Quarterly **Client Report**

Economy | **Capital Markets**

Q2 2019

Economy

Through the first six months of the year, it is apparent that both the economic and investing environment have become a bit more challenging. Although capital markets are enjoying a welcome rebound from last year's lackluster performance, and the economy posted a 3.0 percent annual growth rate through March, several key domestic economic indicators have started to weaken. Further, there are added pressures from the trade war with China, slowing growth in Europe and geopolitical issues around the world. The challenge for investors is sifting through the plethora of data and determining whether the economy is just entering a "soft patch" and growth will soon pick up, or if these pressures will end the 10-year expansion and investors should think about making adjustments to their portfolios and reducing their expectations moving forward.

The World Bank downgraded global growth in 2019 to 2.6 percent, which is 0.3 percent below previous forecasts. This reflects weaker-than-expected international trade and investment so far this year. In emerging and developing economies, growth is constrained by lackluster investment, further escalation of trade tensions between major economies and renewed financial turmoil in certain parts of the world. Domestically, while the overall economy remains solid, there are several unnerving trends developing. According to the latest report from the Institute for Supply Management (ISM), the index of U.S. manufacturing activity slipped in May to the lowest level since October 2016. Three of the ISM index's five components declined, including production, inventories and supplier deliveries. Still, 11 of the 18 manufacturing industries monitored reported growth. In other parts of our economy, it's a bit of a mixed bag. For instance, the employment picture is the best in about 50 years. The unemployment rate is 3.8 percent, which represents the lowest rate since 1969, and the number of job openings hit a record high. Correspondingly, wages are rising and a positive trend in consumer spending is poised to drive growth in the near term. Yet, weaker trends in auto production, existing home sales and durable goods orders gives pause to some of the more positive aspects of the economy.

Amidst the signs of "softening" in world economies, global central bankers have taken notice and stand ready to take action, if necessary. In early June, Federal Reserve Chairman Jerome Powell indicated the central bank was prepared to act to sustain the economic expansion should the economy slow further, or the trade war weaken the economy. More recently, Mario Draghi, the head of the European Central Bank, signaled the bank is ready to resume the massive bond-buying program, known as quantitative easing, that ended last December and confirmed it could push key interest rates even lower than the current negative level of -0.40 percent. China recently boosted liquidity in its financial system and signaled its readiness to supply smaller banks with a steady stream of cash to further ensure liquidity and solvency. On one hand, a quick response by central bankers to any hint of economic trouble tends to reassure investors, which often leads to a rally in risk assets, such as stocks. On the other hand, investors have become accustomed to and reliant on action by central banks around the world, which is not exactly how free markets are designed to operate and the long-term consequences are mostly untested.

Looking ahead to the second half of the year, our general outlook is for lackluster global growth, low inflation and interest rates, and modest performance for both stocks and bonds. Yet, there are several factors that could disrupt this relatively benign outlook, both this year and over the next few years. First, if the trade war with China escalates, China's economy could suffer from a sharper-than-anticipated economic slowdown. The massive buildup of internal debt over the past decade would be more difficult to manage amidst a weaker economy, which could force Chinese authorities to aggressively depreciate their currency. Next, global populism from both sides of the political spectrum could result in either positive or negative economic and financial outcomes. Economic growth and asset prices would be supported if populist governments tackle regulations and tax burdens. But, if policies are aimed at slowing globalization and impeding trade, global growth could suffer. Technology across almost every industry has become better, cheaper and more accessible to a wider range of companies. The benefits are glaring, including increased productivity and greater investment in research and development. Yet, technology can disrupt business models and turn worker skills obsolete. Finally, the Federal Reserve's recent monetary policy "pivot" to a more accommodative stance could force investors to take above-average risk, leading to excess valuations and a significant market disruption at some point. While its easy to get unnerved by potential future problems, let's enjoy the current environment of solid growth, low inflation, record low unemployment and robust financial markets.

As always, investing in capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser.

Capital Markets

The yield on the U.S. 10-year Treasury bond fell significantly during the quarter as the Federal Reserve indicated a willingness to cut interest rates if necessary. Both investment grade and high yield bonds benefitted in this environment and posted solid returns. Global equities continued to rebound, with domestic stocks generally outpacing most foreign markets during the quarter.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Market Index Performance(%)
As of June 30, 2019

	2nd QTR	YTD	1 Year	Annualized 3 Year
S&P500	4.30	18.54	10.41	14.21
Dow Jones Industrial	3.21	15.40	12.20	16.82
Nasdaq Composite	3.88	21.34	7.81	19.66
Barclays Aggregate Bond	3.08	6.11	7.87	2.32
FTSE USBIG Corporate	4.30	9.58	10.53	3.89
MSCI World	4.18	17.39	6.97	12.45

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	3.87%	6.09%	**Represents the number of unemployed persons as a percent of the labor force**	Near historic lows
Consumer Price Index	1.80%	4.00%	**Represents changes in prices of all goods and services purchased for consumption**	Trending modestly lower
U.S. Capacity Utilization	78.10%	80.25%	**The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime**	Slightly lower recently
Gross Domestic Product⁺	3.20%	2.80%	**Total value of all goods and services produced indicates strength or weakness of the economy**	Trending higher
10 Year Treasury Yield	2.02%	6.31%	**Yield on the current 10 year treasury bond**	Trending lower recently
Annual Housing Starts	1,269,000	1,432,000	**New privately owned housing unit starts annualized rate**	Modestly lower

*Average from 1966 to Present ⁺ Annualized *Source: Bloomberg*