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Second Quarter Market Update

The second quarter saw the S&P 500 maintain the momentum it gained in the first quarter of the year and ended the period up 18.54% year to date. While domestic equites led the charge, all other asset classes reported positive second quarter performance and, at this stage, are positive from a year to date perspective as well.

To Cut, or not to Cut, that is the Question.

Despite the positive performance, recession fears remain a mainstay in economic headlines. Even against this backdrop, the market, defined as the S&P 500, was able to reach all-time highs toward the end of the period. The recessionary narrative grew during the quarter due to companies reducing their earnings expectations and reports on various economic data points pointing to slower growth. This led many to believe that the Federal Reserve would begin to cut interest rates to support the ongoing economic expansion. The expectation was that these rate cuts could start this year, coming as early as the July Federal Reserve meeting. While it may seem counterintuitive, a decrease in rates, even one due to softening economic data, was seen as a positive for domestic equities by investors. This shot in the arm pushed domestic equities to all-time highs during the period. At the end of the quarter though, the monthly Jobs Report numbers came in significantly above what was expected. While this is a good economic sign, it cast uncertainty onto the future path of interest rates. This uncertainty, on top of the ongoing geopolitical trade negotiations, will likely increase the level of volatility in equities as market participants try to determine the strength of the underlying economic fundamentals.

Going forward, in somewhat of a self-fulfilling prophecy of market psychology, it is likely the concerns of a recession will escalate as the volatility from trade negotiations and changing interest rate expectations picks up. We would encourage investors to remember that volatility is an inherent aspect of investing and in and of itself is not necessarily a sign of the strength of the underlying economy. A statistic that we think is important to keep in mind is that over the last 39 years, the S&P 500 falls by an average of 14% from its peak at some point during each year. Despite these intra-year declines the stock market ends the year positive 74% of the time. As we work through the second quarter earnings season, against the backdrop of trade negotiations, we think that a resetting of lower growth expectations from S&P 500 companies is prudent which could be a catalyst for increased volatility. With these statistics in mind and given the strength of the underlying economy as evidenced by the near all-time low unemployment rate and stable labor force participation rate, we believe that the economy will continue to expand and that equities will maintain a path of positive growth, albeit bumpier in the back half of the year.

International developed and emerging markets, while not as strong as domestic equities, did have a positive period and contributed to globally diversified portfolios during the period. Coming out of the 2009 recession lows, both domestic and international equites rebounded in line with each other. However, international equities have lagged domestic equities now since mid-2011. Since the 2009 low, domestic equites, defined as the S&P 500, are up 335% compared to only a 112% return by their international counterpart, measured by the MSCI All Country Ex US index. Historically, this lag has not always been the case. In the 2000's international and emerging markets outperformed many different aspects of the domestic equity markets. Just as it is impossible to time when to invest with precision in our markets, the same holds true overseas. We would caution investors to be patient and maintain an appropriate weighting to these asset classes to meet their long-term goals as eventually it is likely the tide will turn to favor international equities.

During the period, fixed income benefited from the speculation that interest rates would decline and ended up 3% and the Barclays US Aggregate index is now up 6% for the year. If rates rise it will put pressure on bond prices resulting in potentially lower returns or losses, and if interest rates go down, it will push prices of existing bonds higher, increasing the probability of positive returns. While the volatility in bond prices is significantly lower than in equity markets, it does still exist, and conservative investors may not be immune to fluctuations in asset prices if interest rates move counter to the markets expectations.

Like other time periods, it is important to remember to rebalance portfolios back to their targeted allocations. Asset classes do not move in lock step, and this can create significant imbalances even if everything had a positive return.

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Correcting these imbalances is important as it will likely reduce exposure to unwanted fluctuations in portfolio balances.

We are always ready to assist you and answer any questions regarding this newsletter or any other financial matter that may come up. If any changes to your situation have occurred, please contact us at your convenience.

Index	Closing Price: 6/28/2019	Closing Price: 3/29/2019	Q2 2019 Return	2019 YTD Return
S&P 500	2,941.76	2,834.40	4.30%	18.54%
S&P 500 Value	1,151.86	1,114.38	4.02%	16.70%
S&P 500 Growth	1,803.32	1,731.25	4.56%	20.19%
Russell 2000	3,893.33	3,826.64	2.10%	16.98%
Russell 2000 Value	6,569.27	6,515.22	1.38%	13.47%
Russell 2000 Growth	6,210.09	6,054.27	2.75%	20.36%
MSCI EAFE	1,922.30	1,875.43	3.97%	14.49%
MSCI EM	1,054.86	1,058.13	0.74%	10.78%
BBgBarc US Agg Bond	2,171.71	2,106.83	3.08%	6.11%

Written by Finity Group

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