Financial & Economic Review

The third quarter of 2019 wrapped up where Q2 left off, posting modest gains across the board in U.S. equity markets. In fixed income, the 10-year Treasury bond continued marching lower to end the quarter. Feeling the squeeze from ultra-low and negative international interest rates, the Federal Reserve began lowering the Fed Funds rate at their September meeting, dropping 25 basis points to 1.75-2.00%. As mentioned in our Q2 analysis, the last three recessions have occurred after the Fed began cutting interest rates, so we are keenly watching for a deterioration in economic conditions in the U.S. We feel the ongoing U.S.-China tariff battle is sufficiently priced into the market, but may prove to add an additional short-term tailwind to markets if signs point to an eventual agreement. The continued House impeachment inquiry in Congress has been the dominating headline for some time and looks to remain in the forefront until the coming 2020 election. Unrest continued in Hong Kong, as pro-democracy rallies were met with resistance from the Communist Chinese government. Additionally, a drone strike by Iran on the Saudi Arabian oil fields briefly spiked oil prices, but they quickly retreated once the fear of an oil disruption dissipated.

Utilities, Real Estate and Consumer Defensive sectors performed best in Q3, rising 6.7%, 6.7% and 3.3%. Energy again was the biggest sector loser retreating -10.2%, followed by Healthcare and Natural Resources dropping -6.3% and -5.5% respectively. The U.S. Aggregate Bond index rose 2.3%, once again benefitting from the lowering of interest rates. Similarly, the 10-year Treasury yield ended the quarter at 1.68%, down another 16% from the end of Q2. Crude oil ended the quarter down -7.5% to end at $54.07 per barrel. The S&P 500, Dow Jones Industrial Average and NASDAQ Composite Indices rose 1.7%, 1.8% and 0.2% in the second quarter respectively. Internationally, the EAFE continues to lag U.S. performance, down -1.1% for the quarter. Similar to last quarter, there are very few quality stocks in our research that trade at a discount to fair value. The sectors trading at the largest discount to Morningstar's coverage universe were once again Energy and Consumer Cyclical, at approximately 80% and 93% of fair value[1]. Utilities and Real Estate were the most overvalued sectors, trading at 17% and 7% above fair value. With the P/E ratio on the S&P500 trading at approximately 21.88, compared to 15.75 historically, an almost 39% premium, we feel U.S. markets are stretched and represent too great a risk for broader market purchases at these levels. We will continue to look for and select individual stock positions for new client money until the broader market retraces or earnings catch up to current price levels. We continue to remain patient, as we navigate fully valued markets.

Thank you for allowing our Firm to manage your investment and retirement assets. We look forward to continually earning your trust and referrals as 2019 draws to a close.

Jack A. Kennedy
Chief Investment Officer

Like

[1] Results referenced from Morningstar.com

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