

# **CAPITAL MARKET REVIEW**

Second Quarter 2019



# The Economy

**The Index is not the Market.** The idea behind index investing is that the index is supposed to represent the market. One problem with this concept is that the index is just a sample of the market and like any investment portfolio it is a sample selected by someone.

Often the index does not really tell the full story. This year if one simply paid attention to the index, one would believe that growth has outperformed value, small cap stocks have lagged and the returns from emerging markets have been anemic at best.

This past quarter the large growth index did indeed outperform the large value index. However, most of our chosen large value managers actually delivered a better return than our large growth managers.

Our small cap managers are outperforming and our small cap growth managers are actually doing better than our favorite large growth managers.

In the emerging markets, our managers are crushing their index.

The point of this is to understand that the index does not tell the whole story. The index often includes areas of investment that no prudent manager would be participating in at the given moment in history. When those things happen the index is not really reflective of the market dynamics. Value and small cap investors have been waiting their turn in the sun for some time. Emerging markets have been out of favor too long. According to the indices this is still the case. According to actual portfolios the story may be changing.

## Equity Style Box

		<i>Investment Style</i>		
		Value	Blend	Growth
<i>Market Capitalization</i>	Large			
	Mid			
	Small			

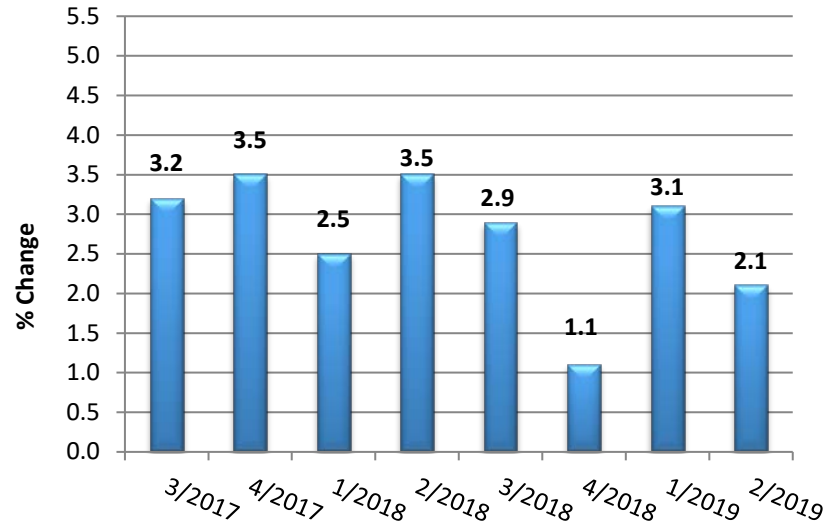
# The Economy

The 1st quarter 2019 GDP growth came in at 3.1 percent which was much higher than expectations. The second quarter of the year is a little slower at 2.1 percent, but this continues to be the best sustained growth we have seen in the US in a very long time.

The official unemployment rate is 3.7 percent in June. This is the longest sustained under 4 percent rate since the 1960's. Wages are growing at 3.1 percent which means real wage growth.

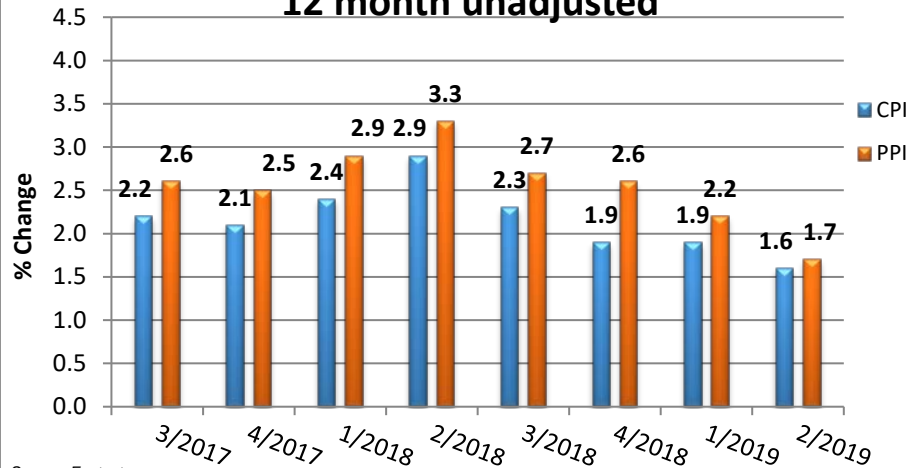
Inflation is 1.6 percent based on the latest consumer price index report. Inflation has gone down as wage growth has remained the same. This means real wage growth is increasing.

## Domestic GDP



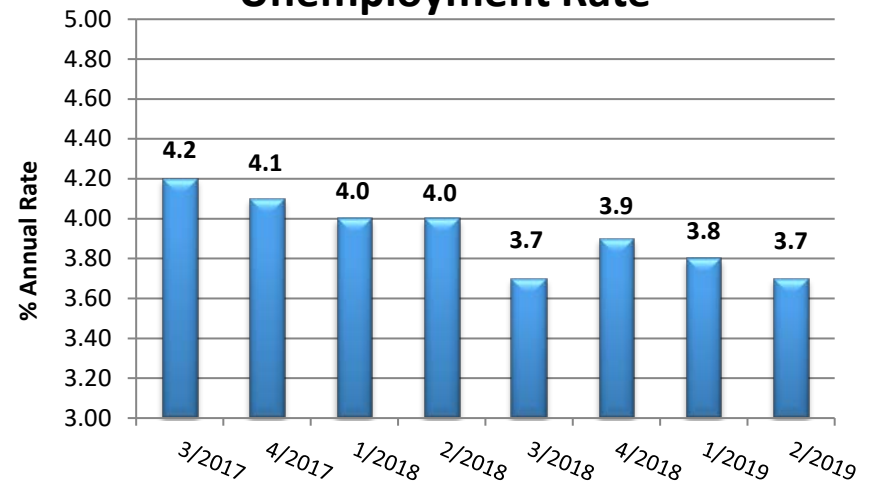
Source: Factset

## Inflation Indicator 12 month unadjusted



Source: Factset

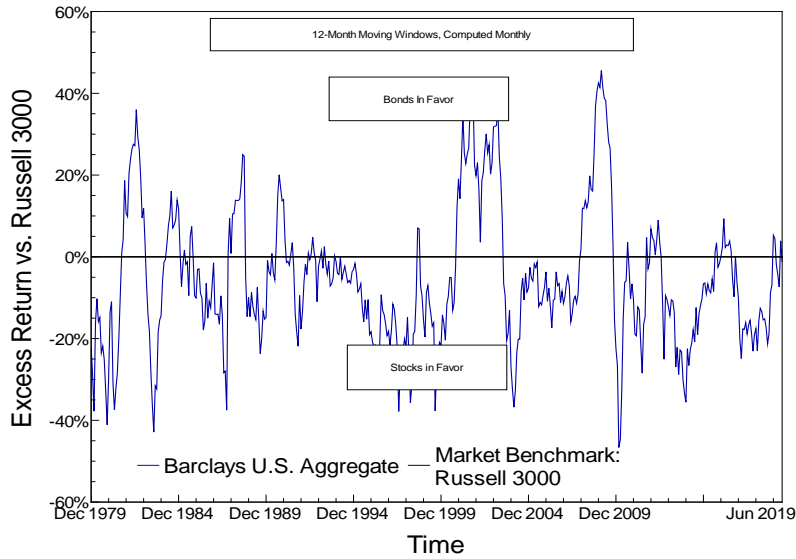
## Unemployment Rate



Source: Factset

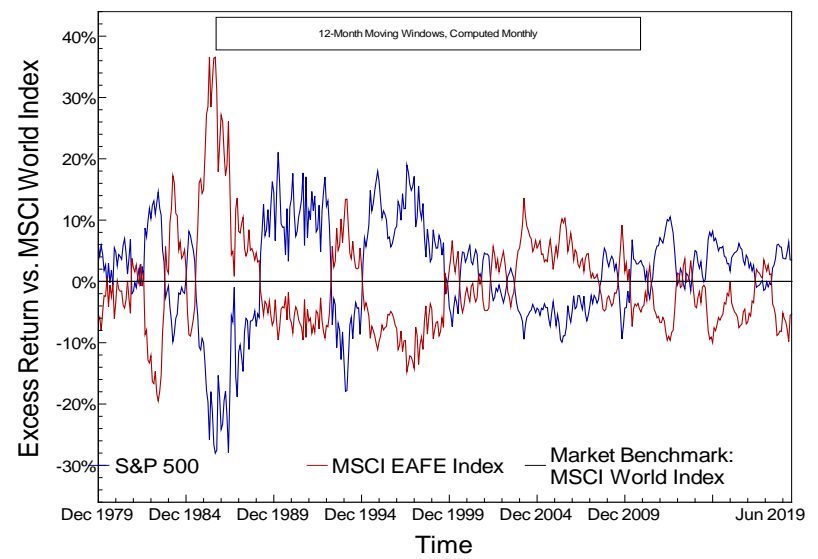
### Bonds vs. Stocks

Zephyr StyleADVISOR: Iron Capital Advisors



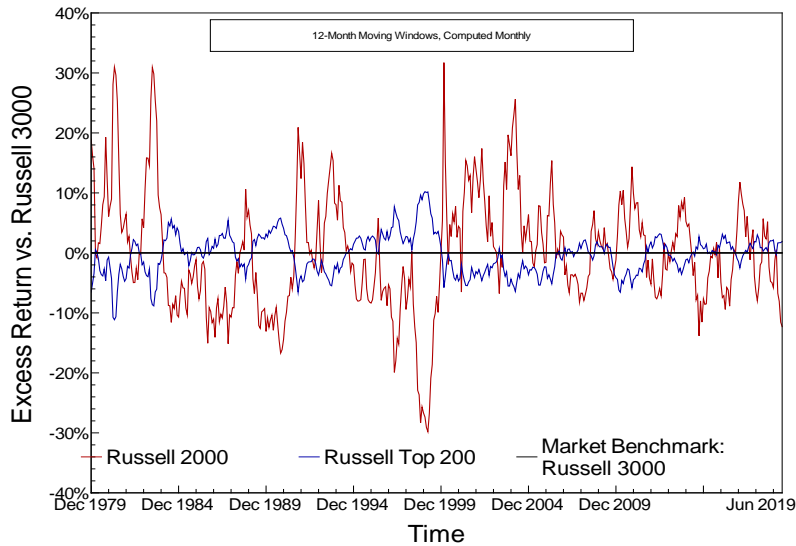
### International Vs. Domestic

Zephyr StyleADVISOR: Iron Capital Advisors

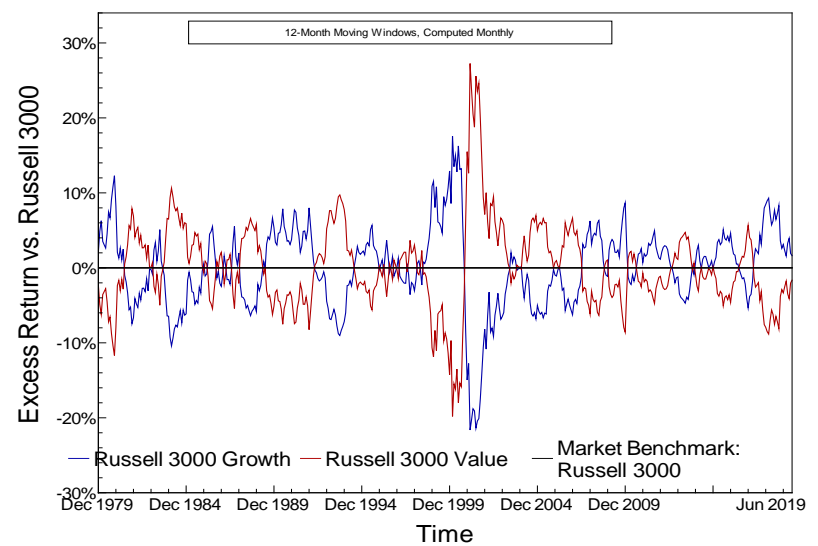


### Large vs. Small

Zephyr StyleADVISOR: Iron Capital Advisors



### Value vs. Growth



# Domestic Equity Markets

**Markets continue to run.** For the quarter the S&P 500 finished up 4.30 percent and small company stocks represented by the Russell 2000 index were up 2.10 percent. Growth once again outpaced value.

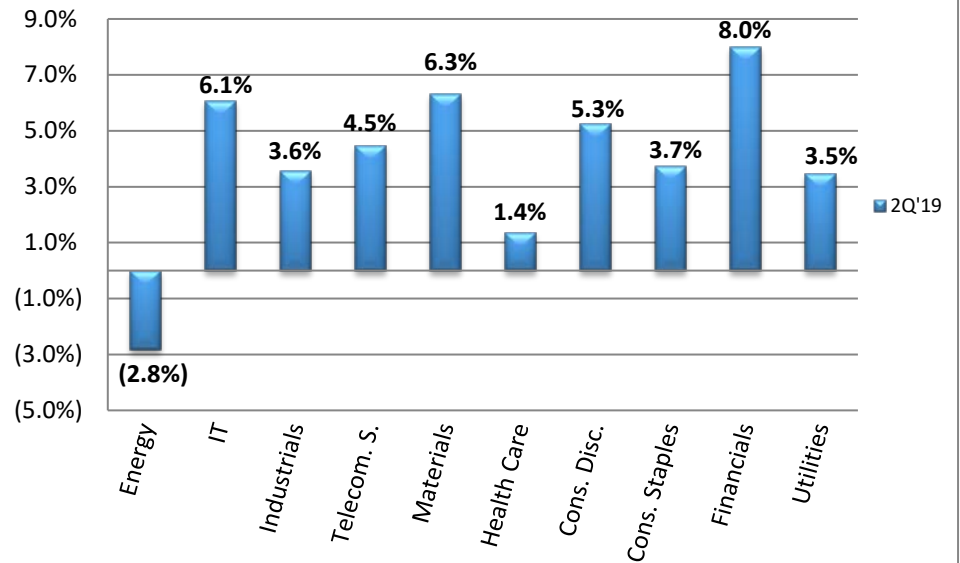
Financials were the best place to be during the quarter. Materials and then technology were the next best. With that, one might think that value would have done better but energy was the one negative sector.

Health care was scared by the threat of Medicare for All and industrials lagged due to the trade wars. Otherwise we would have seen even better growth.

## Domestic Indices Three Months Ending June 30, 2019

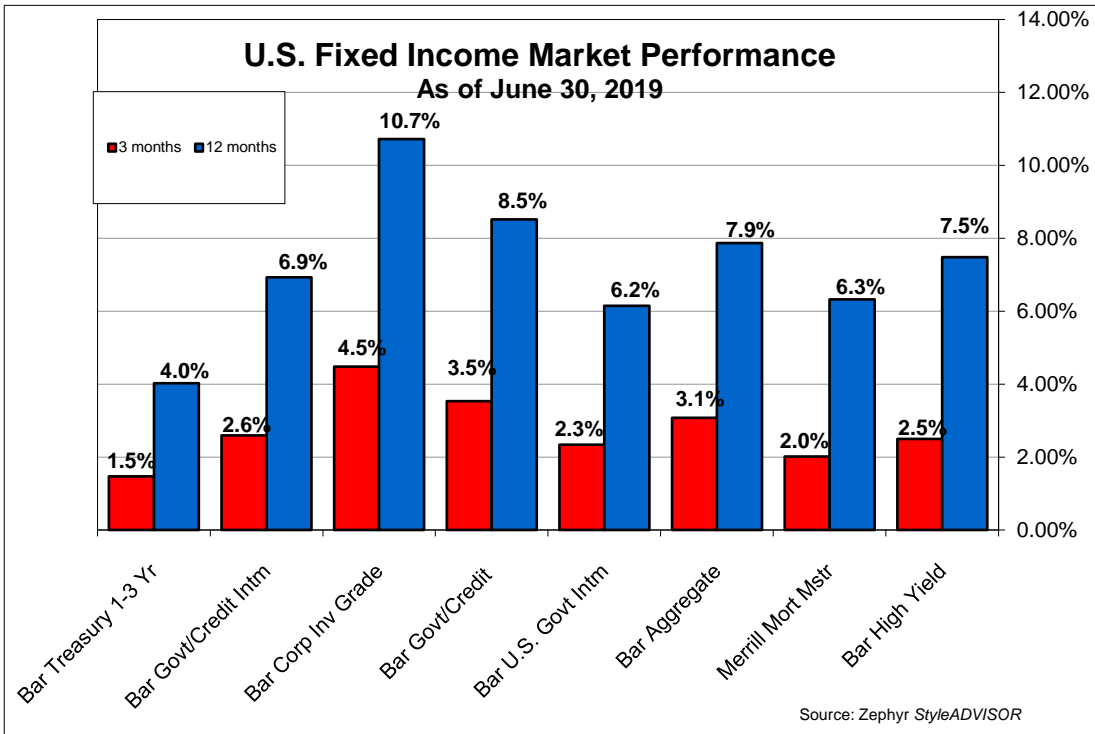
	Yield	Price/Earnings	Price/Book
S&P 500	1.86%	19.3	3.32
Russell 1000 Gr	1.17%	23.6	7.31
Russell 1000 Val	2.48%	16.9	2.03
Russell Midcap	1.62%	22.0	2.79
Russell 2000 Gr	0.63%	61.4	4.06
Russell 2000 Va	2.14%	24.0	1.40

## S&P GICS Sector Returns



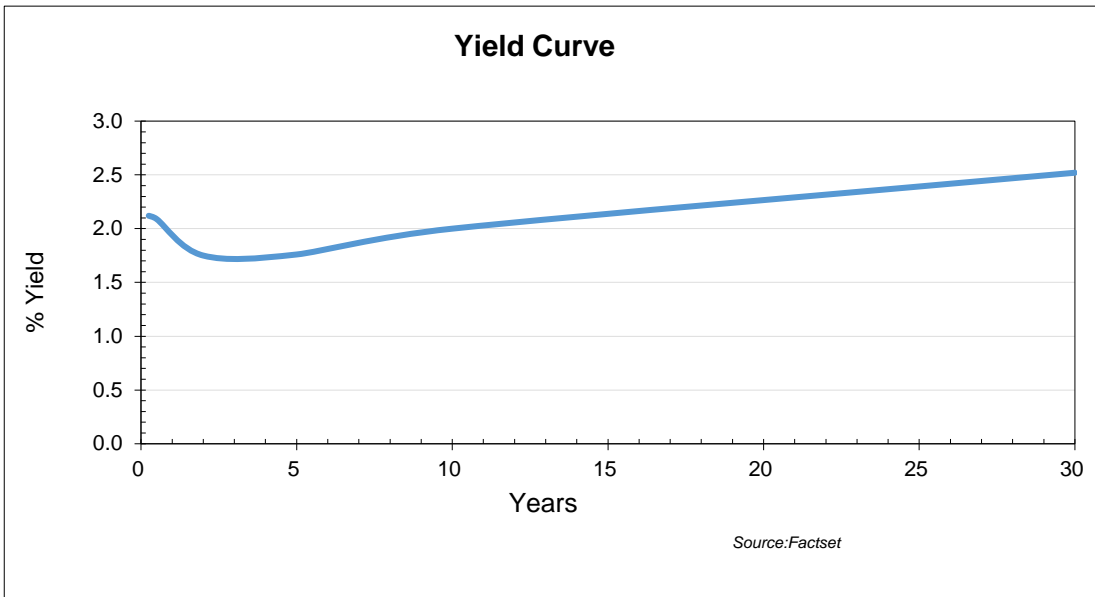
Source: Factset

# DOMESTIC FIXED INCOME MARKET



**Bonds rallied as well.** The Barclays US Aggregate Bond index ended up 3.08 percent. High yield bonds rose 2.50 percent.

With the 10 year Treasury testing the 2 percent bottom we are once again at a place where bonds are our greatest concern.



## Yield Curve as of June 30, 2019

Time to Maturity	Interest Rate
3 Month	2.12
6 Month	2.09
2 Year	1.75
5 Year	1.76
10 Year	2.00
30 Year	2.52

# INTERNATIONAL MARKETS

**International stocks were also positive.** The EAFE index finished up 3.97 percent while the MSCI Emerging Markets index ended the quarter up 0.74 percent.

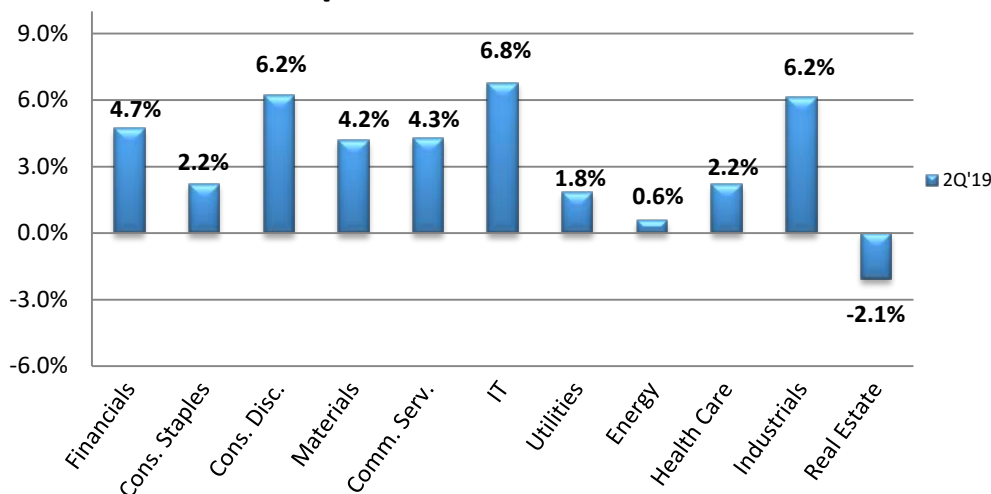
The uncertainty surrounding Brexit is coming to a head. The pound lost value during the quarter and knocked off 2.4 percent of the return for a US investor. The euro on the other hand added value. Currency tends to balance out over time, the bigger concern is for the economies. It does not take much to push Europe into recession and while fear of the Brexit is real, the actual economy in the UK has held up.

Valuations are most attractive in emerging markets, but we have the trade war with China front and center. Whether a deal can get done is not clear, but if it does happen then it would be a huge boost to the global picture. A boost that we do not think is priced into the market at the moment.

## MSCI Country Returns Three Months Ending June 30, 2019

	Return US\$ (%)	Return Local Currency (%)	Currency Effect(%)
Austria	1.24%	-0.18%	1.42%
Belgium	1.85%	0.42%	1.43%
Denmark	1.66%	0.21%	1.45%
Finland	0.87%	-0.54%	1.41%
France	7.31%	5.81%	1.50%
Germany	7.83%	6.32%	1.51%
Ireland	4.90%	3.43%	1.47%
Italy	3.62%	2.17%	1.45%
Netherlands	6.07%	4.73%	1.34%
Norway	3.02%	1.99%	1.03%
Portugal	2.60%	1.16%	1.44%
Spain	2.91%	1.47%	1.44%
Sweden	5.44%	5.47%	-0.03%
Switzerland	8.97%	6.68%	2.29%
UK	0.93%	3.33%	-2.40%
<b>Europe Total</b>	<b>4.91%</b>	<b>4.46%</b>	<b>0.45%</b>
Australia	7.36%	8.68%	-1.32%
Hong Kong	1.02%	0.57%	0.45%
Japan	1.05%	-1.64%	2.69%
New Zealand	3.98%	5.59%	-1.61%
Singapore	6.96%	6.84%	0.12%
<b>Pacific Total</b>	<b>2.46%</b>	<b>0.86%</b>	<b>1.60%</b>
Brazil	7.21%	5.58%	1.63%
Canada	5.11%	2.81%	2.30%
China	-3.92%	-4.21%	0.29%
Greece	16.42%	14.79%	1.63%
Hungary	-4.07%	-5.07%	1.00%
India	0.50%	0.14%	0.36%
Indonesia	3.65%	2.83%	0.82%
Korea	-0.87%	0.84%	-1.71%
Mexico	1.27%	0.30%	0.97%
Poland	3.62%	0.79%	2.83%
Russia	17.28%	13.19%	4.09%
Thailand	9.42%	5.74%	3.68%
<b>Emerging Markets</b>	<b>0.74%</b>	<b>0.33%</b>	<b>0.41%</b>

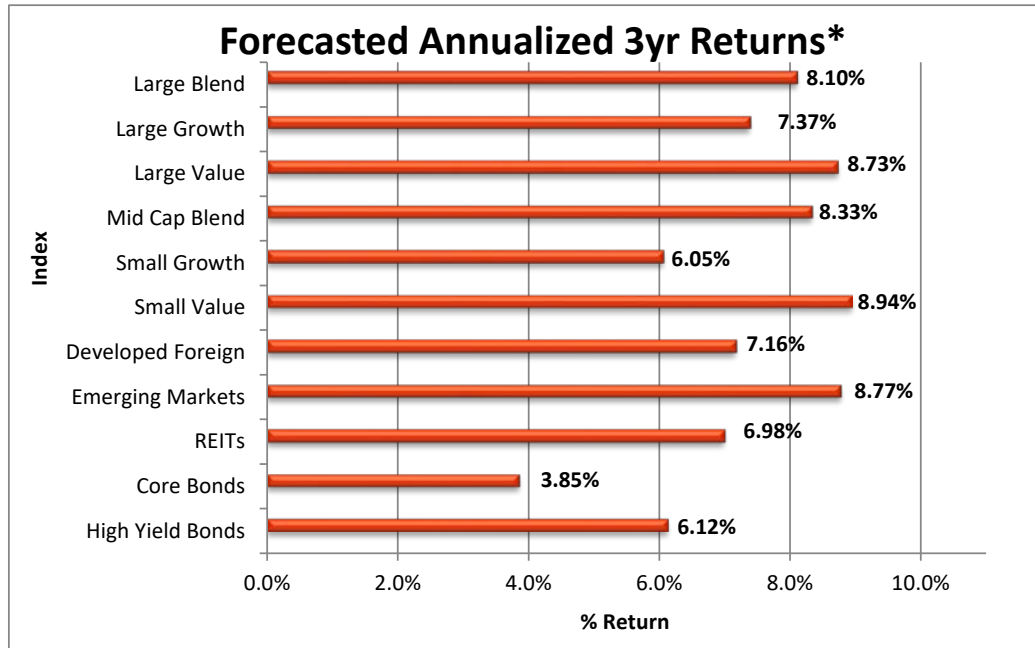
## Developed Int'l Sector Returns\*



Source: Harbor Capital

\* MSCI EAFE Index

## Market Forecast



The economy continues to outperform predictions and so does the stock market. Even with the S&P 500 up 18.71 percent year to date we remain cautiously optimistic. Cautious because markets never go up in straight lines, but optimistic because things remain better than what is priced in.

Small company stocks and value stocks are well overdue to come into a cycle of outperformance. With the economy outperforming, one would think this is a matter of when and not if. Emerging market stocks are also attractive and the best managers in this space are doing much better than the indices would indicate.

Bonds once again are overpriced and not likely to perform well.

**Changes in Return Expectations  
as of June 30, 2019**

Asset Class	Change Over Quarter	Change Over Year
Large Blend	-0.03%	-0.02%
Large Growth	0.10%	0.02%
Large Value	-0.14%	0.01%
Mid Cap Blend	-0.08%	-0.05%
Small Growth	0.19%	0.01%
Small Value	-0.02%	0.20%
Developed Foreign	0.03%	0.03%
Emerging Markets	-0.16%	-0.23%
REITs	-0.15%	-0.22%
Core Bonds	-0.35%	-0.23%
High Yield Bonds	-0.14%	-0.29%

\*Forecasted 3 year annualized returns represent Iron Capital's investment return expectations for various asset classes over the next 3 years. They are calculated using a weighted average of historic returns and forward return assumptions. They are meant to be a tool to judge relative attractiveness of asset classes and not a guarantee of future investment returns.



## SELECTED INDEX RETURNS - PERIODS ENDING June 30, 2019

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
<b>US EQUITIES</b>						
Broad Stock Market - Russell 3000	4.10%	18.71%	8.98%	14.02%	10.19%	14.67%
Large Stocks - S&P 500	4.30%	18.54%	10.42%	14.19%	10.71%	14.70%
Dow Jones Industrial Average	3.21%	15.40%	12.20%	16.80%	12.29%	15.03%
Medium-Size Stocks - Russell Mid-Cap	4.13%	21.35%	7.83%	12.16%	8.63%	15.16%
Small Stocks - Russell 2000	2.10%	16.98%	-3.31%	12.30%	7.06%	13.45%
Small Value Stocks- Russell 2000 Value	1.38%	13.47%	-6.24%	9.81%	5.39%	12.40%
Small Growth Stocks- Russell 2000 Growth	2.75%	20.36%	-0.49%	14.69%	8.63%	14.41%
Large Value Stocks - Russell 1000 Value	3.84%	16.24%	8.46%	10.19%	7.46%	13.19%
Large Growth Stocks - Russell 1000 Growth	4.64%	21.49%	11.56%	18.07%	13.39%	16.28%
<b>US FIXED INCOME</b>						
1-3 Yr Treasury (Gov't) Bonds - Barclays Capital	1.47%	2.47%	4.02%	1.29%	1.22%	1.20%
US Government Bonds Int - Barclays Capital	2.34%	3.96%	6.15%	1.34%	1.94%	2.38%
US Corporate Inv Grade Bonds - Barclays Capital	4.48%	9.85%	10.72%	3.94%	4.08%	6.07%
Government/Credit (Corp) Bonds - Barclays Capital	3.53%	6.90%	8.52%	2.41%	3.11%	4.09%
Int Govt/Credit (Corp) Bond - Barclays Capital	2.59%	4.97%	6.93%	1.99%	2.39%	3.24%
US Aggregate Bond Market - Barclays Capital	3.08%	6.11%	7.87%	2.31%	2.95%	3.90%
Mortgage Master - Merrill Lynch	2.01%	4.32%	6.32%	2.11%	2.57%	3.26%
US Corp High Yield Bonds - Barclays Capital	2.50%	9.94%	7.48%	7.52%	4.70%	9.24%
<b>INTERNATIONAL (Measured in US Dollars)</b>						
Non-US Stocks - MSCI EAFE	3.97%	14.49%	1.60%	9.65%	2.74%	7.40%
World Stocks (includes US) - MSCI World	4.20%	17.38%	6.94%	12.39%	7.20%	11.33%
European Stocks - MSCI Europe	4.91%	16.45%	2.55%	9.79%	1.88%	7.63%
Japanese Stocks - MSCI Japan	1.05%	7.97%	-3.83%	8.44%	4.82%	6.11%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	5.19%	18.10%	8.19%	12.08%	4.17%	9.06%
Chinese Stocks - MSCI China	-3.92%	13.08%	-6.55%	14.51%	7.58%	6.39%
Indian Stocks - MSCI India	0.50%	7.70%	7.94%	10.52%	5.43%	6.53%
Emerging Markets - MSCI EM	0.74%	10.78%	1.61%	11.06%	2.87%	6.17%
Int'l Gov't Bonds -Citi World Gov't Bond (Non USD)	3.93%	5.50%	4.54%	0.83%	0.19%	1.88%
<b>REAL ESTATE</b>						
FTSE NAREIT Equity-Reits Index	1.24%	17.78%	10.72%	4.05%	7.83%	15.41%
<b>SHORT TERM INTEREST RATES</b>						
T-Bills	0.61%	1.21%	2.30%	1.36%	0.84%	0.46%

Note: Returns for periods longer than 12 months are annualized.