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FINANCIAL MARKET SNAPSHOT

Equity Momentum Fades

October 3, 2019

Stocks rebounded a bit in September, but equity momentum is clearly less than it was relative to Q1 and Q2.

Sluggish manufacturing and services activity readings continue to be the primary worry as investors gauge the negative impact of the U.S. trade dispute with China.

However, we are seeing early signs the economy may be already recovering from the current bout of weakness.

Monetary policy accommodation by the Fed and ECB helped equities recover a bit in September; following a lackluster August. However, U.S./China trade and other economic concerns remained pervasive, thus limiting gains. Worries that a drag on fundamentals could impact Q3 corporate earnings were visible toward the close of the month. Meanwhile, Brexit, some repo market unease, and renewed political uncertainty in the U.S. also precluded investors from taking material risk. Questions as to whether the current economic slowdown was a mid-cycle correction or an economic stall became key considerations for many. Equity gains were most-apparent in foreign and U.S. mid-cap markets, while a slight lift in interest rates weighed on the bond market just a bit. The activity in gold faded after a multi-month run. Notably, manufacturing and services indices in the U.S. and across the globe continued to point to slowing economic conditions. However, aggregate economic data, of late, has been coming in better than expected. Many global economies are showing some signs of a rebound (when looking at leading economic indicator data), but the sustainability of this is uncertain. Some resolution of the trade dispute remains key to better fundamental conditions moving forward.

Table 1: Notable Returns / Yields / Spreads: June — September 2019

Source: Bloomberg

Note: BBG Barc = Bloomberg Barclays; 10Yr Treasury Yield figures as of the end of the month

High Yield Corp Spreads = Yield-to-Worst differential vs. 10Yr Treasury (end of month)

	Jun '19	Jul '19	Aug '19	Sept '19
S&P 500 Index	7.05%	1.44%	-1.58%	1.87%
MSCI EAFE Index	5.97%	-1.25%	-2.56%	2.89%
MSCI Emerging Markets Index	6.28%	-1.15%	-4.85%	1.90%
BBG Barc U.S. Aggregate Bond Index	1.26%	0.22%	2.59%	-0.53%
10-Year Treasury Yield	2.01%	2.02%	1.50%	1.67%
U.S. HY Corp Spread (10Yr)	3.86%	3.84%	4.22%	3.97%

The combination of Trump impeachment developments, trade disputes, and the fall in global manufacturing activity has certainly been enough to cast a cloud of uncertainty over this market. While the current negativity surrounding these issue could change course rather quickly, the overhang has caused business leaders to pull back on economic investment and take down their corporate expectations. The concern at the moment seems to be that worry over a potential economic stall may cause such a condition to be

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self-induced. This is not our base-case view, however, as we believe global economies may have already begun to recover from a mid-cycle trough. In our view, any sustained recovery should be modest in nature, but enough to forestall the onset of recession for a bit longer.

We remain cautiously constructive on equities, although our tactical models are suggesting a near-term pare down of equity exposure in favor of an increased cash allocation.

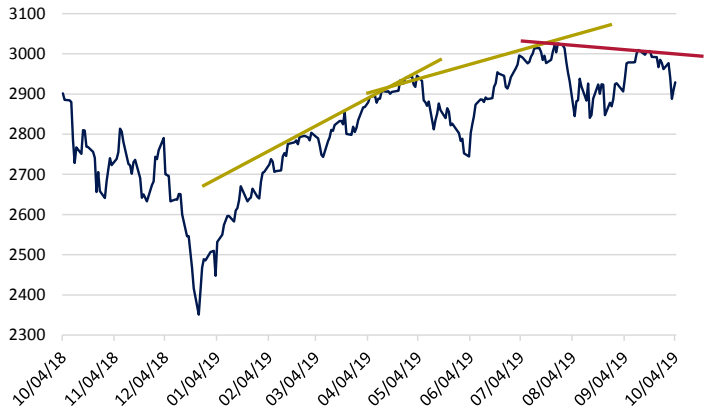
Despite our fundamental forecast of perhaps more stable times ahead, our asset price trend equity model has picked up on the recent deterioration. Therefore, we are slightly raising our overall cash allocation to account for the prevailing risks mentioned. This model tactically functions as a potential buffer against equity risk in a deteriorating market. However, if conditions improve in line with our fundamental base-case, we would anticipate an opportunity to put the excess cash back to work as tactical model variables recover.

On balance, our capital market strategy work is telling us to maintain a fundamental overweight to equities, but to ensure that overweight is backed by intensified risk–mitigation. The bottom line is, current heightened risks leave us still-constructive on the market, cautious in our approach, and glad that our tactical framework allows for the opportunity to move asset exposures in accordance with near-term changes in market conditions.

Heightened macro-economic and political uncertainty has caused equity momentum to fade.

Figure 1: S&P 500 Index—Daily Chart

Source: Bloomberg



Risks

Investors should be aware of the risks associated with all portfolio strategies, and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance, our macroeconomic theories, and the effectiveness of strategic and tactical portfolio approaches.

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Our judgement or recommendations may differ materially from what may be presented in a long-term investment plan. Investors should consult with an investment advisor to determine the appropriate investment strategy and investment vehicle. Investment decisions should be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance.

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The MSCI EAFE Index is a free float –adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

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The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing the major sectors of the U.S. economy.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment grade fixed-rate bond market, including both government and corporate bonds.

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