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Monthly Market Commentary

MCF CAPITAL MANAGEMENT

What is really driving the market: Trade Wars or the Fed?

June 2019 | Marco Fragnito | Managing Principal

KEY POINTS:

- In our opinion, the market decline in May is a result of the Fed's failure to recognize economic downside risks.
- The US economy remains the most dynamic in the world due to strong trade position and American corporations' adaptability to changing market conditions.
- The next Fed FOMC meeting will be on Wednesday, June 19th.

EQUITY MARKET

US and global equities suffered in May their first monthly decline of 2019. US stocks were enjoying their best start of the year since 1987, before renewed trade hostilities between the US and China appeared to send equity markets into a slide. The S&P 500 was down 6.6% for the month of May, while the Nasdaq lost 7.9% and the Dow Jones Industrial Average dropped 6.7%.

While market pundits blamed renewed trade hostilities, we at MCF Capital Management believe that the Federal Reserve's failure to recognize the growing downside economic risks on the horizon at their April 29th to May 1st meeting were most responsible for the decline. Upon closer examination all three market corrections since last September have all begun following Fed meetings. Look for our next Fragreport where we will delve deeper into this subject.

While many will disagree with our view, we ask a simple question: "Why have markets continued to set new record highs despite the absence of a trade deal with China?" We believe that markets have recognized that the US position in trade negotiations is strong and that American corporations are second to none in their tremendous ability to adapt to a changing marketplace. This is why the US economy remains the most dynamic economy in the world. We see this in our strong economic growth, US GDP rose 3.1% in the first quarter, while in general our leading corporations continued to see growth in both revenues and earnings. Investor sentiment can shift abruptly in the short term, we like to remain focused on long term trends and data.

FIXED INCOME

With renewed pessimism in world equity markets, US Treasuries continued to rally sending yields to yearly lows across the yield curve. This led to a persistent inverted yield curve by month's end, the deepest since 2007, and at this point worrisome. We believe, the Fed's inability to acknowledge signs of potential risk to the economy pose the greatest threat to financial markets, just as they did in 2007. The Fed-fund futures data from CME group at the time of writing was pricing as much as a ¾% decline in the Fed-fund rate by year end.

While US economic data remained strong in May, with payrolls increasing 263,000 putting the unemployment rate at 3.6% the lowest in 50 years and a strong US GDP report showing 3.1% growth in

the 1st quarter, risks to the economic expansion were rising. US manufacturing, PMI as measured by the firm Markit came in at its lowest level in the last 10 years, while the global economy continued to weaken, especially across the large economic zones such as the European Union. Deflationary signs were also appearing across numerous commodity markets, such as crude oil. The Federal Reserve's decision to emphasize the positive and not acknowledge the economic risks to the expansion are a real concern for markets.

MARKET OUTLOOK

We remain cautiously optimistic on equity markets; everything will depend on how the Federal Reserve reacts to the economic risks present and by its actions. Their June 19th meeting is setting up to be extremely important in determining the direction of financial markets but also the economy itself for the remainder of this year. Fixed income investors may want to carefully review their bond holdings, especially longer-term maturities. While our call on long term bond holdings has been wrong over the last six months, we remain convinced that the lows in yields were seen in the summer of 2016 and will not be re-visited any time soon.

If you have any questions please contact us directly at 949.472.4579, and feel free to forward this report and our contact information to anyone who might be interested.

Sources: Wells Fargo Advisors, Dan Wanstreet, "Monthly Market Commentary," June 3, 2019.

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