



Market Review
Second Quarter 2019

U.S. equity markets rallied in the second quarter and delivered the best first-half performance since 1997. Investors shrugged off moderating economic data and late night tariff tweets, and instead turned their attention towards a more accommodative Federal Reserve and renewed optimism for a possible U.S.- China trade truce.

The S&P 500 and Russell 2000 indices posted 2Q gains of 4.3% and 2.1%, respectively, against a turbulent backdrop. Policy and politics drove much of the undulation as deteriorating fundamentals took a back seat. Momentum exiting the historically strong first quarter continued into April (the S&P 500 was up 4.1% during the month). Markets rallied on first quarter GDP estimates, topping economists' expectations, and hopes of a trade deal with China. In corporate America, initial earnings results exceeded expectations and jobless claims hit a low not seen since 1969. Sentiment, however, soured in May (S&P 500, -6.4%). Trade negotiations with China fell apart and the market braced for further deterioration between the two parties. Complicating an already precarious diplomatic objective, President Trump raised tariffs on the U.S. largest trading partner, blocked U.S. tech companies from selling components to China-based Huawei (the world's largest telecommunications firm), and threatened tariffs on imported goods from Mexico for good measure. Fears of recession rose, and bond yields collapsed as investors sought safety, further inverting the yield curve. Despite all of the negative headlines, equities were remarkably strong in June (S&P 500, +7.1%). Slowing growth and weak inflation prompted the Fed to give equity markets another shot of adrenalin by signaling it may cut short-term interest rates in the months ahead.

In the Russell 2000 index, Industrials (+8.2%) outperformed during the quarter as investors sought exposure to areas of the market likely to benefit from an improvement in global trade, and Financials (+5.1%) rose on the expectation that a more accommodative Federal Reserve would stoke borrowing demand and a re-steepening of the yield curve. Growth outperformed value as investors continue to crowd into high-growth companies with little-to-no regard for valuation.

The question we ask ourselves is where does the market go from here? Despite robust equity market returns, U.S. economic activity is slowing. The U.S. consumer, however, remains in good shape. High consumer confidence is the result of a strong job market, solid wage gains, and improved savings. Hope springs eternal and investors have been quick to write off bad news as temporary, preferring to believe a favorable trade agreement with China is on the come, and that the Fed will do what it takes to support the stock market.

Since the beginning of 2018, when global economic growth was solidly advancing and U.S. consumers were benefitting from tax cuts, the market made four new highs, yet each successive market top has been only marginally higher than the previous and short-lived. Looking ahead we see the potential for economic stabilization and renewed GDP acceleration, but remain cognizant that deterioration in trade talks may cap near-term economic growth. The Fed's actions have resulted in lower borrowing costs for consumers and corporations, M&A activity is robust, initial public offerings have been well received, and share repurchases remain at elevated levels. However, the rising threat of global protectionism and political uncertainty may counterbalance the many positives we see for a sustained equity market rally. We continue to identify companies through our bottom-up research process with strong long-term fundamentals and attractive risk/reward characteristics.



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Sources: FactSet, GICS Sector Classification

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S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. S&P 500 is part of a series of S&P U.S. indices that can be used as building blocks for portfolio construction.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

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Index Definition Sources: Standard & Poor's; Russell Investments