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Quarterly Market Insights

Trade Headlines and the Federal Reserve

Corporate earnings, Federal Reserve policy, and the economy have historically played a big role in influencing stocks. While Fed policy factored into market activity in the third quarter, earnings and the economy took a backseat to trade headlines and geopolitical issues.

Stock Indices	3rd Qtr. Return*	YTD Return %*
S&P 500 (large)	+1.70%	+20.55%
S&P 400 (midsize)	-0.09%	+17.87%
Russell 2000 (small)	-2.40%	+14.18%
MSCI EAFE (intl.)	-1.07%	+12.80%
Bond Yields	**Sep. 30 Yield & Qtr. Change**	**Yield a/o Dec. 31, 2018**
3-month T-bill	1.88% (-0.24%)	2.45%
2-year Treasury	1.63% (-0.12%)	2.48%
10-year Treasury	1.68% (-0.32%)	2.69%
30-year Treasury	2.12% (-0.40%)	3.02%
Commodities	**Sep. 30 Price & Qtr. Change**	**Year end 2018**
Oil per barrel	$54.07 (-$3.93)	$45.41
Gold per ounce	$1,472.90 (+$59.00)	$1,279.00

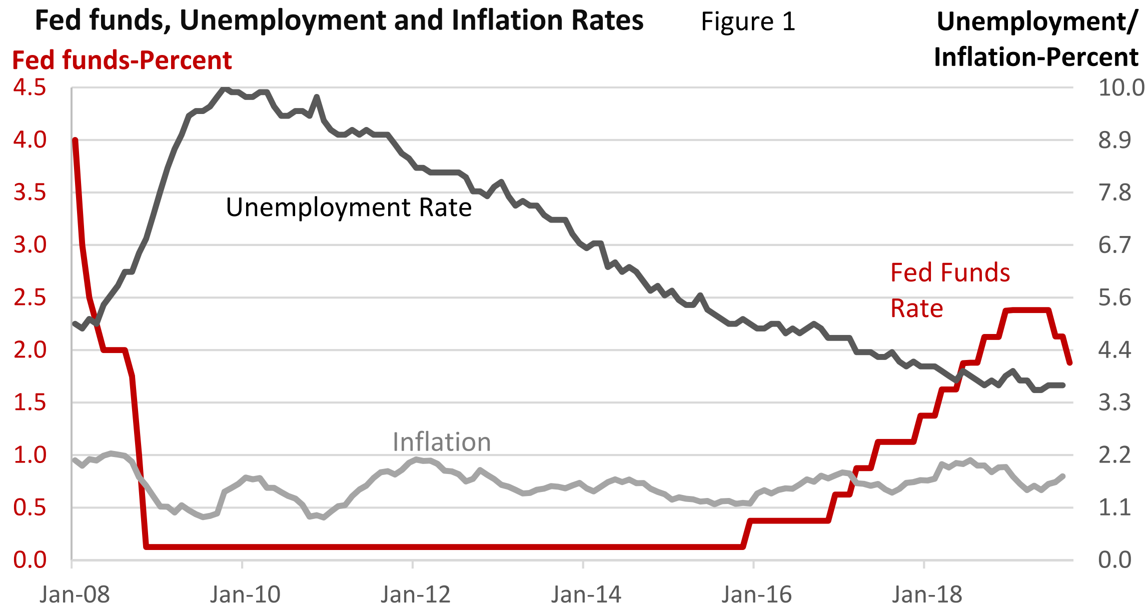
**Stock indices include reinvested dividends and are NOT annualized*

It is not that the economic data had no influence. An expanding economy cushioned August's decline, which was a modest peak-to-trough drop of 6.1% for the S&P 500 Index. If the data had signaled a sharp slowdown or a possible recession, stocks would likely have had a much weaker quarter. Instead, most major stock indices eked out a slight gain or loss.

Still, investors took their cues from trade headlines for much of the quarter. In some respects, that has been the case for the entire year. Talk that China and the U.S. would agree to a comprehensive trade deal fueled gains early in the year. That is, until the train leading toward an agreement ran off the tracks in early May. China backed away from previously agreed-upon terms, President Trump retaliated with new tariffs, and a tit-for-tat escalation between the economic superpowers ensued.

In early June, the Fed shifted gears and hinted that rate cuts might be needed as a buffer against trade uncertainty. Mix in a de-escalation of tensions and stocks recovered.

Enter August, and the Federal Reserve reduced the fed funds rate (Figure 1), but unsettling trade headlines created stiff headwinds. In September, the Fed cut again.



Fed funds rate: Sep 2019; Unemployment Rate: Aug 2019; Inflation Rate: Aug 2019
Inflation Rate: Core PCE Price Index, which excludes the more volatile food and energy categories
Left axis: fed funds rate, Right axis: unemployment & inflation rates

Sentiment improved, however, when more comforting headlines revealed that both China and the U.S. would re-engage in talks. A new round of negotiations between the two sides are occurring as this letter is being written.

Drama Hits a Fevered Pitch in the Nation's Capital

Meanwhile, U.S. House Speaker Nancy Pelosi said she would support an impeachment inquiry against President Trump, which adds another layer of uncertainty into the investment decision analysis. Yet, the initial reaction from investors has been muted.

The likely reason is that the economic fundamentals are still fairly favorable. Still, many investors are asking what the political turmoil may mean for their investments. Past impeachment proceedings may offer some clues – see Table 1.

Table 1: Then vs Now

1973-74—Bear Market	1998—Bull Market	2019—?
Inflation rose to double-digit levels, peaking at over 12%	Inflation low and slowing	Inflation is low
Interest rates were spiking higher; prime loan rate hit 12%	Interest rates steady	Interest rates are low
OPEC oil embargo roils economy; oil prices rise four-fold	Oil plentiful; prices stable	A glut of oil exists today, and prices are well below levels of recent years
The unemployment rate jumped; the economy fell into a steep recession	The economy expanding	The economy is expanding, and the unemployment rate is near a 50-year low

During President Nixon's second term, inflation and interest rates were high, and the economy slipped into a steep recession. In other words, the economic fundamentals were terrible and the market results reflected that.

While Nixon resigned from office without being impeached, the House impeached Clinton but the Senate failed to convict. Despite the political brouhaha, stocks performed well amid a favorable economic backdrop.

Although no economic cycle follows the exact same path, today's economic environment appears more closely aligned to the late 1990s than the mid-1970s.

Going Forward

As we enter the 4th quarter of 2019, uncertainty abounds. Investors will continue to grapple with trade, a possible European recession, Brexit, and a soft manufacturing sector. Yet, an expanding U.S. economy (albeit slowing), low interest rates, an accommodative Federal Reserve, stability in bond yields, and cautiously upbeat trade headlines have lifted the major indices.

We have seen volatility on a short-term basis, and we will likely see more.

However, the two 2019 selloffs—one in May and one in August—amounted to less than 7% each and shares subsequently recovered. For the longer-term investors, 2019 has been relatively calm, and stocks and bonds have performed well.

How to Invest

With all of this as a backdrop, how should one invest?

Have a Plan!! While your investments are very important in the process, it is essential that you have a Plan first that takes into account where you are now, where you want to be and then sets a course for getting there. After that is accomplished, you can develop a portfolio that best helps you achieve your unique personal goals.

While markets go up and down over the short to intermediate term, your investment strategy should be designed to help you meet your various financial goals and one that you will be comfortable with. By utilizing this approach, you greatly increase your chances of success over time.

Final Thoughts

As we continue to strive to give you the highest level of service, we are pleased to introduce a new member of our team: **Rachel Lowman**. Rachel is a recent graduate of Virginia Commonwealth University (VCU) with a degree in marketing. Her title is Client Service Administrator and she will be involved in many areas of the firm. Please say hi to Rachel if you get a chance.

As we enter the last quarter of the year, we feel very blessed to have you as a client. We constantly work to serve you to the best of our abilities. Thank you for your business.

Please do not hesitate to contact us if we can ever be of service.

Hopwood Financial Services, Inc.