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Market Note

Integra Capital ADVISORS

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Welcome to the 4th Quarter

As we enter the final quarter of 2019, we thought a review of the last 12 months of ups and downs for stock prices would be appropriate. The table below shows the performance of several exchange traded funds (ETFs) which target different indexes and the performance over the last year. As you can see, the returns are low, as a result of the correction in the final quarter of 2018 and the subsequent recovery in 2019.

Major U.S. Stock Indexes Trailing 12 Month Returns

Trailing Returns

Data Point: Return Calculation Benchmark: Russell 1000 Growth TR USD

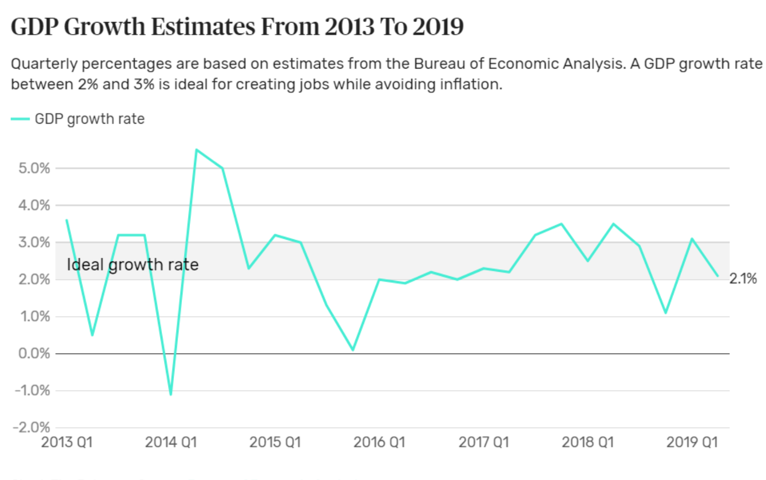
	1 Year
Invesco QQQ Trust	2.55
SPDR® S&P 500 ETF	4.19
SPDR® Dow Jones Industrial Average ETF	4.08
Russell 1000 Growth TR USD	3.71

Our tendency as human investors is to reconfigure data focusing on what is most appealing and comfortable emotionally. For example, take the real estate investor who boasts the return on a recent sale of real estate based on the original price paid versus the gross sales price obtained. What about costs incurred along the way? Real estate taxes, maintenance, interest on any indebtedness, repairs, closing costs, etc. The "real return" isn't as emotionally appealing to discuss. With major indexes up double digits year to date 2019, the trend is to focus on that far more visually pleasing time period. The reality is that over the last 12 months stocks turned positive only recently. In fact, lately volatility in October decreased the return on the S&P 500 to around 1.57% over the last year.

The "R Word" (Recession) or Mid-Late Cycle Temporary Slow Down?

At the beginning of 2019 our investment committee estimated the *potential* for a gain of 25% on the S&P 500, but with increasing volatility. We arrived at that figure with some simple math; recover the 20% lost in the 4th quarter of 2018 and add 5% to that. Why 5%? We were estimating an increase in corporate profits of around 5% for the year, and 5% nominal growth in GDP (nominal includes inflation – the real GDP number, which is the widely reported metric, subtracts the rate of inflation and so is lower than the nominal number).

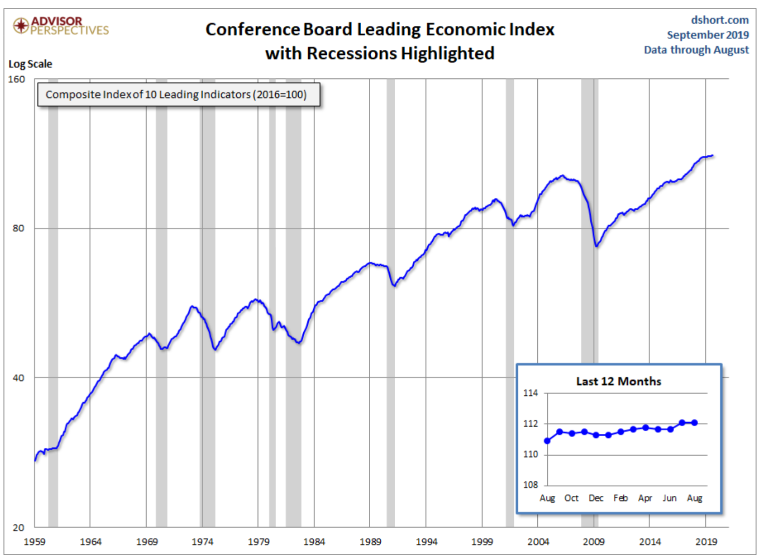
As you can observe in the chart of real GDP growth quarter over quarter below, economic output of the U.S. economy currently sits in the "ideal growth rate" range where unemployment is low but inflation remains under control. Output dipped to a 1.1% rate in the 4th quarter of 2018 and snapped back to a robust 3.1% in the 1st quarter of 2019 before settling in at about 2% for the 2nd quarter. It will be a few weeks before measurements are published for the just finished 3rd quarter.



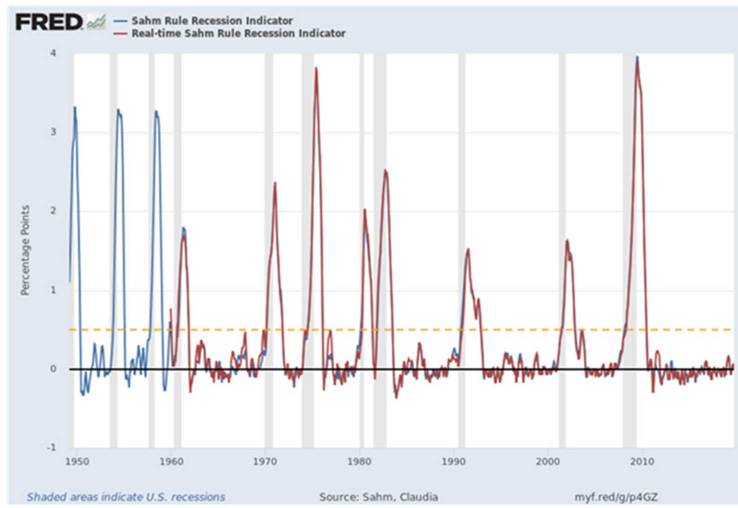
Looking Forward

People who are involved in investing in markets, public or private, look to future prospects with historical data already digested and accounted for in current asset prices. The information highlighted above is all rear-view mirror information. Let's take a look through the windshield now. Keep in mind looking forward requires estimation and forecasting, not an exact science.

Below we have included a snapshot of the Bureau of Economic Analysis' Leading Economic Indicators Index (LEI), which includes a variety of forward looking data points to measure where the rate of economic growth may head next. Recent flattening of this indicator is consistent with the current slowdown in the economy, but is not declining to the point where a recession would be expected in the near future.



The United States Federal Reserve Bank has recently begun using the "Sahm Rule Indicator" to help identify when the economy may be at risk of a recession. See the chart below. Readings above the 0.50 level indicate an impending recession or a recession that has already just begun. The latest reading for September was 0.0, indicating no impending recession, at least with the information in hand today.



The various data points certainly don't point to an "all systems go" scenario, and caution is warranted, but the next recession doesn't seem close at hand so far. Risks for stocks include trade wars and tariffs, manufacturing recessions in many foreign countries, negative interest rates abroad, too much strength in the dollar hurting exports, lack of business investment in the United States due to uncertainty, fiscal deficit spending, politics at home and abroad, and a few others to a lesser degree.

By our way of thinking it's a time to stay invested as is, which in most cases is a risk neutral posture, hold a bit of cash for future investment and hedging, and remain vigilant as new data becomes available.