MARKET MATTERS

Advisor Group
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Q3 Economic & Market Review – Slow and steady U.S. economic growth… but how long will it last?

Advisor Group Investment Product Research

	Beginning of year	July 31	August 31	September 30
10-year US Treasury Yield	2.69%	2.02%	1.51%	1.68%
Gold (London pm fixing per ounce in US dollars)	$1,285	$1,423	$1,529	$1,479
WTI Crude	$45.80	$57.56	$54.93	$54.24
VIX Index	25.42%	16.12%	18.98%	16.24%

All economic and market data as of 9/30/2019

Economic Review

In the third quarter, the Federal Reserve cut the Fed Funds rate, which is the rate that banks charge each other for overnight lending, two times by 25 basis points each time to a range of 1.75-2.00%. In its statement following September's second rate cut, the Fed commented that, "In light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to lower the target range for the Federal Funds rate to 1¾ to 2 percent. This action supports the Committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective are the most likely outcomes, but uncertainties about this outlook remain." Following the meeting, Fed Chairman Powell in his press conference stated that, "We're not on a pre-set course. We'll take things meeting by meeting and we'll try to be as transparent as we can." Based upon the comments by the Fed Chairman, market participants should anticipate that upcoming Federal Reserve decisions will be dependent upon economic data. The Federal Reserve also opened up the possibility of bond market purchases if economic conditions warrant it at a future point.

The third quarter also marked continued friction in the U.S./China trade war after trade talks in Shanghai between the two parties did not result in a new trade deal. After the unsuccessful talks, additional tariffs were instituted by both countries. However, new trade talks are scheduled for mid-

October. The other major development of the quarter in the U.S. was Speaker Nancy Pelosi announcing that the House of Representatives would launch a formal impeachment inquiry of President Trump, following allegations that Trump had pressured Ukraine to investigate Democratic Presidential candidate Joe Biden and his son, Hunter. It is important to be aware that as of the end of the third quarter this is an impeachment inquiry: articles of impeachment have not been filed or voted on at this point. In the history of the U.S., only two Presidents have been impeached by the House of Representatives with both being acquitted by the Senate – Andrew Johnson in 1968 and Bill Clinton in 1998. A third President, Richard Nixon, likely would have been impeached by the House of Representatives and the Senate had he not resigned. It is a very small sample size but in the one-year period following President Nixon's resignation in 1974, the S&P 500 rose 6% while in the one-year period following President Clinton's impeachment in 1998, the S&P 500 climbed 20%.

Below is a look at the key economic indicators that Advisor Group monitors on a regular basis and their most recent level of strength.

Key Economic Indicators

🟢 No current indications of weakness in this economic indicator

🟡 Economic indicator is slowing or demonstrating steady-but-slow growth

🔴 Economic indicator is flat or contracting

Economic Indicator	Current Strength Level	Commentary
Leading Economic Indicators	🟡	Latest reading shows a slowly expanding economy. The August reading was unchanged from the prior month but 0.4% higher than June.
U.S. Employment	🟢🟡	Employment situation remains relatively strong with unemployment at a 50-year low of 3.5%. Job growth has slowed though in 2019 relative to the pace of growth in 2018.
GDP Growth	🟢🟡	Slow and steady growth in GDP with second quarter GDP growing by an estimated 2.0%.
Retail Sales	🟢	Retail Sales were strong throughout the quarter, registering a 0.4% gain in August, which represents 4.1% year-over-year growth. This is an area that we are closely watching for signs of a slowdown.
Housing	🟡	Mixed results throughout the quarter with August's 7.1% growth in new home sales on the heels of an 8.6% slump in July. Existing home sales reached their highest levels since

		March 2018 in August. Case-Shiller showed 3.2% growth in home prices with Seattle being the only city showing a price decline year-over-year.
Inflation		Inflation remains subdued. The Consumer Price Index rose 1.7% while the Producer Price Index shows 1.8% growth in prices over the last year.
Manufacturing		The September reading of manufacturing PMI was at 47.8%. This was the second consecutive month of contraction in manufacturing (flat growth would be at 50.0%).
Consumer Confidence		The Conference Board Consumer Confidence Index fell to 125.1 in September, down from 134.2 in August with expectations falling from 106.4 to 95.8. The Board blamed an escalation in trade and tariff concerns for the decrease.
Fixed-Income Yield Curve		The yield curve is inverted between short-term (3-month) and the 10-year Treasuries but is slightly positive between the 2-year and 10-year. The yield curve was briefly inverted between the 2-year and 10-year earlier in the quarter; however, it flattened back out after two cuts in the Fed Funds rate by the Federal Reserve. An inversion of the 2-year and 10-year has historically been very successful (though not perfect) at predicting future recessions.
Equity Markets		Equity markets were very volatile during the third quarter; however, the S&P 500 ended the quarter with a year-to-date gain of 19% - the highest nine-month return to open a year since 1997.
Federal Reserve Policy		The Federal Reserve became much more accommodative during the quarter, cutting the benchmark Federal Funds rate twice during the quarter to a range of 1¾-2%. Foreign central banks were also

		accommodative during the quarter with several central banks cutting rates.
Corporate Profits	🟡	According to FactSet, the S&P 500 is expected to show a decline in earnings of 4.1% in the third quarter. If the S&P 500 earnings are negative year-over-year in the third quarter, it would be the first time since Q4 2015-Q2 2016 that the U.S. has seen three consecutive quarters of contraction.
Geopolitical risks	🔴	Geopolitical risks are elevated in response to trade wars, country-specific issues such as in the U.K. with Brexit and unrest in the Middle East and Hong Kong, and in global attacks against central banks.
Google searches for 'recession' followed by year. Ex: recession 2020.	🟡	Often times a soft economy can be tipped into a recession by consumers and businesses retracting just a small amount. While it's a newer indicator, Google searches for recession followed by the year was a very good early indicator of the 2008 recession. Such searches are now becoming elevated for 2020.
AG Economic View	🟡	We remain cautious in the outlook for the U.S. economy. The U.S. is currently experiencing its longest expansion in history. In recent months, we have seen signs of slowing growth in the U.S. economy while parts of Europe may be entering a recession. The Federal Reserve is preemptively attempting to lessen the chances of a recession; however, we believe there is an elevated chance of an economic slowdown in 2020 and a recession is very possible. It is important to be in a highly diversified portfolio to help counter any potential weakness. At the same time, those with intermediate and long-term investment horizons may find very attractive opportunities with any price weakness in financial markets.

Global Index Performance

	Q3 19	YTD	1 Year
S&P 500	1.19%	18.74%	2.15%
Russell 2000	-2.76%	12.96%	-10.21%
NASDAQ	-0.09%	20.56%	-0.58%
MSCI EAFE	-1.72%	10.34%	-4.86%
UK (FTSE)	-0.24%	8.35%	3.93%
Germany (DAX)	0.23%	17.70%	1.48%
Japan (NIKKEI)	2.26%	8.70%	-9.91%
MSCI Emerging Markets	-4.25%	5.89%	-2.02%
Barclays Aggregate TR	2.27%	8.52%	10.30%

Market data as of 9/30/2019; all Price Return with the exception of Barclays Aggregate TR

Markets Review

- **Domestic equities** were mixed during Q3 19 with the benchmark S&P 500 Index rising 1.19% for the quarter. While a modest quarterly return, the price return of nearly 19% for the first three quarters marks the best first three-quarter return in 22 years. Small-cap stocks, as measured by the Russell 2000 Index underperformed the broader market for the quarter, falling 2.76%. Drilling down into sector performance, more defensive sectors and sectors that benefit from lower interest rates outperformed with the S&P 500 Utilities sector climbing 9.3%, the Real Estate sector higher by 7.7% and Consumer Staples up by 6.6%. Meanwhile, the Energy sector was the worst performer in the S&P 500, falling by 6.3% in response to lower energy prices on concerns of slowing global growth. For the year to date, the best performing sector has been Information Technology which is up by 31% while Energy and Healthcare are up just 6%.

- U.S. equity markets were volatile during the third quarter after a very strong first half of the year. After a strong first two-thirds of July, equity markets fell roughly 5% over the next 30 or so days in response to increased trade tensions, mixed economic data and concerns that an inverted yield curve between the 2-year and 10-year Treasury notes could signal increased risk of a recession. The Federal Reserve reacted to the economic news with two consecutive interest rate cuts, which helped to calm markets late in the quarter.

- **International equities** were mostly lower during Q3 19 with the MSCI EAFE index falling 1.72%. Looking at developed markets, U.K. stocks, as measured by the FTSE 100, declined by 0.24% during the third quarter on slow economic growth and continued uncertainty around Britain's potential plan to exit the European Union (also known as Brexit). Stocks in Germany, as measured by the DAX index rose 0.23% despite increasing recession worries. Stocks in Japan outperformed by rallying 2.26% during the quarter. Emerging markets stocks, as measured by the MSCI Emerging Markets index, underperformed falling by 4.25% during the quarter on global slowdown worries and uncertainty surrounding a potential U.S./China trade deal.

- **Fixed-income** markets generally outperformed other asset classes during the quarter as interest rates fell, with the yield on the 10-year Treasury note moving down from 2.00% to 1.68%. At one point during the quarter, the 10-year Treasury note fell to 1.44%, its lowest level in more than three years and just seven basis points above the lowest 10-year Treasury yield in U.S. history. Despite this, the yields look high relative to those seen across much of Europe and Japan where more than $17 trillion in debt traded at negative yields at the end of the quarter. Yields across the globe remained relatively low in response to concerns around global economic growth, heightened geopolitical risks and low inflation in most parts of the world. The benchmark Bloomberg Barclays Aggregate Bond Index rose 2.27% for the quarter. All major fixed-income sectors rose during the quarter with high yield and emerging market bonds outperforming with each posting gains of more than 5%.

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