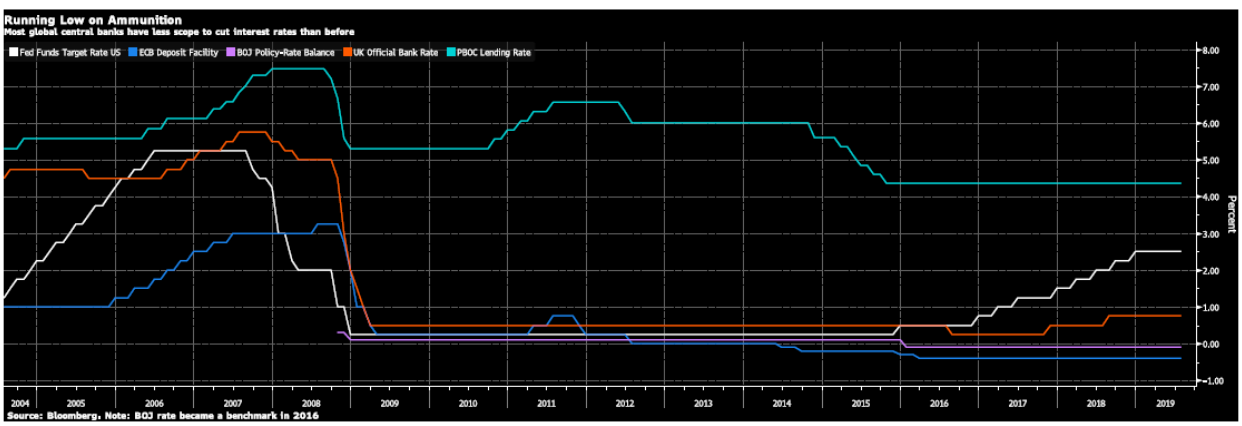
second quarter 2019

INVESTMENT *perspective*

During the second quarter of 2019, equity markets continued to recover from the steep sell off experienced in the fourth quarter of 2018. The S&P 500 and Russell 2000 Value appreciated approximately 4.30% and 1.37%, respectively. With the strong performance year-to-date, the S&P 500 has fully recovered from last year's decline while small cap indices remain materially below 3Q 2018 levels.

Global central banks are slowly moving to increase monetary stimulus to reinvigorate global growth and we expect the U.S. central bank to begin cutting rates during the third quarter. Unfortunately, given the prior reliance on monetary stimulus, the extended period of ultra-low rates, China rebalancing its economy, and the secular shift in trade flows; central banks' policies will have less of an impact on underlying economic growth **(Chart 1)**. There are many structural elements suppressing economic growth that cannot be addressed by lowering the federal funds rate. Global negative interest rates and inverted yield curves reflect a growing shortage of "U.S. dollar funding liquidity" outside of the United States. In order to address this U.S. dollar funding shortage, central banks will be forced to resume quantitative easing, or a coordinated devaluing of the U.S. dollar versus major trading currencies will be necessary to boost dollar liquidity.

CHART 1



We continue to expect only a modest resolution to tariff/trade negotiations with China and other countries. It is important to note that the global slowdown began prior to the implementation of tariffs and trade negotiations and we do not expect any resolution to the trade tensions to result in a material sustainable increase in economic growth. The industrial cycle, both domestically and internationally, continues to slow with some areas of the world such as Japan susceptible to entering a recession.

U.S. equity markets continue to price in a second half recovery in earnings growth. Unfortunately, the leading indicators we track continue to show slowing industrial activity. The slowdown is now spreading to the services sector, which will likely cause a softening in employment activity. We expect earnings expectations for the broad market averages to continue to decline during the second quarter earnings season. Volatility is likely to increase as further earnings weakness is met with increasing monetary stimulus. Valuations have risen materially in the first half of 2019, and we expect markets to remain volatile until we are in an environment of sustained economic growth.

The 10-year Treasury yield declined 40bps to 2.01% **(Chart 2)**. The 2-year to 10-year Treasury yield curve steepened 10bps to +25bps while the 2-year to 30-year curve steepened 22bps to +77bps. Credit spreads narrowed slightly in the quarter but are 38bps tighter year-to-date. That improvement in credit spreads generated 360 basis points of excess return over U.S. Treasury returns year-to-date.

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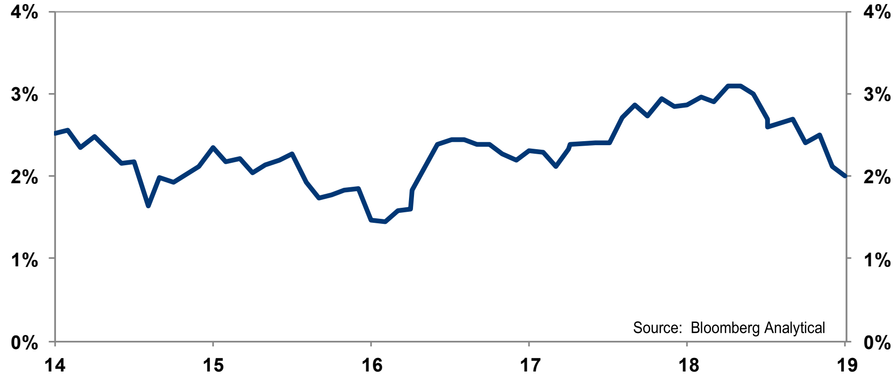
CHART 2
10-Year U.S. Treasury Yield



The Bloomberg Barclays Aggregate Index returned 3.08% in the second quarter and is up 6.11% year-to-date. Within the investment grade bond universe, longer duration and lower quality bonds have been the best performing areas. Municipal bonds continue to benefit from strong investor demand, reduced new issue supply, and the decline in Treasury yields. In the quarter, the ICE BofA Merrill Lynch 1-10 Year A-AAA Municipal Bond Index returned 1.51% and is up 3.58% year-to-date.