	-2.02

Turbulence
(Continued from page 1)

when the Fed projected 2 hikes in 2019 and the yield on the US 10-year stood at ~3.25%.

Still, US rates are delicious compared to the rest of the developed world where yields on $15 trillion of government debt are below 0%. German and Japanese 10-year bonds closed at -0.57% and -0.22%. Will negative yields migrate to the US? Seduced by positive returns, a steady inflow of overseas capital is likely to keep Treasury rates under wraps and the USD strong. On the flip side, the flood of new Treasury debt needed to fund an estimated $1 trillion budget deficit should create a floor above 0%.

The Repurchase "Repo" Market supplies banks and broker-dealers with overnight funds and became the crisis du jour in mid-September. Tax payments triggered extraordinary money market redemptions and siphoned reserves out of banks and into the Treasury's general account. Simultaneously, dealers sought funding to settle large Treasury issues. The supply of available overnight collateral fell short of demand forcing borrowing costs up from 2% to nearly 10%. Ultimately, the NY Fed injected capital into the system – the first such intervention since the 2008 Financial Crisis. Some believe this was an isolated episode triggered by a series of "perfect storm" events. Others contend it was a preview of structural liquidity issues facing the system as the Fed unwinds its massive balance sheet and hope they will focus on devising a permanent solution.

Nervous investors in search of a safe haven but disenchanted by miniscule if not negative yields on quality debt polished up demand for precious metals. In spite of a late quarter retreat, gold and silver returned 4% and 11%, respectively, during Q3. Why these commodities are viewed as safety nets puzzles us. Gold is down over 20% from its mid-2012 peak and silver has lost 64% over the past 8 years with nary a dividend or interest coupon paid. The Silver Trust ETF has a 10-year standard deviation of 30%.

The decimation of yields on safe securities has fueled a "risk on" sentiment among income-oriented investors overall. Capital pouring into US High Yield and Emerging Market Debt pressured rates down from around 8% 15 years ago to a range of around 4%-5%. Preferred stocks and REITS have soaked up a fair share of money seeking yield. The FTSE Nareit index is up 28% through Q3 and the Invesco Preferred ETF well ahead of Agg Bond at 12%. Investors have ploughed record amounts into municipal "junk" hoping to bag 4% - a 2.1% spread over investment grade. Corporations are taking advantage of the feeding frenzy to refinance at lower rates and plump up balance sheets. Global corporate bond sales exceeded a record $300 billion in September.

One long-term trend that showed no signs of reversing is the superior performance of U.S. equities over international. Developed Foreign and Emerging Market equities sloughed off -1.71% and -4.25%, respectively during the quarter. The annualized return on the Vanguard FTSE Europe over five years is a meagre 1.7% and -9% behind the S&P 500. For all its faults, investors clearly believe the US is a better bet.

Tainted by her failure to negotiate an acceptable Brexit deal, Theresa May resigned to make way for Boris Johnson, a hardline Brexiteer who has vowed to extricate the UK from its EU ties by October 31st – deal or no deal. Sterling suffered a -3.2% decline in Q3 landing near levels last seen in the months following the 2016 Brexit referendum. The pound has since recovered over 1% as departure negotiations intensified in anticipation of the EU summit later this week.

Mario Draghi's last hurrah as ECB President was to cut its key interest rate to -0.5% and launch a new €20 billion per month bond buying program "for as long as necessary." The euro complied, sliding down -4.2% for the quarter. Q2 statistics indicate the weakest year-to-year growth rates within the 20 leading economies since 2013. Mr. Draghi leaves his successor with a nearly empty monetary policy toolbox and directed criticism at EU governments for failing to implement fiscal stimulus.

Consumption growth in Europe has slowed to just 1%. Investment spending is likely to contract with the loss of exports to China. Europe lacks tech and is overweight in banks, energy and autos, sectors that have suffered from economic stagflation. On the flip side, dividend yields average 4% and European stocks trade at around 14 times projected 2019 earnings – a substantial discount from the S&P 500. US and foreign investors disheartened by rock bottom rates may find them increasingly appealing.

A strong dollar is an unwelcome result of the disparity in US conditions relative to other economies. When the dollar strengthens it can stifle growth, especially in export-dependent sectors, and erode multinational corporate profits. Negative impacts go global as the cost of dollar priced commodities increases. To break the cycle Europe must recover, global rates normalize and uncertainty driving heightened dollar demand dissipate.