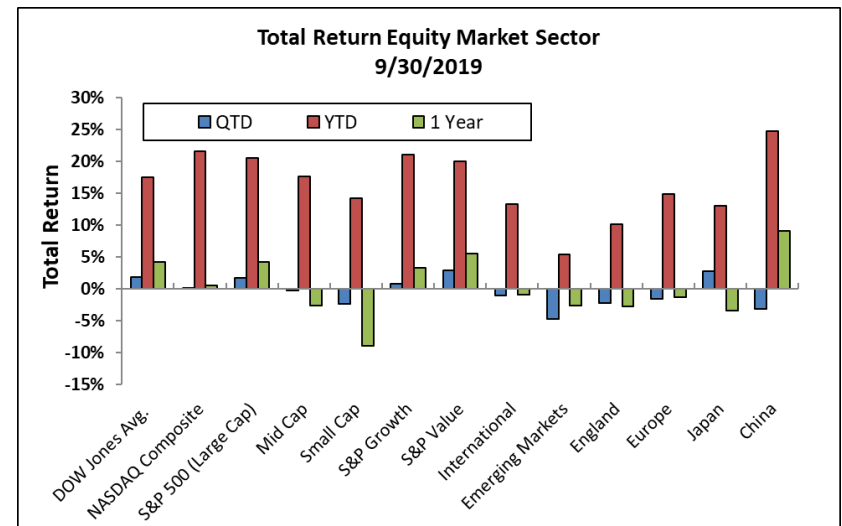
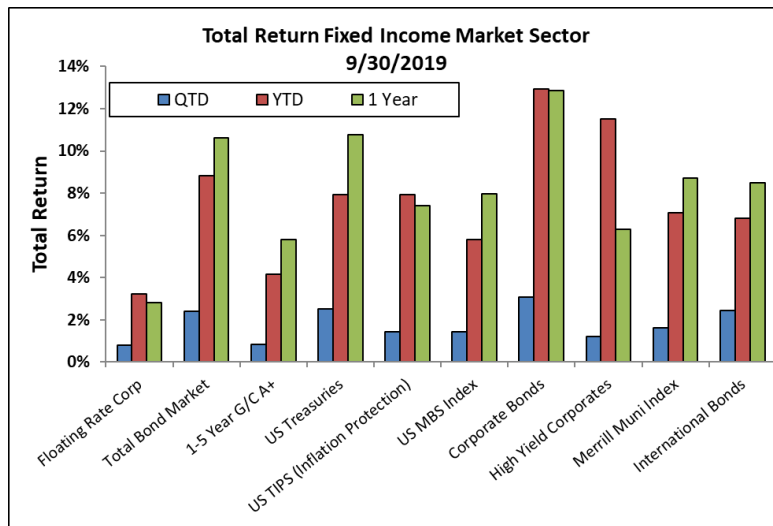

Market Review and Outlook

September 30, 2019

Market Review

September 30, 2019

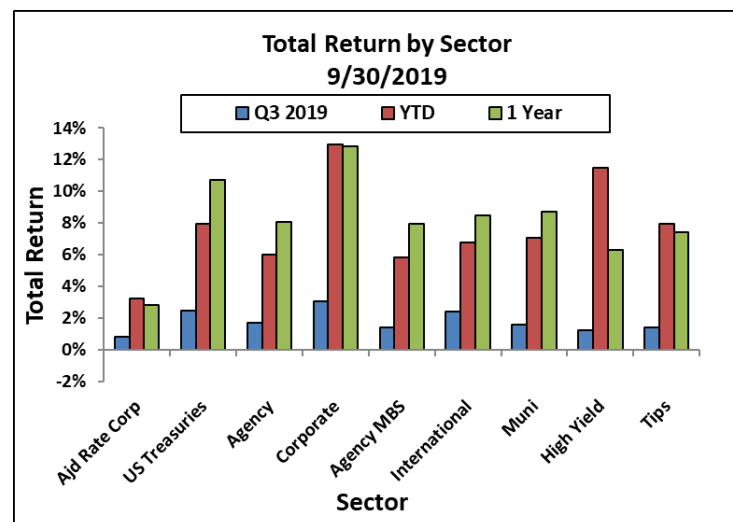
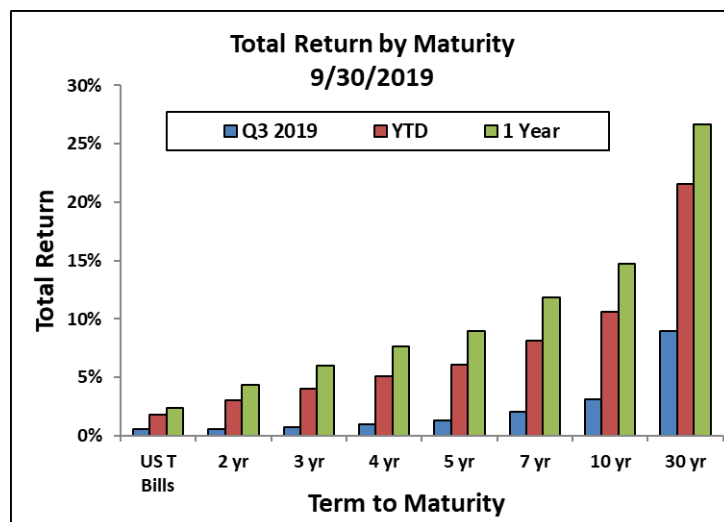
- The drop in interest rates, primarily in August, caused bonds to generate significant positive returns again in Q3.
- While the rates market would imply a high probability of a recession, on the contrary, corporate bonds performed best in fixed income markets and equity markets traded near recent new record highs. International and Emerging markets lagged.
- The significant drop in rates also helped boost “Value”, or dividend paying sectors relative to “Growth”, a reversal of recent trends as investors searched for higher yields.



Market Review

Yield Curve and Sector Returns – September 30, 2019

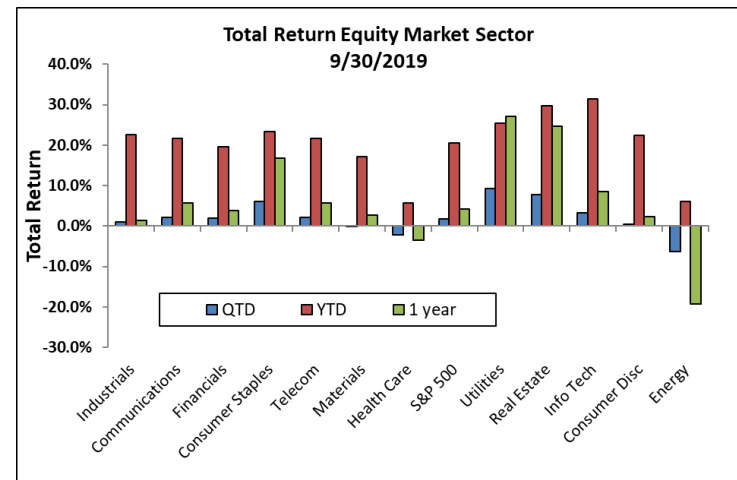
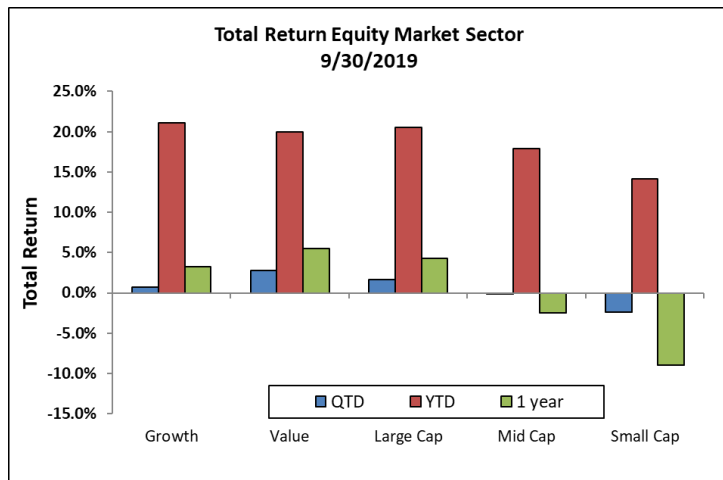
- Total returns on Treasuries in Q3, like Q2, are significantly positive driven by price gains due to falling interest rates. The longer the duration and maturity, the greater the price gains have been.
- The Fed eased twice, lowering rates and resuming QE, and the bond market moved to price in a high probability of additional multiple Fed rate cuts in Q4 and into 2020.
- As evidence of the continued underlying economic strength, rather than recession, deeper credit corporates and high yield has benefitted due to higher income and credit spread tightening.
- Adjustable rate securities generated higher income, but have lagged due to lack of price movement from interest rate sensitivity.



Market Review

Equity Market Returns – September 30, 2019

- Value oriented stocks, driven by Utilities and REITs performed well in during the quarter as interest rates fell and investors migrated to income oriented equities.
- Large cap stocks performed best given market uncertainty while Small and mid cap stocks have lagged.
- Fed induced liquidity has provided significant capital that has driven larger cap stocks higher.
- Utilities and REIT oriented stocks led equities amid the demand for income.
- For the year to date, consumer and technology oriented stocks have driven market gains due to continued economic growth and solid earnings.



Market Environment Summary

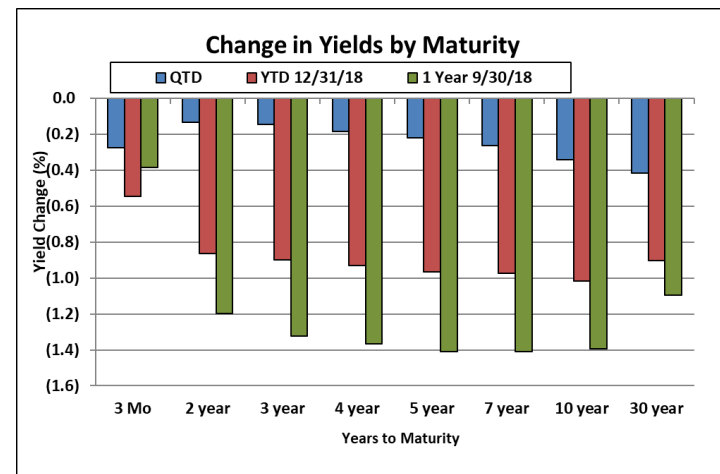
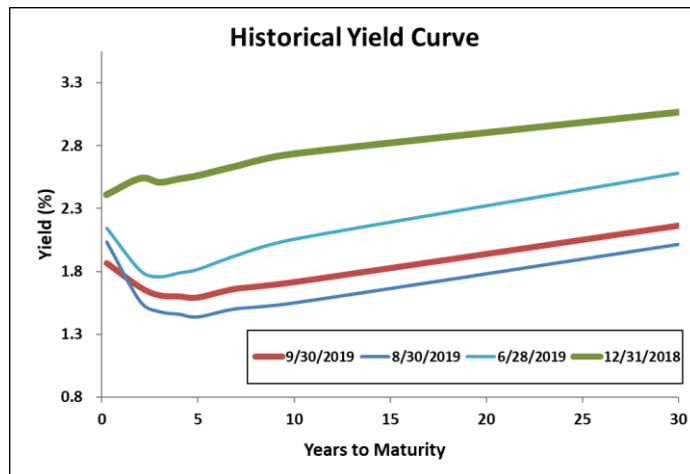
September 2019

- While the US domestic economy continued at a solid pace in Q3, the extended trade talks between the US and China have contributed to moderation in global trade, which has slowed international manufacturing activity.
- The Federal Reserve continued to stress the risk elements of the prolonged trade talks between the US and China, and eased interest rates twice and resumed quantitative easing as “insurance” against a slowing of growth in the US.
- Interest rates fell significantly as the market continues to push the Fed to lower rates, and they are succumbing to market forces, reinforcing the potential for multiple rate cuts in the future, which would evaporate should a trade deal and other risks such as Brexit get resolved.
- The S&P 500 returned near all time record high again during the quarter as the Fed eased and domestic economic activity remained strong, including the unemployment rate falling to 3.5% with rising wages.
- Despite a solid US economic foundation and growth, the overriding narrative in the market is focused on the risk of the global slowdown impacting the US, as trade talks have dragged on.
- Markets are on the one hand projecting the risk environment and arguing for, and pricing in an easing of monetary policy, while at the same time sending equity markets to all time highs and credit risk premiums near all time lows.
- Reflecting Fed expectations, global central bank stimulus and negative international rates, and excessive liquidity in the system, market participants have pushed interest rates to new lows since 2016.

Market Review

Yield Curve – September 30, 2019

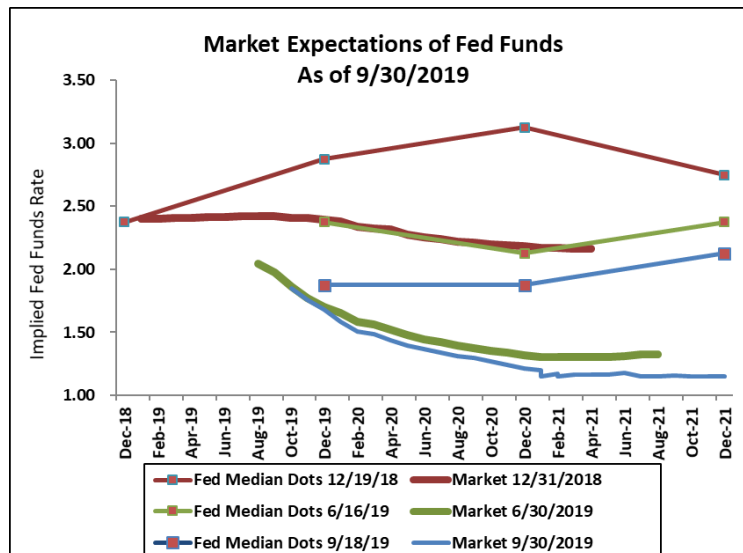
- Interest rates fell again in Q3 and year to date on a combination of Fed easy policy and capital flows into the US bond market. Rates reached new three years lows during the quarter, but began a move back up in September with better than expected economic results.
- Despite the strong US economy and equities maintaining record highs, markets continue to be preoccupied by fears of a global slowdown pushing the US into a recession and have pushed intermediate rates down below the current Fed funds rate, implying multiple future rate cuts by the Fed.
- Low rates will stimulate already solid economic activity which will ultimately push rates higher as expectations of an ease are unwound.



Market Review

Monetary Policy – September 2019

- The Fed eased rates twice and stopped unwinding QE, and helped push market expectations toward additional eases this year and next.
- The market is pricing in at least one more ease for 2019 and more by 2020. The Fed continues to underestimate the strength of GDP and over estimate unemployment.
- Inflation is running much closer to the Fed targets than the narrative suggests.
- The Fed has let the market dictate their actions.

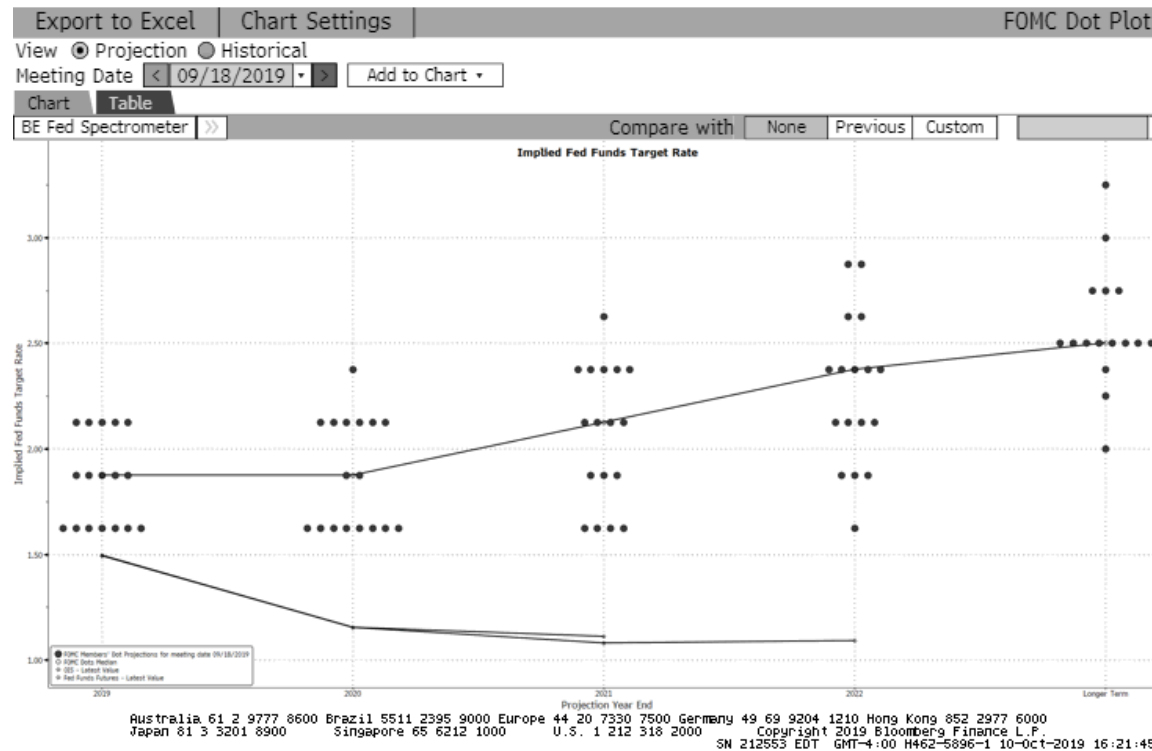


Federal Reserve Median Economic Projections					
As of 9/18/2019					
Change in GDP	Actual	2019	2020	2021	Longer Run
September 2019 Projection		2.2	2.0	1.9	1.9
June 2019 Projection		2.1	2.0	1.8	1.9
Actual Q2 2019 yoy/qoq	2.3/2%				
Unemployment Rate					
September 2019 Projection		3.7	3.7	3.8	4.2
June 2019 Projection		3.6	3.7	3.8	4.2
Actual Q3 2019	3.5%				
PCE Inflation					
September 2019 Projection		1.5	1.9	2.0	2.0
June 2019 Projection		1.5	1.9	2.0	2.0
Actual Sept 2019	1.4%				
Core PCE Inflation					
September 2019 Projection		1.8	1.9	2.0	
June 2019 Projection		1.8	1.9	2.0	
Actual September 2019	1.8%				
Projected Policy Path- Fed Funds					
Sep-19	1.85	1.9	1.9	2.1	2.5
June 2019 Projection	1.85	2.4	2.1	2.4	2.5

Market Review

Monetary Policy – September 2019

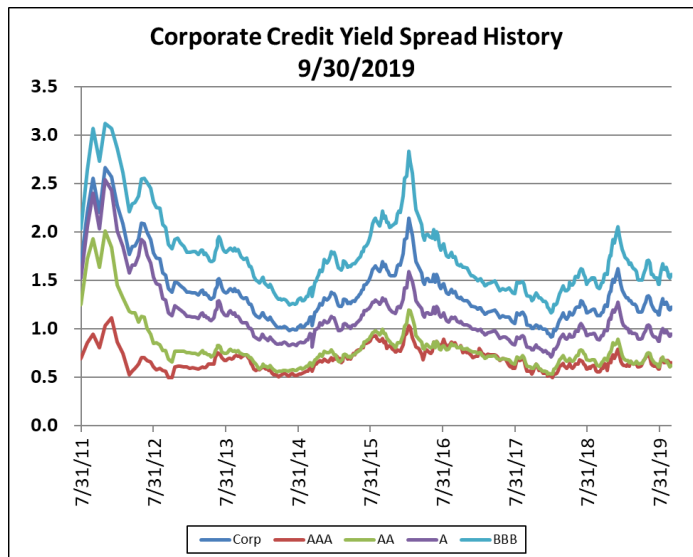
- The Fed Board has become extremely split, with some Governors wanting to not have eased at all, with other looking for more aggressive stimulus.
- The market continues to price in significantly more easing than even the most dovish Fed members.
- The Fed has recently been trying to walk back some of their more dovish comments.



Market Review

Corporate Yield Spreads – September 2019

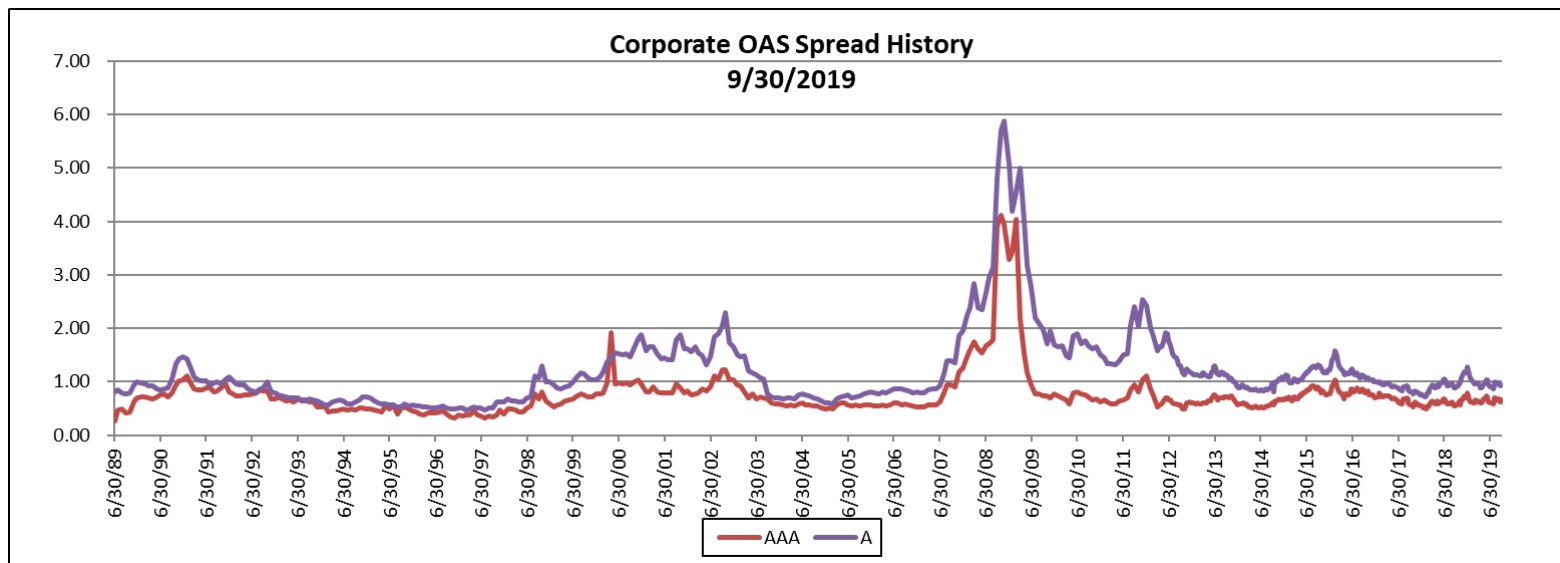
- As interest rates fell and equity markets recovered, corporate yield spreads maintained tighter levels, bucking the inverse relationship between interest rate risk and credit risk.
- Continued strong economic conditions and corporate earnings continue to conflict with market narrative that has implied significant deterioration in economic fundamentals.
- Corporate credit conditions remain strong and risk of default has not risen to the degree that would push credit spreads wider. Spreads may continue to grind lower as the year progresses.



Market Review

Corporate Yield Spreads – September 2019

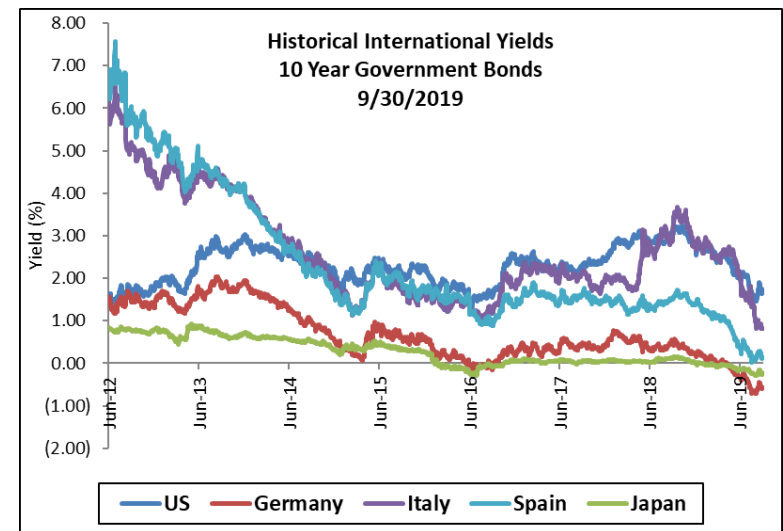
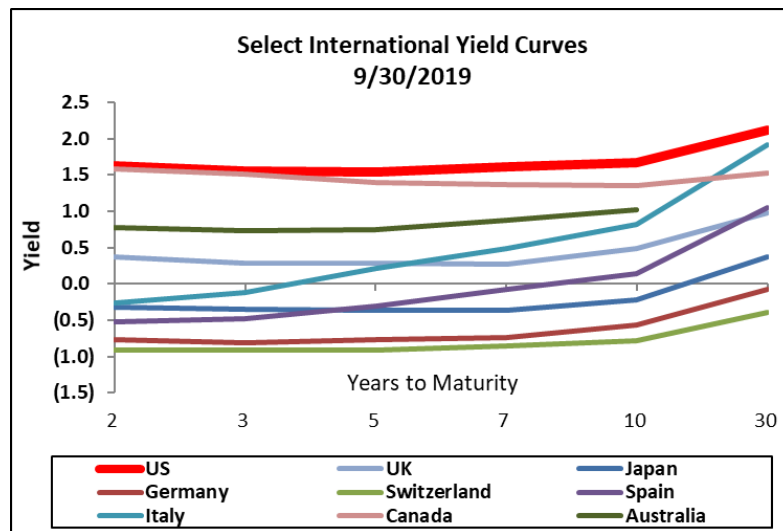
- When looking at corporate credit risk premiums on a longer term basis, it is useful to look at the mid to late 90's environment with similar policy and economic conditions.
- Steady policy after a recession induced extended monetary ease provided a solid economic foundation, and the economy progressed with steady growth and inflation.
- Credit spreads remained steady and moved tighter as credit risk remained low and investors craved additional income.
- The Fed may be trying to repeat the playbook with an “insurance” ease of policy.



Market Review

International Yield Curves– September 2019

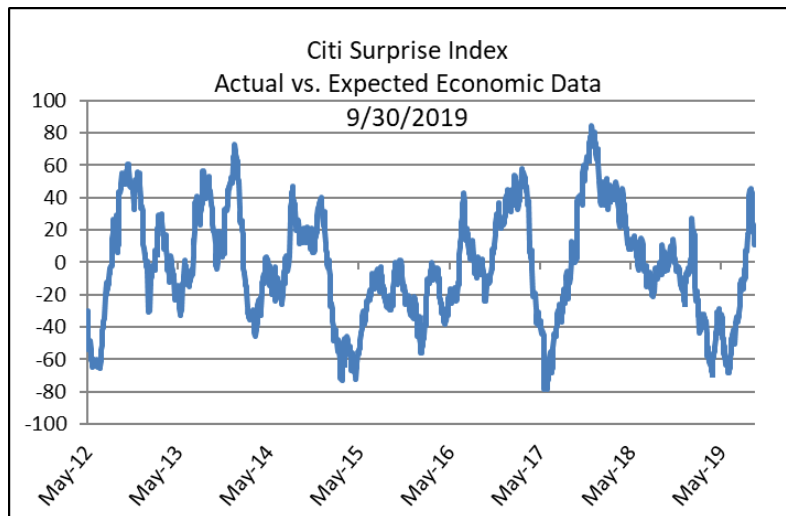
- Global interest rates continue to push deeper into negative territory.
- The US continues as one of the highest yielding developed countries and the yield spread over Europe widened in Q3. German 10 year rates went below zero to negative $-.70\%$.
- The European Central Bank and Bank of Japan continue aggressive easy monetary policy with deep negative rates in Europe and a targeted 0% ten year rate in Japan, which have drifted below.



Economic Environment

September 2019

- The Citi economic surprise index reversed course with actual economic data coming in much better than expected as the rhetoric continues to be dominated by risk caused by the trade talks.
- There is a preoccupation with the moderation in economic growth around the globe, particularly in China and Europe, that is an ongoing discussion at the Fed and in the markets.
- Moving forward, US economic data have moderated but remain solid. Many market expectations are tied to trade talks while actual economic data show solid real activity.



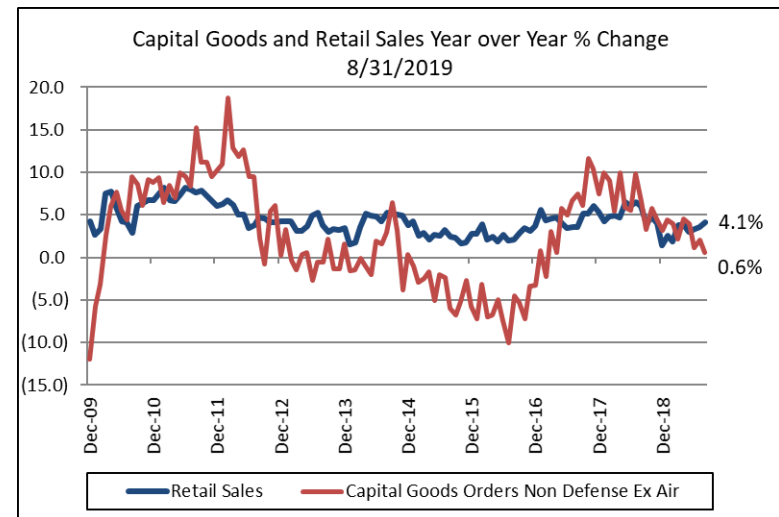
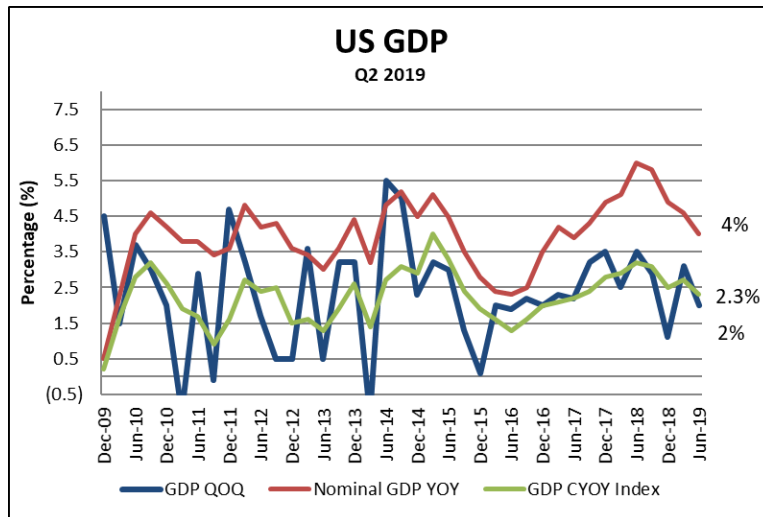
	GDP YoY % Change		
	One Year		
	Current (Q2)	Ago	Change
US	2.30	3.20	(0.90)
Eurozone	1.10	2.20	(1.10)
Germany	0.40	2.10	(1.70)
France	1.40	1.90	(0.50)
Italy	0.00	1.02	(1.02)
UK	0.00	1.40	(1.40)
Canada	0.00	4.30	(4.30)
Mexico	0.00	2.58	(2.58)
Australia	0.00	3.10	(3.10)
Japan	1.20	1.50	(0.30)
China	6.20	6.70	(0.50)
Russia	0.90	2.20	(1.30)
Brazil	1.01	0.90	0.11

	Inflation YoY % Change		
	One Year		
	Current (Q3)	Ago	Change
US	1.70	2.30	(0.60)
Eurozone	0.80	2.10	(1.30)
Germany	1.20	1.90	(0.70)
France	0.90	2.20	(1.30)
Italy	0.30	1.40	(1.10)
UK	1.70	2.40	(0.70)
Canada	1.90	2.20	(0.30)
Mexico	3.00	5.02	(2.02)
Australia	1.60	1.90	(0.30)
Japan	0.20	1.20	(1.00)
China	3.00	2.50	0.50
Russia	4.00	3.40	0.60
Brazil	2.89	4.53	(1.64)

Economic Environment

September 2019

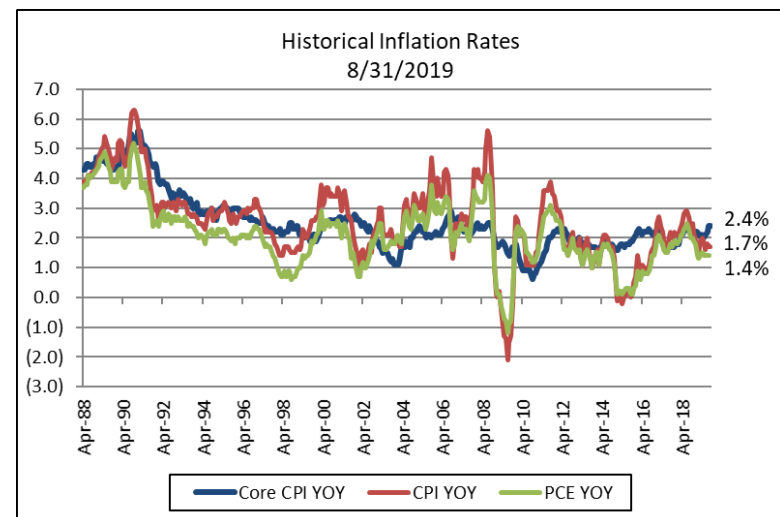
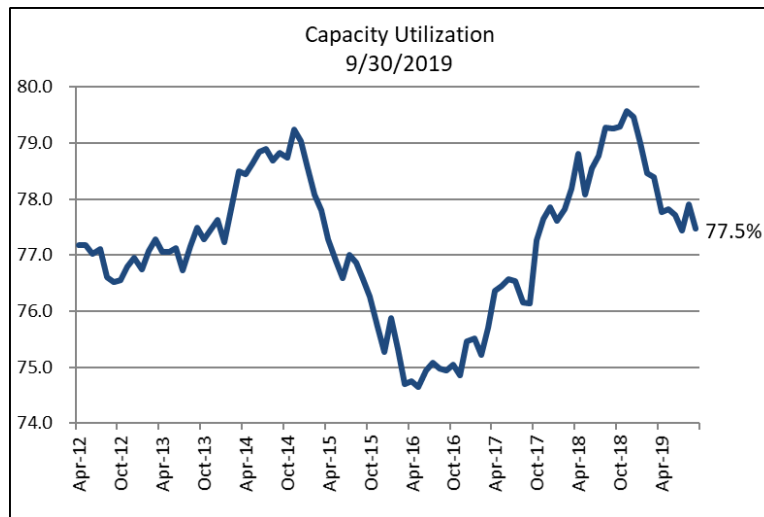
- Economic activity has moderated but remains solid.
- Consumption remains strong while investment has decelerated due to extended trade talks.
- Retail sales have ticked up recently while investment may have paused due to trade uncertainties.



Economic Environment

Employment and Inflation – September 2019

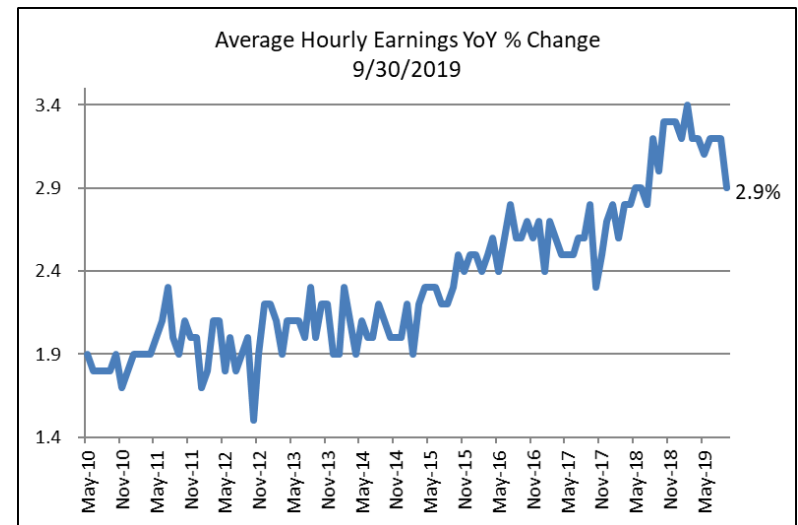
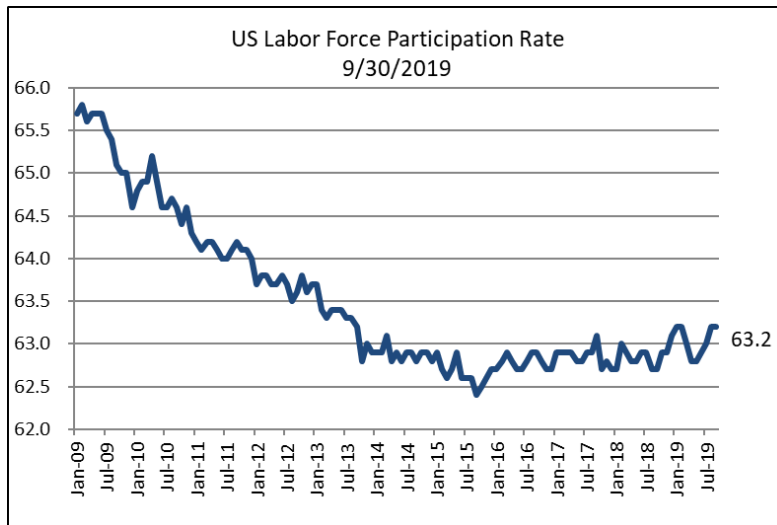
- Inflation, by most all measures, has been maintaining a range between 1.5% and 2% for about two years, essentially in the range of Fed targets.
- While capacity utilization has increased recently, it remains below levels that would normally push prices higher due to tighter resources.
- The YOY Personal Consumption Expenditure Index (PCE), the Fed's favored inflation gauge, also reached the target area of 2%, but has recently dipped. Core PCE is closer to 2%.



Economic Environment

Employment and Inflation – September 2019

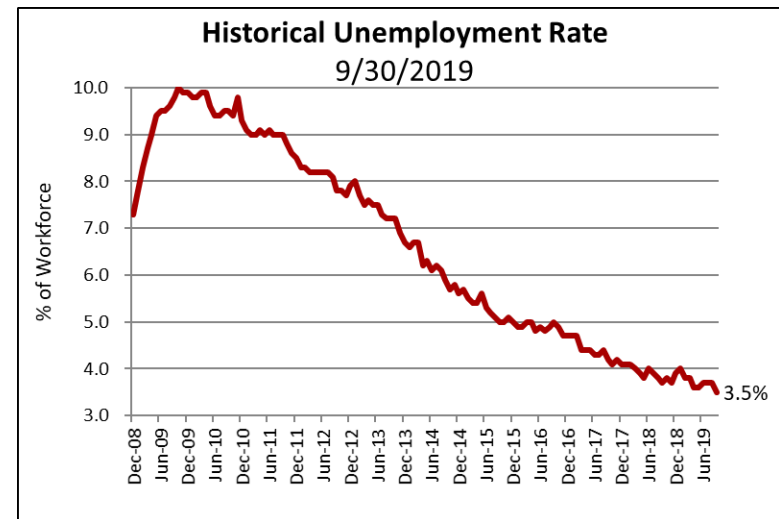
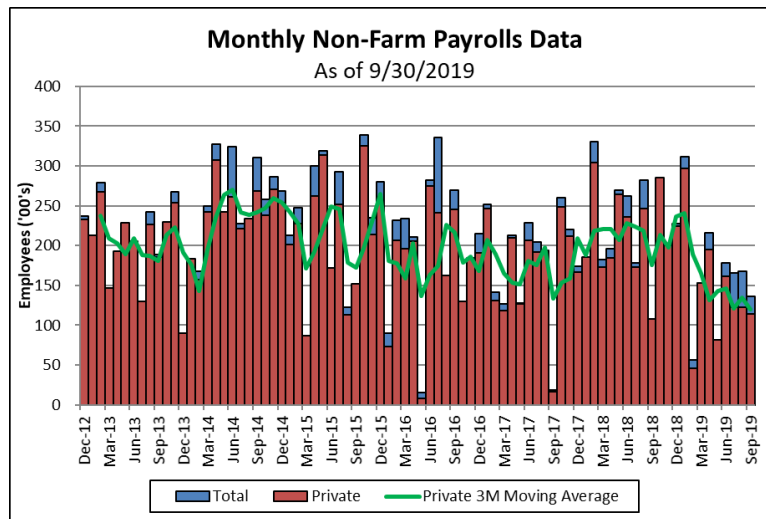
- Like overall capacity utilization, employment utilization, or the labor force participation rate remains at a low level, but has been climbing.
- Average hourly earnings have moderated recently however remain in an upward trend showing strong demand for labor and positive real income growth.



Economic Environment

Employment – Monthly Payrolls – September 2019

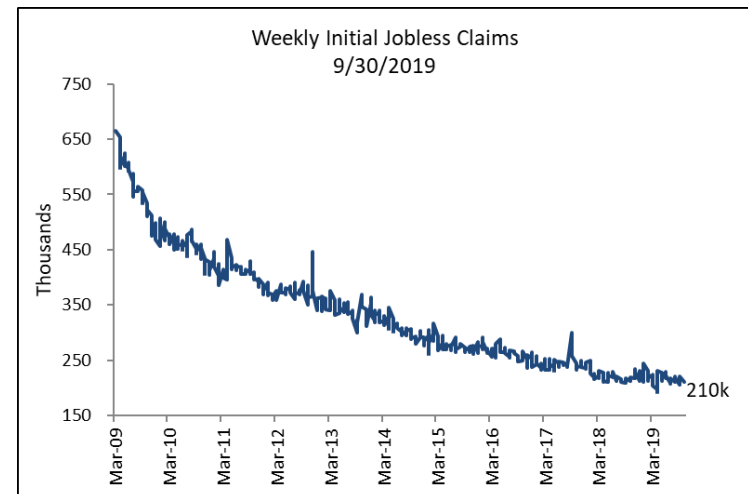
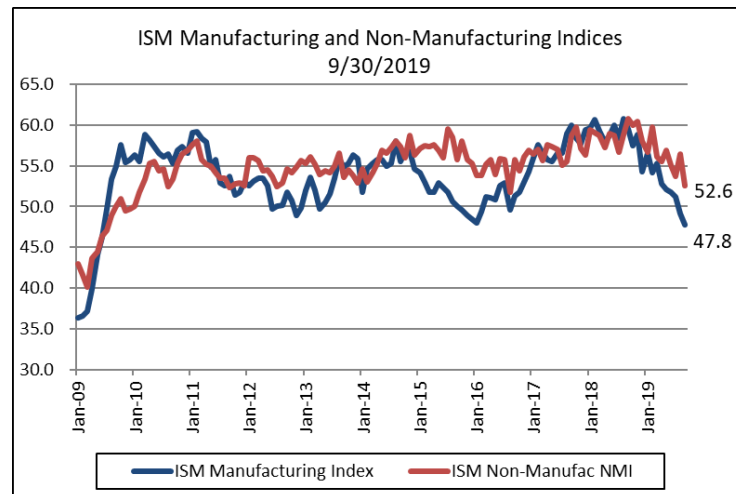
- Monthly additions to payrolls has maintained a solid pace at around 150k per month, albeit down from over 200k last year.
- The unemployment rate has fallen to 3.5%, with record low rates across categories.
- There continued to be more jobs available than job seekers.



Economic Environment

Employment – Monthly Payrolls – September 2019

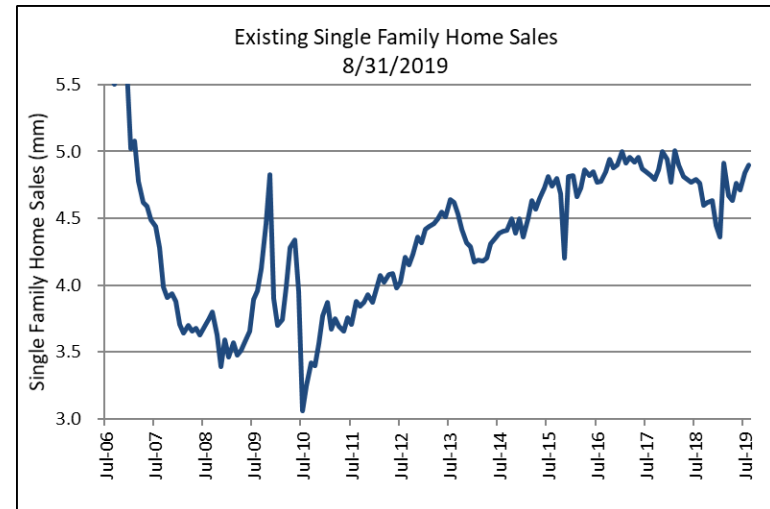
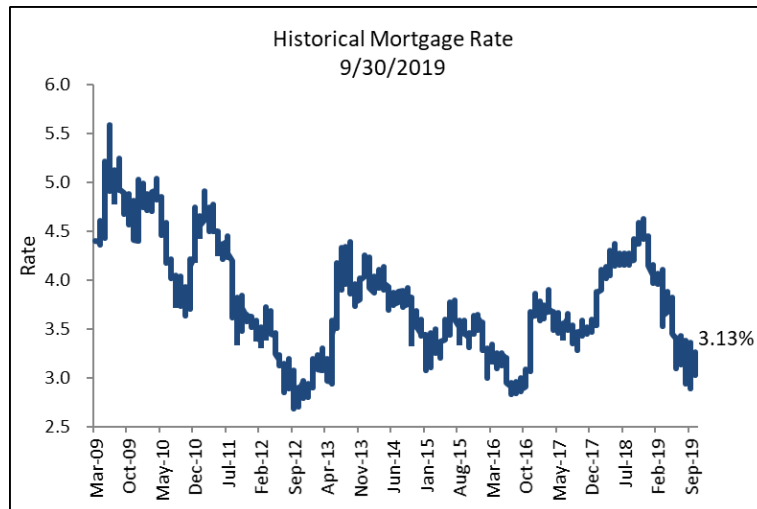
- Consumption, services, and manufacturing activity have recently moderated from a high rate.
- The manufacturing sector, as measured by the manufacturing purchasing manager index has fallen recently likely due to trade talks, and has fallen below 50.
- The Non Manufacturing index has also remained at a solid level, coming off record highs in Q4.
- Initial claims for unemployment remain low, indicating limited layoffs.



Economic Environment

Mortgage Rates and Housing – September 2019

- The recent drop in interest rates has brought mortgage rates down with it, more than 1% from their highs of last year.
- Lower mortgage rates have supported home sales to some degree, and recent moderation in home prices has generated renewed activity in the housing market.
- The strong jobs market has provided a foundation for new household formation.
- Higher income, moderating home price increases, increased inventory, and lower interest rates have led to an increase in home purchases.



Economic Environment

September 2019

- The dynamics of supply and demand in the oil market have created an increase in price volatility.
- Offsetting the significant increase in US oil production, OPEC continues to curb production. Together with sanctions the supply of oil has recently been reduced.
- Concerns around global economic growth are influencing expectations of demand for oil.
- The direction the dollar takes will have implications for emerging markets, earnings of multinational corporate earnings, and trade. It has recently been relatively stable, but maintained its upward trend.

