

# **CAPITAL MARKET REVIEW**

Third Quarter 2019



# The Economy

**Trade and the Fed.** These two items were the top stories of the third quarter. The Fed has begun easing rates to help a slowing economy, but the slow growth is coming from the trade war.

The 2<sup>nd</sup> quarter GDP report made it clear. The consumer grew at over 4 percent, but business investment basically stopped. It is difficult to see how this could be tied to anything other than trade tensions. The trade war produces uncertainty in the minds of business leaders and they in turn go into wait and see mode.

This is important, because while the market may cheer low interest rates, the impact on the real economy will be negated. If business decision makers are on halt because of trade, then it does not matter that the loan they would need if they moved forward is a few basis points cheaper.

There is a limit to the power of cheap money. If you don't believe me ask the Japanese, or in a few years the Germans. They both have negative rates and their economies are not exactly strong. Japan has been in this situation for nearly 30 years now. It brings to mind the quote from John Maynard Keynes, "the difficulty lies not so much in developing new ideas as in escaping from old ones."



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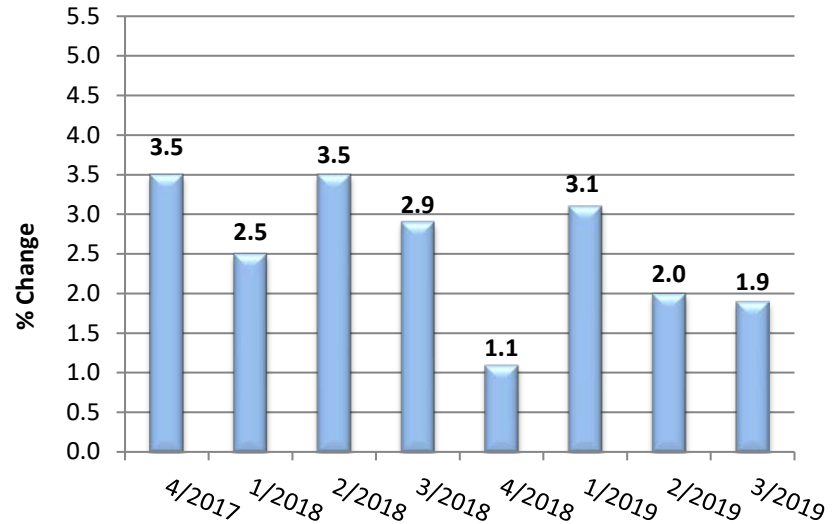
# The Economy

The 2nd quarter 2019 GDP growth came in at 2.0 percent. Initial reading for the 3rd quarter is 1.9 percent. Underneath the surface the consumer is doing fantastically well, as business investment has come to a sudden halt. It is all about tariffs. If we get a breakthrough with China, business investment will resume and we will continue to grow. If we do not, it becomes a matter of how long the consumer can keep us afloat.

The official unemployment rate is 3.5 percent in September. This is the lowest rate in 50 years. What else can we say?

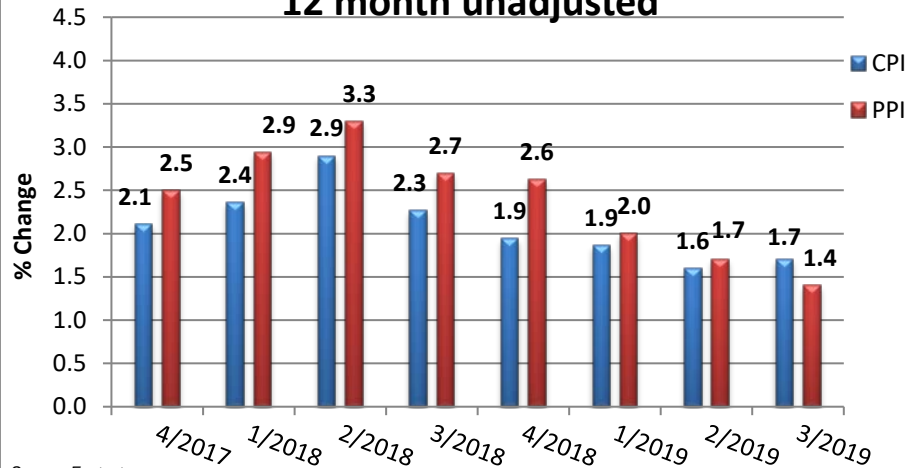
Inflation is 1.7 percent based on the latest consumer price index report. Inflation remains low even with full employment and rising wages.

## Domestic GDP



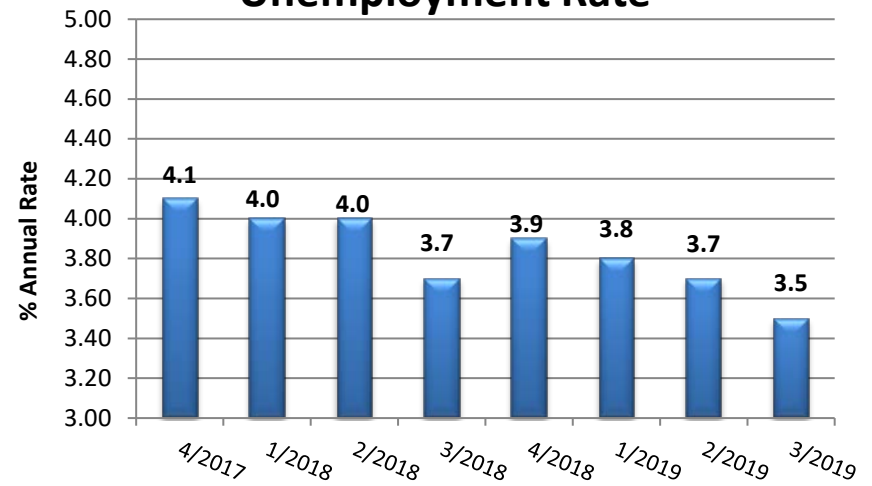
Source: Factset

## Inflation Indicator 12 month unadjusted

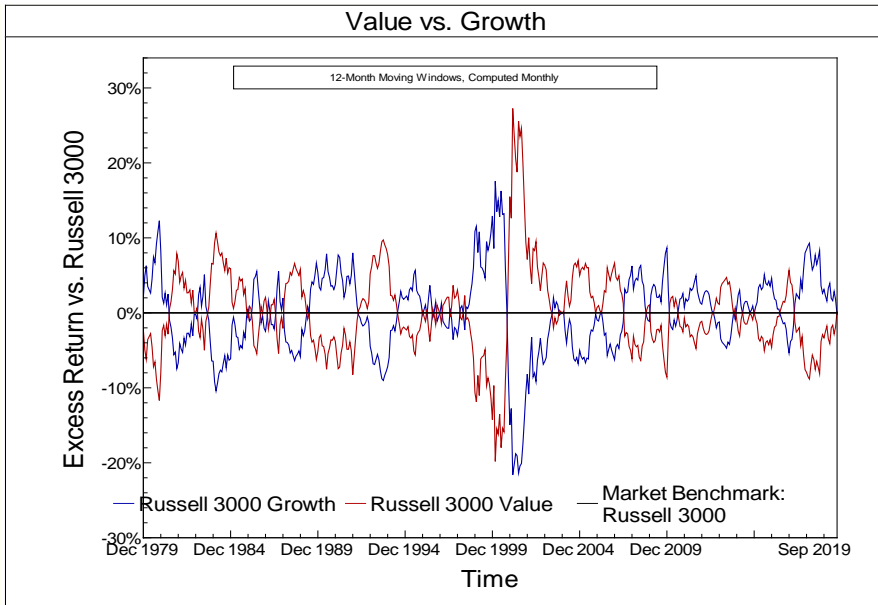
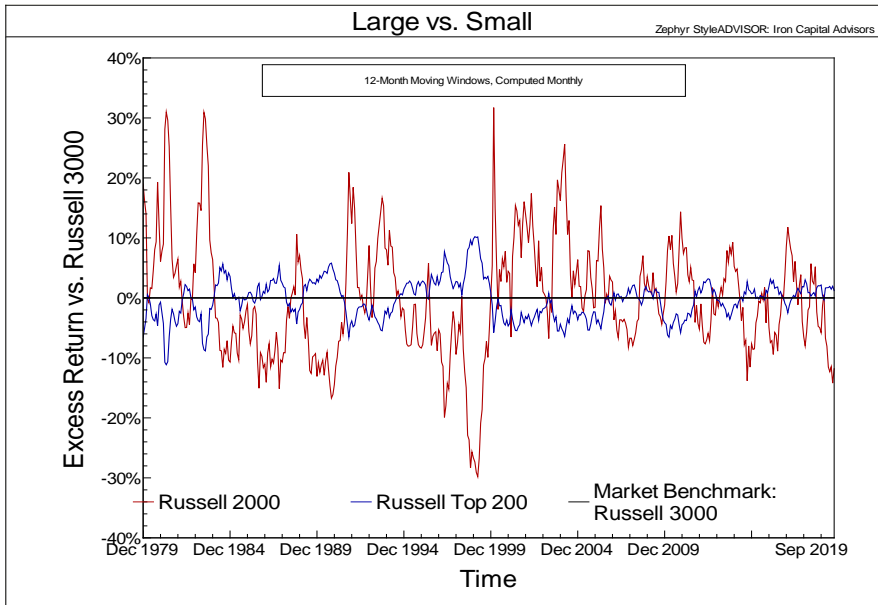
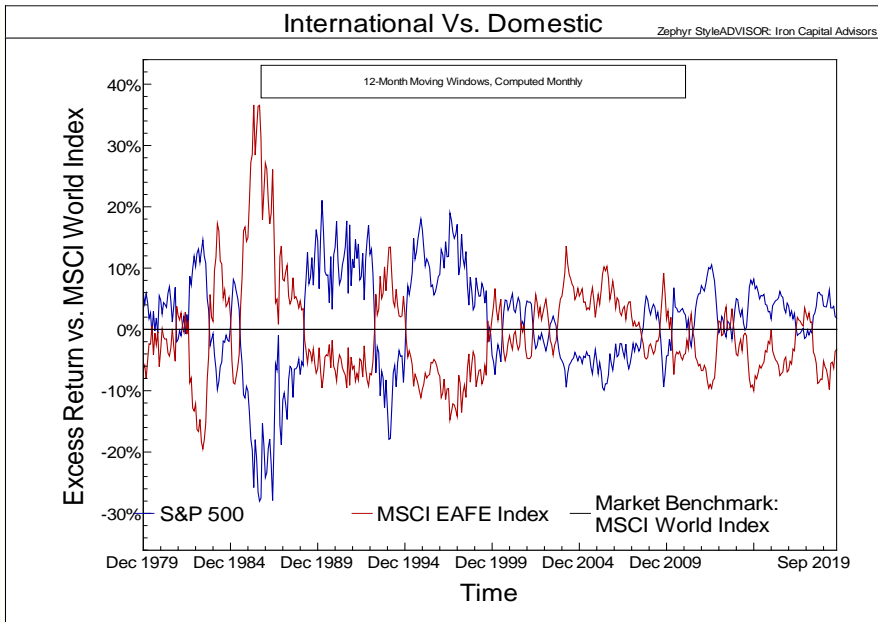
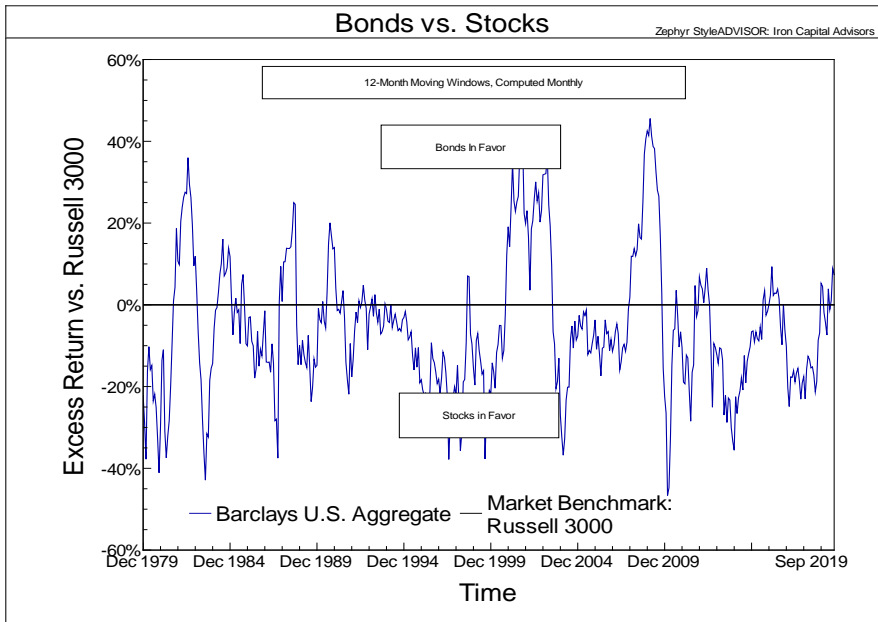


Source: Factset

## Unemployment Rate



Source: Factset



# Domestic Equity Markets

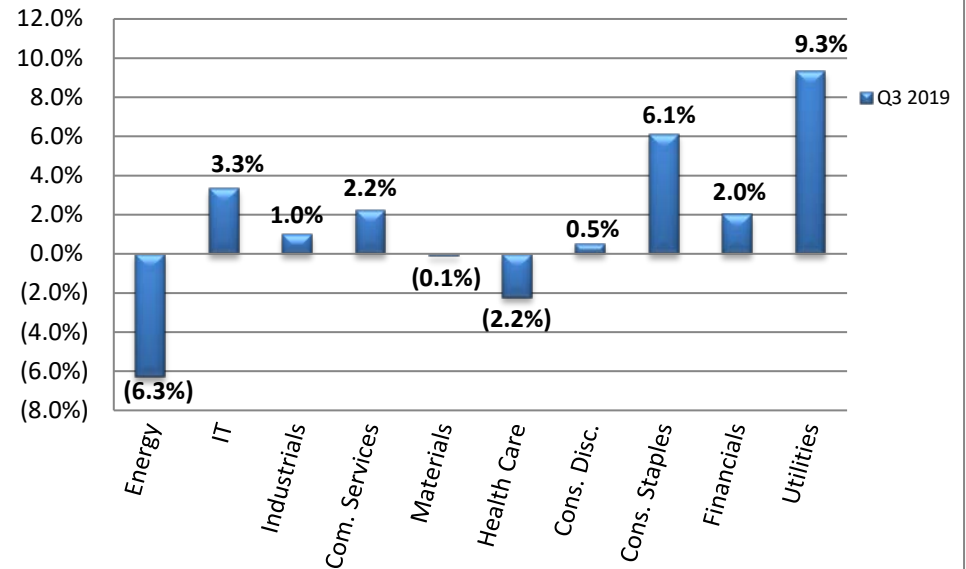
**Markets were volatile and mixed.** For the quarter the S&P 500 finished up 1.70 percent and small company stocks represented by the Russell 2000 index were down 2.40 percent. Growth outpaced value barely in large stocks, but value investors fared much better in the small company market.

Utilities and staples were the best places to be as fear of the trade war leading us into recession took hold of the market. Energy suffered under the same assumption coupled with over supply. Healthcare was also sharply negative as the talk of Medicare For All has investors understandably nervous.

## Domestic Indices Three Months Ending September 30, 2019

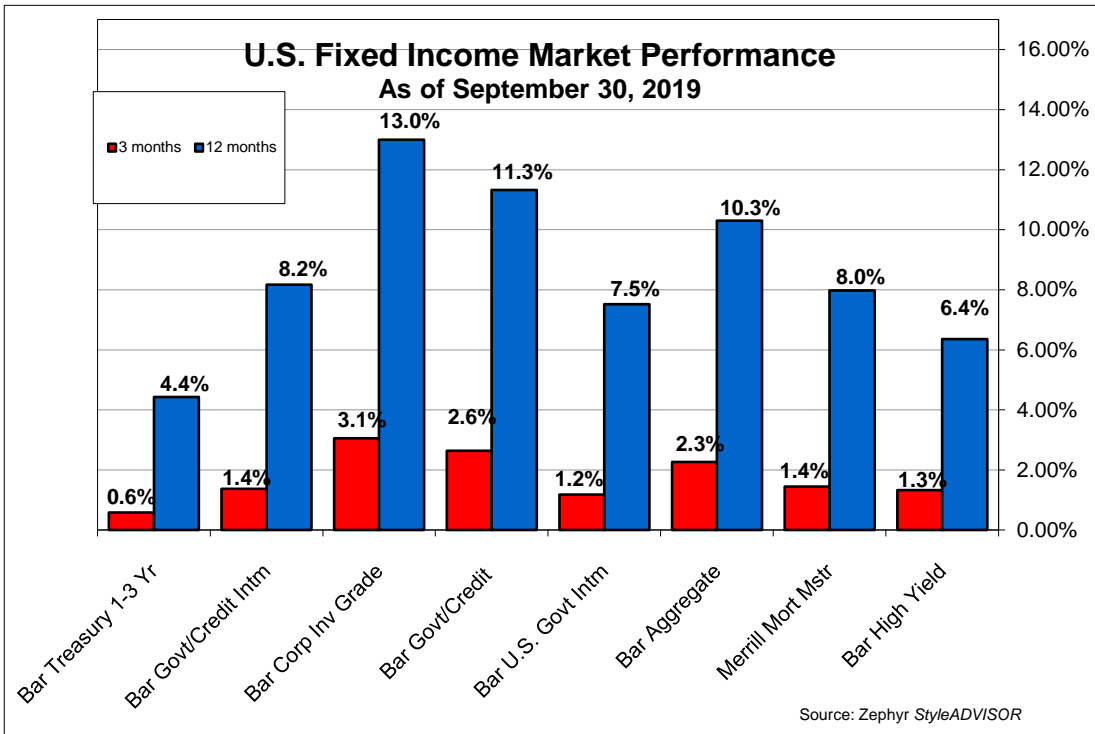
	Yield	Price/Earnings	Price/Book
S&P 500	1.87%	19.5	3.36
Russell 1000 Gr	1.14%	25.8	8.27
Russell 1000 Val	2.51%	16.5	1.99
Russell Midcap	1.67%	22.3	2.64
Russell 2000 Gr	0.73%	100.8	4.06
Russell 2000 Va	2.18%	26.7	1.31

## S&P GICS Sector Returns



Source: Factset

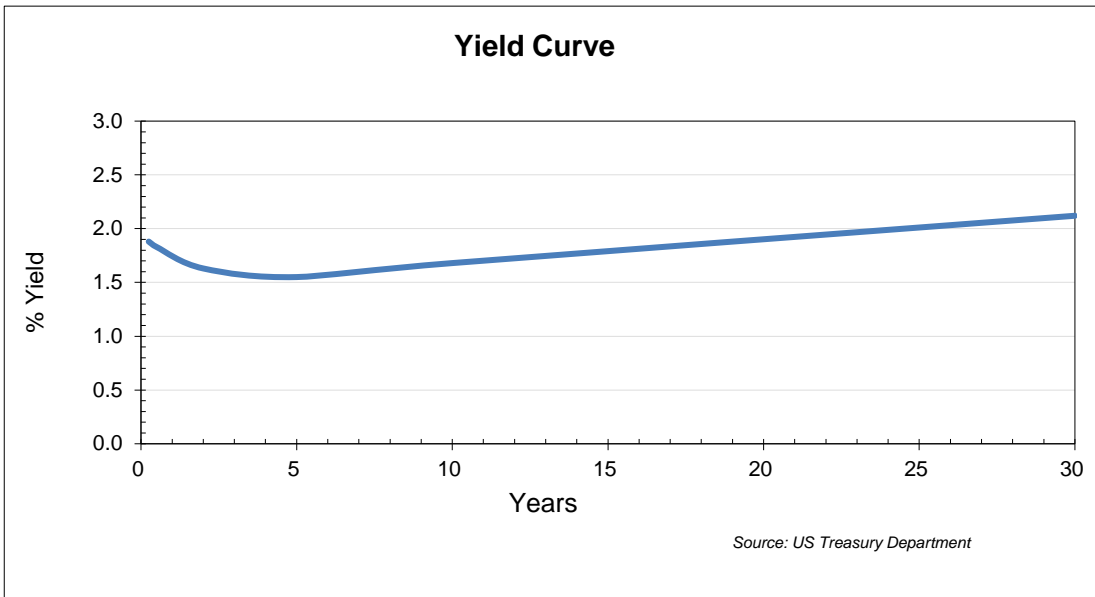
# DOMESTIC FIXED INCOME MARKET



**Bonds rallied.** The Barclays US Aggregate Bond index ended up 2.27 percent. High yield bonds rose 1.33 percent.

A year ago we were celebrating rates being over 3 percent and now the 10 year is at 1.68 percent.

Can yields go lower? Sure, but there is much farther to go on the up side. Bonds remain unattractive.



## Yield Curve as of September 30, 2019

Time to Maturity	Interest Rate
3 Month	1.88
6 Month	1.83
2 Year	1.63
5 Year	1.55
10 Year	1.68
30 Year	2.12

# INTERNATIONAL MARKETS

**International stocks were down.** The EAFE index finished down 1.00 percent while the MSCI Emerging Markets index ended the quarter down 4.11 percent.

Global growth is slowing. Germany posted negative growth in the second quarter and it is anticipated to do the same this quarter. That would mean Germany is in recession which will drag on all of Europe.

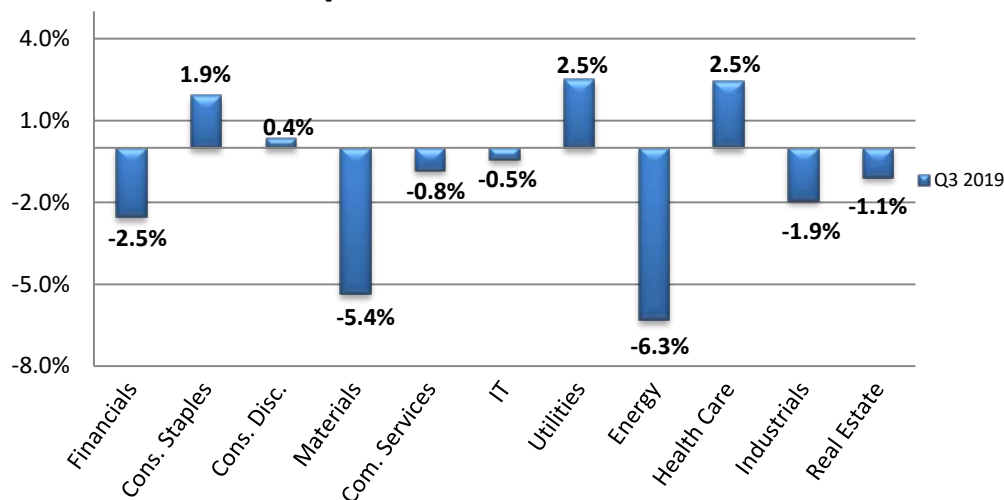
In addition we still have no idea how Brexit will end. In the long term we guess it will have less impact than feared, but the short run will be painful for Britain and their trading partners in Europe.

China's growth in the meantime is the slowest in almost 30 years. While 6 percent growth would be blistering here or in Europe, China is used to much better. The trade war is having an impact.

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

	Return US\$ (%)	Return Local Currency (%)	Currency Effect(%)
Austria	-2.98%	1.34%	-4.32%
Belgium	3.48%	8.09%	-4.61%
Denmark	-0.90%	3.55%	-4.45%
Finland	-1.70%	2.68%	-4.38%
France	-1.64%	2.75%	-4.39%
Germany	-4.03%	0.24%	-4.27%
Ireland	-0.46%	3.98%	-4.44%
Italy	0.14%	4.60%	-4.46%
Netherlands	2.51%	6.62%	-4.11%
Norway	-3.31%	3.04%	-6.35%
Portugal	1.84%	6.38%	-4.54%
Spain	-3.76%	0.53%	-4.29%
Sweden	-4.79%	0.89%	-5.68%
Switzerland	0.29%	2.57%	-2.28%
UK	-2.48%	0.72%	-3.20%
<b>Europe Total</b>	<b>-1.75%</b>	<b>2.09%</b>	<b>-3.84%</b>
Australia	-1.36%	2.63%	-3.99%
Hong Kong	-11.94%	-11.66%	-0.28%
Japan	3.29%	3.61%	-0.32%
New Zealand	-2.78%	4.14%	-6.92%
Singapore	-5.77%	-3.69%	-2.08%
<b>Pacific Total</b>	<b>0.35%</b>	<b>1.50%</b>	<b>-1.15%</b>
Brazil	-4.54%	3.75%	-8.29%
Canada	0.65%	1.98%	-1.33%
China	-4.67%	-4.25%	-0.42%
Greece	-2.99%	1.34%	-4.33%
Hungary	-3.92%	4.16%	-8.08%
India	-5.15%	-2.62%	-2.53%
Indonesia	-5.17%	-4.72%	-0.45%
Korea	-4.45%	-1.02%	-3.43%
Mexico	-1.64%	1.08%	-2.72%
Poland	-11.69%	-5.06%	-6.63%
Russia	-0.91%	1.53%	-2.44%
Thailand	-5.89%	-6.15%	0.26%
<b>Emerging Markets</b>	<b>-4.11%</b>	<b>-1.93%</b>	<b>-2.18%</b>

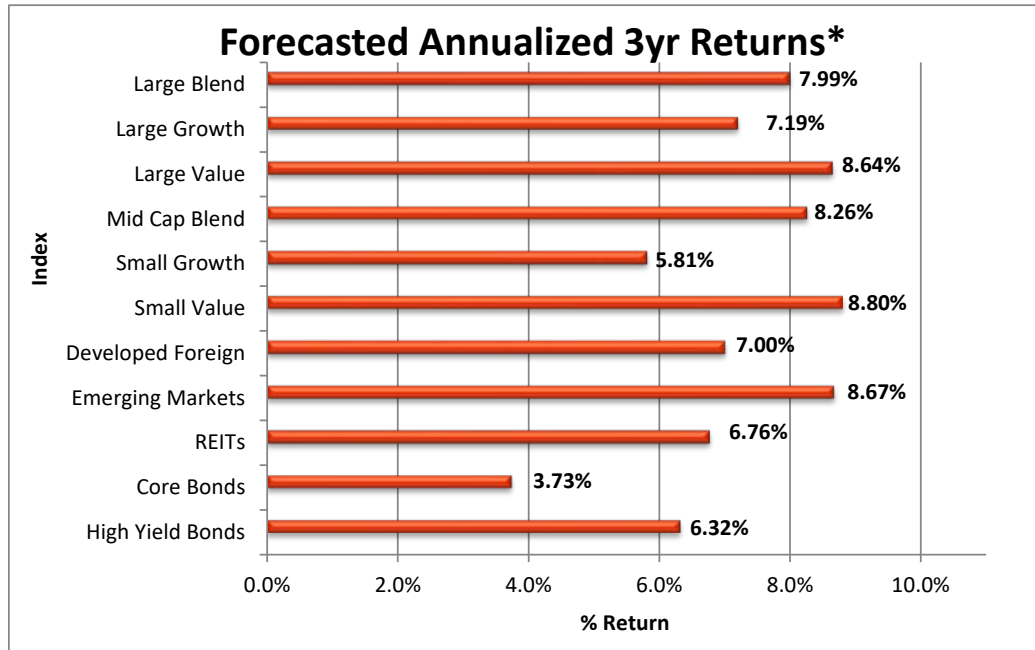
## Developed Int'l Sector Returns\*



Source: T. Rowe Price

\* MSCI EAFE Index

## Market Forecast



**The trade war appears to be hitting home.** We are more cautious now than we have been in a while. Fundamentals remain strong, and if we get a deal with China the market should rally. However, if we do not then the economy will continue to slow and the market will drop.

Small company stocks and value stocks are still overdue to come into a cycle of outperformance. Emerging economy stocks are also attractive and the best managers in this space are doing much better than the indices would indicate. There is lots of risk there, but this is still the most attractive based on valuations.

Bonds remain overpriced and not likely to perform well.

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

Asset Class	Change Over Quarter	Change Over Year
Large Blend	-0.11%	0.02%
Large Growth	-0.18%	-0.02%
Large Value	-0.09%	0.02%
Mid Cap Blend	-0.07%	-0.02%
Small Growth	-0.25%	-0.19%
Small Value	-0.15%	0.07%
Developed Foreign	-0.16%	0.00%
Emerging Markets	-0.11%	-0.20%
REITs	-0.22%	-0.24%
Core Bonds	-0.09%	-0.41%
High Yield Bonds	-0.01%	-0.09%

\*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 September 30, 2019

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
<b>US EQUITIES</b>						
Broad Stock Market - Russell 3000	1.16%	20.09%	2.92%	12.83%	10.44%	13.08%
Large Stocks - S&P 500	1.70%	20.55%	4.25%	13.39%	10.84%	13.24%
Dow Jones Industrial Average	1.83%	17.51%	4.21%	16.44%	12.28%	13.56%
Medium-Size Stocks - Russell Mid-Cap	0.48%	21.93%	3.19%	10.69%	9.10%	13.07%
Small Stocks - Russell 2000	-2.40%	14.18%	-8.89%	8.23%	8.19%	11.19%
Small Value Stocks- Russell 2000 Value	-0.57%	12.82%	-8.24%	6.54%	7.17%	10.06%
Small Growth Stocks- Russell 2000 Growth	-4.17%	15.34%	-9.63%	9.79%	9.08%	12.25%
Large Value Stocks - Russell 1000 Value	1.36%	17.81%	4.00%	9.43%	7.79%	11.46%
Large Growth Stocks - Russell 1000 Growth	1.49%	23.30%	3.71%	16.89%	13.39%	14.94%
<b>US FIXED INCOME</b>						
1-3 Yr Treasury (Gov't) Bonds - Barclays Capital	0.58%	3.07%	4.43%	1.52%	1.33%	1.18%
US Government Bonds Int - Barclays Capital	1.18%	5.18%	7.52%	1.82%	2.18%	2.34%
US Corporate Inv Grade Bonds - Barclays Capital	3.05%	13.20%	13.00%	4.50%	4.72%	5.56%
Government/Credit (Corp) Bonds - Barclays Capital	2.64%	9.72%	11.32%	3.16%	3.61%	3.94%
Int Govt/Credit (Corp) Bond - Barclays Capital	1.37%	6.41%	8.17%	2.40%	2.68%	3.05%
US Aggregate Bond Market - Barclays Capital	2.27%	8.52%	10.30%	2.92%	3.38%	3.75%
Mortgage Master - Merrill Lynch	1.44%	5.82%	7.98%	2.38%	2.83%	3.17%
US Corp High Yield Bonds - Barclays Capital	1.33%	11.41%	6.36%	6.07%	5.37%	7.94%
<b>INTERNATIONAL (Measured in US Dollars)</b>						
Non-US Stocks - MSCI EAFE	-1.00%	13.35%	-0.82%	7.01%	3.77%	5.39%
World Stocks (includes US) - MSCI World	0.66%	18.15%	2.42%	10.82%	7.79%	9.62%
European Stocks - MSCI Europe	-1.75%	14.41%	-0.09%	7.23%	3.00%	5.24%
Japanese Stocks - MSCI Japan	3.29%	11.52%	-4.32%	6.59%	5.97%	5.78%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	-5.18%	11.98%	3.13%	7.25%	4.33%	5.88%
Chinese Stocks - MSCI China	-4.67%	7.80%	-3.77%	7.90%	6.23%	5.09%
Indian Stocks - MSCI India	-5.15%	2.14%	4.73%	6.53%	3.84%	4.09%
Emerging Markets - MSCI EM	-4.11%	6.23%	-1.63%	6.37%	2.71%	3.73%
Int'l Gov't Bonds -Citi World Gov't Bond (Non USD)	-0.11%	5.39%	6.78%	0.60%	1.28%	1.15%
<b>REAL ESTATE</b>						
FTSE NAREIT Equity-Reits Index	7.80%	26.96%	18.42%	7.20%	10.16%	12.99%
<b>SHORT TERM INTEREST RATES</b>						
T-Bills	0.56%	1.78%	2.36%	1.52%	0.96%	0.52%

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