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Second Quarter 2019 Review & Outlook
by Whitney Brown

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INVESTMENT OUTLOOK

- Stocks gain in second quarter to close strong first half.
- Trade friction and Fed policy drive market action.
- Bond yields drop on growth concerns.
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Equity markets put in a solid showing for the second quarter. Strong momentum from the first quarter of the year carried through April, but stocks sold off in May after U.S.-China trade talks fell apart. Investors had been assuming a deal was all but done based on signals from both sides. Nevertheless, the market regrouped to rally in June and close out the quarter on the upswing. As we pass the halfway point of the year, major U.S. stock indexes are at or near new highs. While small cap indexes and most international markets are not at new highs, the second quarter was positive across most markets and asset classes. Nearly all international markets are ahead year to date.

In the U.S., recent market action has been broad-based with Energy being the only 1 of 11 sectors down for the second quarter. Financials and Materials picked up during the quarter on hopes that declining interest rates will reinvigorate new housing construction. For the half year, Information Technology has dominated returns followed by Consumer Discretionary and Industrials. These sectors are full of the quality growth stocks that investors favor in the kind of moderate-to-slow growth economy we've been experiencing since the Great Recession of 2007-2009. The dramatic decline in bond yields throughout the first half has been good for bond prices but has many market watchers concerned about what it may be signaling for the economy. *Please see the article on page 2 for more on the current state of the yield curve.*

Market Measures	2nd QTR	YTD 2019
S & P 500 (price)	3.8%	17.3%
Dow Jones Industrial Average	2.6%	14.0%
NASDAQ Composite	3.6%	20.7%
Russell 2000	1.7%	16.2%
MSCI EAFE	2.5%	11.8%
Barclays Capital Inter Gov't/Credit Bond Index		
	6/30/19	6/30/18
10-Year U.S. Treasury Bond Yield	2.01%	2.87%
Three-month U.S. Treasury Bill Yield	2.10%	1.92%

Over the past year and a half, equity markets have been on the move, buffeted by volatility around trade and Federal Reserve policy, but on balance have made only modest progress. Some could claim that the first half market recovery from the December 24th low would have been much stronger if not for the overhanging uncertainty about the impact of global trade friction. Others could argue that if not for signs that global trade uncertainties, especially the U.S.-China trade battle, were taking some steam out of global growth, the Fed might not have made such an abrupt monetary policy reversal from hawkish to dovish. Without that change of policy, markets could have gone lower. Of course, there is no way to know what could have been, but it does seem clear that markets will continue to be keenly sensitive to developments around these two major unknowns, the path of Fed monetary policy and the future of U.S.-China trade relations.

From a technical perspective considering just the historical market data, the strong stock market performance of the first half implies that momentum is likely to carry through the third quarter and set the stage for a good finish to the year as well. Even so, there are some potential pitfalls. The economic disruption from the trade tariffs imposed by the U.S. and counter-tariffs in

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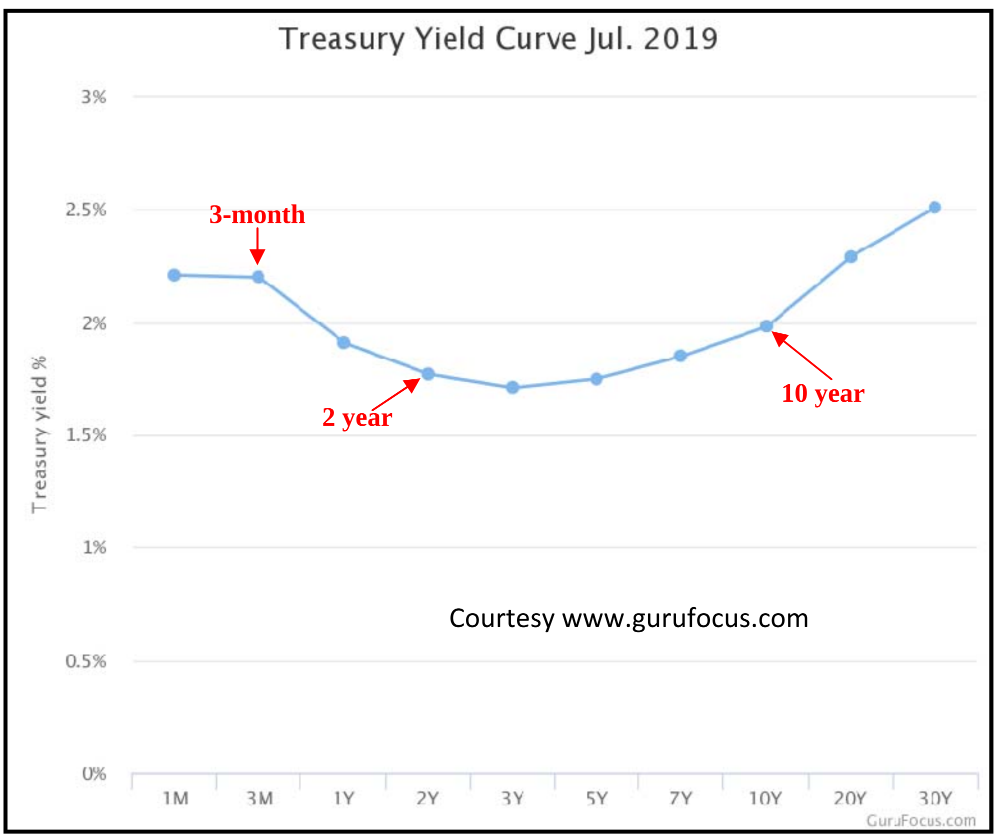
Implications of the Inverted Yield Curve by John Hubard

The recent inversion of the 10-year/3-month yield curve has stoked anxiety among many investors that an economic recession is imminent. While it is true that the inversion of the yield curve has preceded every recession over the past five decades, each time there has been significant lead-time from the first extended inversion to the beginning of an economic recession (as much as 17 months before a recession in the case of the 1982-1990 business cycle). As the S&P hits an all-time high, many analysts are pointing to ways in which this yield curve inversion may be different.

The yield curve illustrates the difference in interest rates for bonds across different maturities. The yield curve reflects the fact that investors expect to receive higher yields when their money is tied up for longer periods of time. Looking at the yield curve below, the time to maturity of bonds becomes longer as you move from left to right. In normal, healthy economic periods, the corresponding interest rate paid on bonds increases with the maturity. Therefore, for example, the yield on a 3-month treasury bill will be lower than the yield on a longer term bond like the 10-year note.

The yield curve is said to be "inverted" when the yield on a 3-month treasury bond is higher than the yield on the 10-year note as can be seen in the chart below. The spread between the 2-year note and 10-year note is also monitored and often preferred because it summarizes long-term perception and sentiment of bond market investors, while the 10-year/3-month spread is viewed more as a reasonable indicator of the Fed's current stance on monetary policy.



Historically, these two spreads have always inverted in tandem, with the 10-year/2-year always leading the 10-year/3month, generally by a few months. However, currently the 10-year/3-month has been inverted for an entire quarter while the 10-year/2-year has yet to invert. Using history as our guide, 10-year/3-month inversion would suggest that a recession is between 8 to 17 months away. Yet, as previously mentioned, many analysts suggest that unique factors specific to this business cycle may be leading to an inversion that is actually not signaling a recession within the expected time frame. While each business cycle is unique, it seems notable that until this current business cycle, the 10-year/2-year has always inverted first. The fact that we still have not seen this inversion should not be ignored.

Looking at past yield curve inversions, another fact that is clear is that the stock market moves to its peak after the 10-year/3-month inverts. Therefore if the current inversion of the 10-year/3-month is in fact signaling a recession, history says that the stock market should continue upward in the near future. If the inversion is due to something

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Coordinate and Consolidate Investments in Multiple Accounts by Jim Hall

Most investors have two different types of accounts (taxable and tax-deferred). Taxable accounts are straight-forward and easy to understand as funds are invested based on individual goals and risk-tolerances. Earnings are derived either from interest, dividends, gains, or some combination of the three. Taxes are paid based on the sources of the income with interest, non-qualified dividends and short-term gains generally being taxed as regular income. Qualified dividends and long-term gains (12 months or longer) are usually taxed at more favorable rates.

Tax-deferred accounts originated in the mid-1970s as Individual Retirement Accounts (IRAs). They were created as a method to allow employees to save to supplement retirement income for their later years when they were no longer working. Shortly thereafter, 401k plans were created to allow workers a way of saving towards their own retirement as companies began eliminating traditional pension plans. As the years have passed, the tax code continues to be altered and often causes individuals to end up with a variety of "retirement" accounts. Sometimes contributions were before-tax; sometimes after-tax. Sometimes withdrawals may be taxed; sometimes tax-free. Often, workers may have multiple retirement plan balances from previous employers in IRA rollovers or even remaining in those employers' 401k or profit sharing plans. Many of these may still be maintained in their original investment strategy with no coordination among the various bits and pieces.

There are many names associated with retirement accounts---IRA, Spousal IRA, Roth IRA, Keogh, 401k, Pension, employee savings plan and SEP are some of the usual names encountered. Each was designed to be utilized in specific circumstances and all may have differing contribution rules while most have similar withdrawal rules. Typically, account holders are penalized for withdrawing funds before age 59-½ and are required to take minimum withdrawals after age 70-½. Roth IRAs avoid the required minimum withdrawal rules.

For many, the complexities and nuances of the different accounts can be daunting and may cause account owners to ignore options to "rollover" or combine them. By leaving them separate, the benefits and efficiencies of a comprehensive investment strategy may be lost. Upon retirement, Required Minimum Distributions (RMDs) may be calculated incorrectly, perhaps resulting in errors and penalties on tax returns. Further, withdrawal timing strategies may not be effectively utilized.

If you find yourself with multiple investment accounts, we would welcome an opportunity to review all and discuss any possibilities for simplification via consolidation. Further, we would be happy to review your overall investment strategy between your taxable and tax-deferred accounts to ensure your strategy is appropriately aligned with your goals and risk tolerance.

Implications of the Inverted Yield Curve (continued)

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other than pre-recession factors, it also seems likely that the stock market will continue to new highs.

Even absent the inversion of the 10-year/2-year, the inverted 10-year/3-month spread is sending a message that investors are distressed about near-term economic growth. Regardless of whether this indicator is still predictive of a recession, it is clear that it is indicating financial stress that could weaken the economy. The issue then becomes whether and to what extent the Fed responds with interest rate cuts. If so the economy could plod along continuing this record expansion. It is also likely that a permanent trade détente between China and the United States would aid the global economy's efforts to avoid a recession.

Whether or not the situation is different this time in the absence of an inversion of the 10-year/2-year yield curve, equities seem likely to continue to advance through 2019. With most all economic indicators still showing that the economy is healthy and growing, albeit at a slower pace than other times during the expansion, the biggest risk to the economy appears to be the impact which the imposition of further tariffs on Chinese or other nations' goods by the Trump administration would have.

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response may have delayed the end of the global economic slowdown. Signs of firming have not fallen into place yet, and we cannot be sure that markets won't backslide again before the picture clears up. Equity markets usually lead the economy into and out of slowdowns and recessions.

Quarterly corporate earnings are just now coming into view and could present another challenge to markets. Expectations are that earnings have peaked and growth will be hard to come by. Companies have guided lower, and presumably analysts have adjusted their estimates accordingly. If most corporations meet or beat these lowered expectations, markets are not likely to react strongly one way or the other. However, if the effects of tariffs and the global slowdown cause earnings to come in worse than anticipated, markets could be in for a tough time of it, at least in the short run. The good news is that the trade war is primarily a political issue with the White House calling the shots. The administration is going to be sensitive to not wrecking the economy in the run up to the 2020 election, and they can recalibrate at any point they think they may be going too far.

On balance, we think the second half of the year will see markets work higher with some inevitable pullbacks along the way. The U.S. should avoid recession, and the global economy should pick up again. Bond yields should move higher ahead of renewed economic growth, and inflation should remain a backburner issue.