ASSET STRATEGY CONSULTANTS

MARKET REVIEW

Third Quarter 2019

We are pleased to present *Market Review,* featuring a discussion of the Capital Markets during the Third Quarter 2019 and a summary of historical performance for the major asset style passive indices for the period ending September 30, 2019. We hope you find the information useful and helpful in your investment considerations.

We welcome your comments.

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Asset Strategy Consultants

Founded in 1991, Asset Strategy Consultants provides investment consulting services to institutional clients representing $9.9 billion under advisement. Headquartered in Baltimore, Asset Strategy Consultants has offices throughout the East Coast.

THE MACROECONOMIC ENVIRONMENT

Global Headwinds Cloud Outlook for U.S.

Spoiler: Disappointing manufacturing data in the U.S. on October 1 exempted from this write-up

The U.S. economy continued to perform reasonably well in the third quarter, with several September data points surpassing expectations. That said, global growth continued to languish, especially in manufacturing where trade wars have taken a toll. Inflation also remained stubbornly low. Against that backdrop, the U.S. dollar was a star performer, up 3.4% versus a basket of trade partner currencies and up 4.3% vs the beleaguered euro. U.S. fixed income also posted another solid quarter, with the Bloomberg Barclays US Aggregate Bond Index up 2.3%. The S&P 500 Index eked out a modest gain of 1.7% and the MSCI ACWI ex USA lost 1.8%. The worst-performing sector was emerging market equity, which lost over 4%.

GDP across the 19-country euro zone grew 1.2% (annualized) in the second quarter, but its largest country, Germany, is now widely thought to be in recession; its second quarter GDP contracted modestly from the previous quarter. The ECB has lowered its forecast to 1.1% in 2019 and 1.2% in 2020. Japan revised its second quarter GDP down from 1.8% to 1.3% (annualized). In China, industrial output growth was an annualized 4.4% in August, its lowest monthly gain in 17 years. Euro zone PMI, a measure of manufacturing health, fell to 45.6, the lowest in seventeen years. Germany saw its manufacturing data decline to the worst level in more than 10 years. Gyrations in trade talks continued throughout the third quarter. While the U.S. and China imposed and threatened tariffs on one another, the countries agreed to a 13th round of trade talks in October, thus easing concerns somewhat going into quarter-end.

In an effort to spur growth, central banks around the world in both developed and emerging markets cut rates in the third quarter. The ECB reduced its deposit rate from -0.4% to -0.5% and announced a new bond purchase program at a rate of €20 billion a month, beginning in November. Australia and New Zealand cut their benchmark interest rates to record lows of 0.75% and 1.0%, respectively. And negative- yielding debt ended the quarter at roughly $17 trillion, leaving investors to grapple with the dire implications of paltry yields and reduced return expectations for both stocks and bonds.

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Against this rather gloomy backdrop, the U.S. economy continued to hum along. The consumer continued to be a bright spot, bolstering services sectors, while manufacturing dampened growth. Unemployment remains low (3.7%) and average hourly earnings ticked up (3.2% year over year). The Citi Economic Surprise Index was up sharply in August, surpassing expectations. Consumer confidence remains elevated, though the expectations component ticked down in September. GDP growth in the U.S. was 2.0% for the second quarter (annualized) and 2.3% year over year. Current estimates from the Atlanta and the New York Fed for third quarter GDP growth are just over 2.0%. However, worries over the impact of tariffs and concerns about growth overseas have led to rate cuts here as well. The Federal Open Market Committee cut the Fed Funds rate by 25 basis points at its September meeting, bringing the range to 1.75%-2.00%. Commentary around the rate cut cited it as being a "mid-cycle adjustment," but Fed Chair Jerome Powell also recently said that it is his objective to "sustain the expansion." It is notable that two members voted against a cut and one voted for a 50 bps cut. The broad Fed view does not show another cut until after 2020, but expectations are mixed among the members. Market expectations are more dovish.

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Headline CPI in August was 1.7% (Core: 2.4%) and the Fed's favored indicator, the Core PCE Index, was +1.8% (annualized), below its 2% target. Monetary stimulus has not been able to spur inflation or growth, and thus talks of potential fiscal stimulus packages are beginning to surface in the U.S. and abroad. While this may be politically attractive, it should be noted that the U.S. federal budget deficit hit over $1 trillion for the first 11 months of fiscal year 2019, the highest in seven years, and roughly 5% of GDP. This has not posed a problem in recent years given sufficient overseas buyers of U.S. Treasuries, but it is an important data point to acknowledge.

Economic data along with striking political headlines in the U.S., Brexit uncertainty, Iran/Saudi tensions, civil unrest in Hong Kong, and ongoing trade talks leave much room for uncertainty in the fourth quarter. ■

EQUITY MARKETS

The S&P 500 gained 1.7% in the third quarter, and 20.6% for the year to date. However, returns were mixed across sectors. Real Estate (+7.7%) and Utilities (+9.3%) both benefited from lower interest rates. Returns for both sectors are approaching 30% on an YTD basis. Energy, hurt by falling oil prices, lost 6.3% and is up only 6.0% for the year. Health Care was another poor performer, down 2.2% and up 5.6% YTD. From a style perspective, value mounted a comeback late in the quarter, but over the full quarter returns across styles were similar (R1000: +1.4%; R1000G: +1.5%; R1000V: +1.4%). Small caps underperformed (R2000: -2.4% vs R1000: +1.4%) and, notably, small cap value outperformed small cap growth by a significant margin (R2000V: -0.6% vs. R2000G: -4.2%).

Overseas, the strong U.S. dollar hurt results. The MSCI ACWI ex USA Index fell 1.8%, with emerging markets (MSCI EM: -4.2%) underperforming developed (MSCI EAFE: -1.1%). The U.K. sank 2.5% due solely to performance of its currency, which lost just over 3% versus the U.S. dollar on Brexit-related woes. Japan (+3.1%) was one of the few countries to post a positive return, but the yen was also relatively flat vs the U.S. dollar. EM countries were generally down, with Brazil, Russia, and China falling about 5% and Russia down a more modest 1.4%. Political uncertainty in Argentina caused its market to lose half its value in August (-47%); that said, Argentina just entered the Index in May 2019 and accounts for a very small slice (less than 1%). Value outperformed growth in both developed and emerging markets but remains far behind on a YTD basis. From a sector standpoint, Technology (MSCI ACWI ex USA

Technology: +2.2%) was up the most while Materials (-6.5%) and Energy (-4.6%) performed the worst. ■

FIXED INCOME

Ten-year U.S. Treasury yields were volatile in the third quarter, especially in September, hitting a 2019 low of 1.40% on Sept. 4, soaring to 1.90% mid-month and closing the quarter at 1.68%, down 32 bps from June 30. U.S. Treasuries thus posted strong results (Bloomberg Barclays US Treasury Index: +2.4%). Long U.S. Treasuries soared (Bloomberg Barclays Long US Treasury Index: +7.9%; +19.8% YTD) in the falling rate environment. The Bloomberg Barclays Aggregate rose 2.3%, bringing its YTD result to +8.5%. High yield was up just over 1% (+11.4% YTD) but, notably, lower quality significantly underperformed (CCC: -1.8% vs BB: +2.0%, and +12.8% vs +5.6% YTD) representing some concern about deteriorating quality at the lower end of the spectrum. TIPS (Bloomberg Barclays TIPS: +1.3%) underperformed as inflation expectations waned; 10-year breakeven spreads were 1.53% as of quarter- end, down from 1.69% as of 6/30/19. The 10-year real yield dipped briefly into negative territory in early September. Municipal bonds performed well, but did not keep pace with U.S. Treasuries (Bloomberg Barclays Muni: +1.6%; +6.7% YTD). The shorter duration Bloomberg Barclays Muni 1-10 Year lagged with returns of +0.8% for the quarter and +4.7% YTD.

Rates fell overseas as well, but the U.S. dollar appreciated versus most currencies. The Bloomberg Barclays Global Aggregate ex US fell 0.6% (unhedged) while the hedged version was up 2.8% for the quarter. Emerging market returns were roughly flat (JPM EMBI Global Diversified: +1.5%; JPM GBI-EM Global Diversified: -0.8%) but both are up sharply YTD (+7.9%; +13.0%) respectively. Within the dollar- denominated benchmark, Argentina (-42%) and Venezuela (-51%) were among the few to post negative returns. Conversely, returns in the local debt benchmark were more mixed with Turkey (+19%) and Argentina (-60%) being an outliers. ■

REAL ASSETS

Given the declining rate environment witnessed during the third quarter, several real asset categories performed well, notably both the listed Real Estate (FTSE: NAREIT Equity Index +7.8%; +27.0% YTD) and Infrastructure (DJB: Global Infrastructure +2.5%; +23.8% YTD) sectors. But while the MLP category also generally benefits from declining rate environments, volatile and falling oil prices weighed more heavily on the space in the quarter (Alerian MLP Index: -5.0%; +11.0% YTD). Oil prices slid from 58.47 to 54.07 (WTI) during the quarter and the energy-heavy GS Commodity Index was off 4.2%, while Gold (S&P Gold spot price: +4.25; +15.0% YTD) benefitted from its safe haven status. Looking across the rest of the Commodity complex, Agriculture Commodities finished in negative territory (Bloomberg Commodity: Agriculture Subindex: -6.2%), weighed down by Coffee, Corn and Cotton in particular, while Nickel (+35.5%) almost single-handedly lifted the Industrial Metals Subindex (+2.4%) into positive territory for the quarter. ■

CLOSING THOUGHTS

Markets were subdued as the quarter ended in spite of an unexpected impeachment inquiry into the President of the U.S., an imminent Brexit outcome that poses the threat of a harsh no-deal departure, violence in Hong Kong, and other assorted challenges. Trade negotiations are slated to continue, but uncertainty remains. Returns across capital markets have been outsized in 2019, especially in the U.S., where stock markets have rewarded investors with 20% results and fixed income is up nearly 10%. There appears to be ample fuel for lowered expectations going forward, but we continue to guide investors to adhere to a disciplined process that includes an appropriate and well-defined long-term asset allocation policy. ■

Important Disclosure Information

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PRELIMINARY RETURNS FOR VARIOUS PERIODS: 3Q19

		July	August	September	Last Quarter	Year to Date	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 15 Years
EQUITY	1 Russell:3000 Index	1.49	(2.04)	1.76	1.16	5.31	2.92	12.83	10.44	13.08	9.10
	2 Russell:1000 Index	1.55	(1.83)	1.73	1.42	5.73	3.87	13.19	10.62	13.23	9.17
	3 Russell:1000 Growth	2.26	(0.77)	0.01	1.49	6.20	3.71	16.89	13.39	14.94	10.40
	4 Russell:1000 Value	0.83	(2.94)	3.57	1.36	5.25	4.00	9.43	7.79	11.46	7.82
	5 Russell:Midcap Index	1.43	(2.85)	1.97	0.48	4.63	3.19	10.69	9.10	13.07	9.92
	6 Russell:Midcap Growth	2.33	(1.82)	(1.14)	(0.67)	4.69	5.20	14.50	11.12	14.08	10.53
	7 Russell:Midcap Value	0.83	(3.53)	4.06	1.22	4.45	1.60	7.82	7.55	12.29	9.29
	8 Russell:2500 Index	1.04	(4.00)	1.77	(1.28)	1.64	(4.04)	9.51	8.57	12.22	9.16
	9 Russell:2500 Growth	1.56	(2.84)	(1.88)	(3.18)	0.83	(4.11)	12.33	10.22	13.48	10.14
	10 Russell:2500 Value	0.65	(4.87)	4.58	0.13	2.03	(4.35)	6.87	6.98	11.00	8.09
	11 Russell:2000 Index	0.58	(4.94)	2.08	(2.40)	(0.36)	(8.89)	8.23	8.19	11.19	8.19
	12 Russell:2000 Growth	0.98	(4.32)	(0.82)	(4.17)	(1.54)	(9.63)	9.79	9.08	12.25	9.04
	13 Russell:2000 Value	0.16	(5.58)	5.13	(0.57)	0.79	(8.24)	6.54	7.17	10.06	7.23
	14 S&P:500	1.44	(1.58)	1.87	1.70	6.08	4.25	13.39	10.84	13.24	9.01
	15 S&P:400 Mid Cap	1.19	(4.19)	3.06	(0.09)	2.96	(2.49)	9.38	8.88	12.56	9.82
	16 S&P:600 Small Cap	1.14	(4.51)	3.34	(0.20)	1.66	(9.34)	9.33	9.89	13.02	9.52
	17 MSCI:ACWI ex US	(1.21)	(3.09)	2.57	(1.80)	1.13	(1.23)	6.33	2.90	4.46	5.66
	18 MSCI:EAFE	(1.27)	(2.59)	2.87	(1.07)	2.57	(1.34)	6.48	3.27	4.90	5.29
	19 MSCI:EM	(1.22)	(4.88)	1.91	(4.25)	(3.66)	(2.01)	5.98	2.33	3.37	7.82
	20 MSCI:ACWI	0.29	(2.37)	2.10	(0.03)	3.59	1.38	9.71	6.65	8.35	7.07
FIXED INCOME	21 Blmbg:Aggregate	0.22	2.59	(0.53)	2.27	5.42	10.30	2.92	3.38	3.75	4.21
	22 Blmbg:Gov/Credit	0.15	3.26	(0.76)	2.64	6.26	11.32	3.16	3.61	3.94	4.26
	23 Blmbg:Credit	0.52	3.13	(0.65)	2.98	7.38	12.63	4.33	4.54	5.32	5.12
	24 Blmbg:Corporate High Yld	0.56	0.40	0.36	1.33	3.87	6.36	6.07	5.37	7.94	7.33
	25 Blmbg:Municipal Bond	0.81	1.58	(0.80)	1.58	3.74	8.55	3.19	3.66	4.16	4.37
	26 Blmbg:US TIPS	0.36	2.38	(1.36)	1.35	4.25	7.13	2.21	2.45	3.46	3.90
	27 Blmbg:Glob Agg ex USD	(0.72)	1.59	(1.42)	(0.58)	2.82	5.34	0.43	0.87	1.27	3.06
	28 S&P:LSTA Levg Loan	0.80	(0.27)	0.47	0.99	2.69	3.10	4.53	3.98	5.21	4.72
	29 ML:US Treasuries 1-3 Yrs	(0.12)	0.81	(0.11)	0.58	2.02	4.36	1.52	1.32	1.18	2.12
	30 LIBOR - 3 Month	0.19	0.18	0.17	0.55	1.18	2.56	1.90	1.31	0.82	1.79
	31 3 Month T-Bill	0.18	0.21	0.17	0.56	1.20	2.39	1.54	0.98	0.54	1.39
REAL ASSETS	32 Blmbg:Commodity TR Idx	(0.67)	(2.32)	1.17	(1.84)	(3.00)	(6.57)	(1.50)	(7.18)	(4.32)	(3.13)
	33 GS Commodity Index	(0.21)	(5.62)	1.75	(4.18)	(5.53)	(16.31)	1.54	(11.74)	(5.43)	(5.86)
	34 MSCI:US REIT Index	1.25	3.41	2.86	7.69	9.08	18.31	7.26	10.11	13.00	8.97
	35 Alerian:MLP Index	(0.19)	(5.51)	0.71	(5.02)	(4.91)	(8.13)	(2.46)	(8.65)	6.25	7.23
	36 DJB:Glbl Infrastructure	(0.39)	1.81	1.11	2.53	6.96	16.51	7.77	5.23	10.95	10.47
	37 US DOL:CPI All Urban Cons	0.17	(0.01)	--	--	--	--	--	--	--	--