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SECOND QUARTER 2019 ECONOMIC AND FINANCIAL MARKETS REVIEW

Stocks rallied strongly during the first quarter of this year as the major market indices erased losses caused by the late-2018 stock market plunge. However, volatility returned during the second quarter because concerns regarding the weak global economy and escalating trade tensions created anxiety among investors and traders. Over the last several years, the U.S. economy has been stronger than the economies of other developed foreign countries. However, there is a concern that global economic weakness could begin to negatively impact U.S. economic growth. The trade war with China could exacerbate the global economic slowdown because the U.S. and Chinese economies, the two largest economies in the world, will likely both be harmed in the near term. Due to these economic concerns, investors began to anticipate that the Federal Reserve Board will lower interest rates in order to create stability. The anticipation of a stimulative interest rate cut put the stock market back on track, and the S&P 500 Index ended the first half of this year up 17.35%, while the Dow Jones Industrial Average finished up 14.03%. In contrast to last year, declining interest rates in the bond market caused bonds to appreciate during the first half of the year. As a result, the Bloomberg Barclays U.S. Intermediate Government/Credit Bond Index gained 4.97% during the first half of this year.*

Despite the positive first half of 2019, global economic and trade concerns still linger, which could lead to additional volatility throughout the rest of the year. After it appeared that the U.S. and China were very close to a comprehensive trade deal in April, negotiations suddenly broke down, leading to concerns about a longer-term trade conflict between the two countries. A continuing trade war with China can continue to disrupt global supply chains and cause corporations all over the world to rein in spending due to trade and economic uncertainty. In addition to the insecurity created by the trade war with China, tariffs placed on goods imported by both countries will likely be passed on to consumers, resulting in rising costs of goods. If the cost of goods increases, consumers may spend less, causing the U.S. economy to slow. Investors are also concerned that if consumers join corporations in becoming uncertain about their financial future, the U.S. economy will weaken, potentially leading to a recession. A U.S. recession would result in lower corporate earnings - on which stock prices are based.

Because of uncertainty regarding the global economy and additional damage inflicted by the China trade war, there has recently been a “flight to safety” where global investors have been seeking the shelter of U.S. government bonds. This demand for U.S. bonds has led to higher bond prices and lower bond yields (there is an inverse relationship between bond prices and bond yields). Lower interest rates in the bond market combined with worries about the global economy, exacerbated by trade concerns, have led to hopes that the Federal Reserve Board will lower their benchmark interest rate this year. Interest rate cuts by the Fed to stimulate growth would have short-term positive implications for stocks. This is because, despite economic and trade concerns, there are very few choices for investors beyond the stock market when interest rates are suppressed and bond prices are elevated.

A lack of other viable investment options and avoidance of a U.S. recession could prevent a long-term bear market decline for stocks for now. However, it is even more important than usual to invest in the right types of stocks. For example, if the trade conflict is prolonged, companies that depend on

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demand or supplies from China are likely going to underperform. Conversely, U.S. companies that derive their profits primarily in the U.S. as opposed to foreign countries may outperform companies that rely primarily on foreign sales. Companies that provide relatively large dividends may be attractive compared to low bond market interest rates. Until it appears that overseas economies are recovering, we continue to favor U.S. stocks over their foreign counterparts.

As long as the global economic slowdown and trade wars do not lead to a recession in the U.S., we believe that any stock market weakness in the second half of this year could create good buying opportunities for long-term investors. We are particularly interested in mid-size company stocks because they do not typically have as much foreign exposure as large companies and they are generally less volatile than small-size company stocks. We will be more concerned about a long-term decline in stocks if interest rates begin to rise again. This is because rising interest rates would create higher borrowing costs for the U.S. government, businesses, and consumers, leading to a longer-term economic downturn.

In the meantime, please contact us if you have any questions regarding your investments or the financial markets in general.

* *Index returns were obtained from the Wall St. Journal and Bloomberg Barclays on June 29, 2019.*

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