THE PRIVATE CLIENT GROUP
WEALTH MANAGEMENT

Economic & Market Insights

~ T H I R D   Q U A R T E R   2 0 1 9 ~

EXECUTIVE SUMMARY

Heading into the third quarter, the U.S./China trade war and Brexit dispute ground on, and global interest rates continued to fall. Unexpected threats soon emerged when rising tensions in the Middle East roiled the energy markets and the U.S. Federal Reserve was forced to intervene to stave off a liquidity crisis in the money markets. Meanwhile, looser monetary policy and easing financial conditions supported the U.S. equity and bond markets. Despite a spike in volatility, U.S. stocks advanced for the quarter, adding to healthy gains from earlier in the year. International markets fared less well, but losses were contained, and international stocks and bonds were still in positive territory year-to-date. Commodities were mixed, with steep losses in energy and select industrial metals offset by precious metals such as gold.

Within the equity markets, the returns to specific regions and sectors diverged widely. Emerging markets, hampered by a dependence on trade and commodities as well as sharp currency declines versus the U.S. dollar, were hardest hit. Small cap stocks, which are viewed as more sensitive to an economic slowdown, declined both in the U.S. and abroad. Health care and technology stocks were hindered by concerns over increased regulation.

Investor sentiment seemed to notably shift during the quarter. Fixed income, safe-haven precious metals and defensive equity sectors outperformed more volatile, momentum-driven investments. Mutual funds and ETFs invested in equities as well as less liquid sectors, such as bank loans, experienced net outflows. Meanwhile, investors piled into cash despite yields that are less than inflation. Interest rate sensitive sectors such as real estate and utilities came back into favor. Few market forecasters would have called these trends at the beginning of the year.

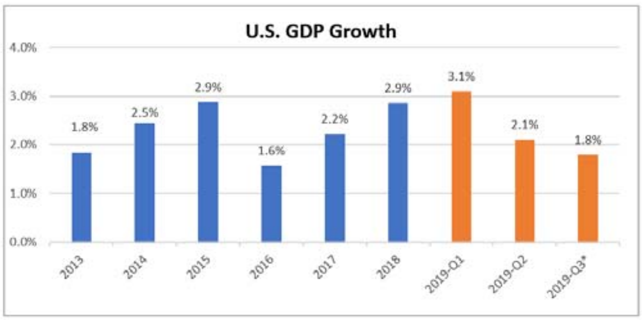
Ongoing political uncertainty is likely to drive market swings in the months ahead. Asset class diversification is the most powerful tool to protect investment portfolios from volatility and the erosion of purchasing power over time. A well-diversified portfolio includes defensive assets to stabilize returns during market corrections as well as growth-oriented assets with the potential to earn higher returns than inflation. This is the best way to achieve a reasonable outcome in the face of uncertainty and unknown risks.

Steven W. Lieberman, MBA, CFP®   The Private Client Group, LLC   (973) 285-3637   slieberman@sfr1.com

ECONOMIC INSIGHTS

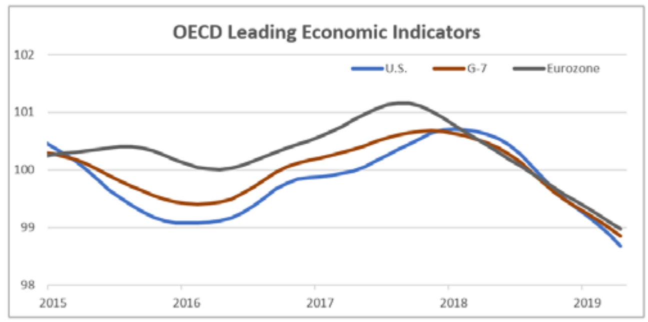
The global economy is at a crossroads. U.S. economic growth continued at a healthy pace of around 2% over the third quarter. A strong labor market and consequent robust U.S. consumer have been at the core of the world's growth engine. The housing market has also received a healthy boost from the recent fall in rates and subsequent decline in borrowing costs. Contrarily, growth overseas continues to slow. In Europe, Brexit confusion and a German manufacturing slowdown endure. In Asia, Japan's sovereign debt levels have ballooned while China is fighting slowing growth on one front and a trade conflict with the U.S. on the another. The U.S. is also not without faults. Putting aside the partisan divide and presidential impeachment inquiry, it also is showing some signs of declining growth, particularly in the manufacturing sector.

It's now been over a year since the first round of tariffs were exchanged between the U.S. and China. The ensuing period has offered constantly evolving sentiment and introduced volatility into global markets. The conflict has also expanded, with ramifications felt by most major developed and emerging nations. Despite what seems like countless trade-oriented meetings and discussions, it’s still unclear if the U.S. and China are much closer towards a long-term resolution.



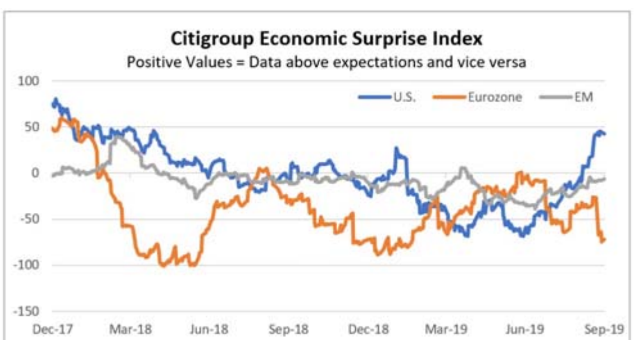
*U.S. Department of Commerce, *Atlanta Fed GDPNow Estimate*

The Atlanta Fed's latest "GDP Now" forecast for third quarter growth was revised down from just over 2% to 1.8%. The drop reflects disappointing U.S. manufacturing data. The downward revision supports the notion of slowing growth within the U.S.



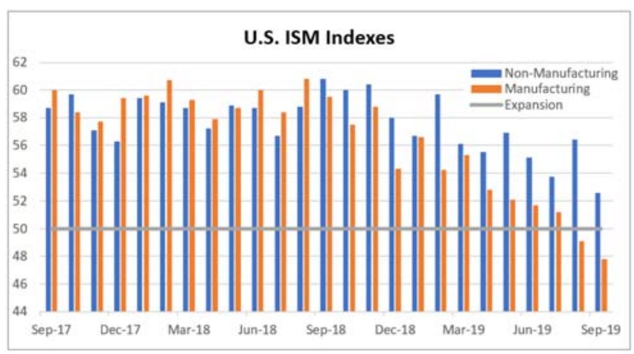
Organization for Economic Cooperation and Development

Leading economic indicators (LEIs), designed to show inflection points, have continued their trend downwards and anticipate slowing growth amongst most major markets. The decline reflects the trade war's toll on growth and impact on sentiment and capital investment globally.



Citigroup

The Citigroup Economic Surprise Index had a volatile year. Coming into 2019, Eurozone data was exceeding expectations while U.S. data was largely underwhelming them. U.S. expectations have since come down and recent data has been more in-line and even ahead of estimates. Eurozone data, on the other hand, has recently underwhelmed.

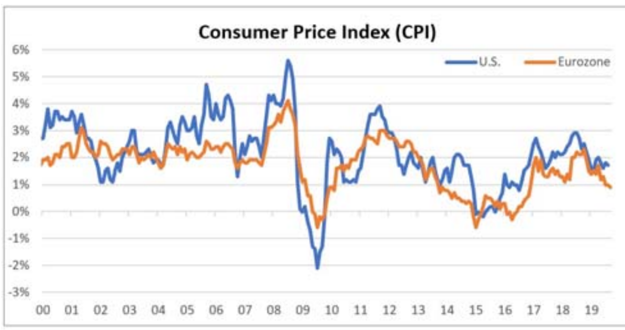


Institute for Supply Management

Non-manufacturing data continued to expand while manufacturing data has recently slipped below the meaningful 50 level. September was the second month in a row indicating manufacturing contraction and the lowest reading since mid-2009. Tariffs have hit this part of the economy particularly hard as demand for exports has slipped.

2019 offered a meaningful transition in interest rate policy. Entering the year, the world appeared as if it was heading towards a period of monetary policy normalization. The Fed was in the middle of a hiking schedule and the ECB just ended net asset purchases. Fast forward several months and slower growth concerns, a global trade conflict and benign levels of inflation have transitioned the world back to a period of coordinated central bank easing. The Fed already cut rates twice so far this year and the ECB launched a new bond buying program in September, both of which had large implications. According to Bloomberg at the end of August, roughly 30% of all investment grade securities now have negative yields.

Despite recent cuts, U.S. yields remain above other developed market's sovereign debt. This contributed to U.S. Dollar strength, presenting a challenge to the domestic manufacturing sector. The U.S. dollar also retains its status as a global reserve currency amongst heightened levels of uncertainty which increases its demand.



U.S. Bureau of Labor Statistics

Inflation remains benign in most developed economies globally. This is unusual in the U.S. given the historically low level of unemployment and recent uptick in wage growth. Lower energy and food prices have helped partially offset these factors.

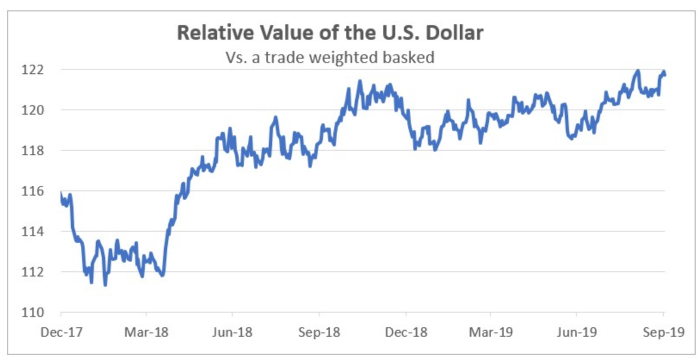
Bloomberg

After nearly a decade of strong growth, S&P 500 earnings have recently plateaued. While the U.S. consumer remains in solid shape, slowing global growth and margin pressures from wage inflation/tariffs have eroded companies' earnings per share.

Global Growth Rates	2017	2018	2019	2020	2021
Advanced	**2.4%**	**2.2%**	**1.8%**	**1.7%**	**1.7%**
Euro	2.4%	1.8%	1.3%	1.5%	1.5%
U.S.	2.2%	2.9%	2.3%	1.9%	1.8%
Japan	1.9%	0.8%	1.0%	0.5%	0.5%
U.K.	1.8%	1.4%	1.2%	1.4%	1.5%
Canada	3.0%	1.8%	1.5%	1.9%	1.8%
Emerging	**4.8%**	**4.5%**	**4.4%**	**4.8%**	**4.9%**
China	6.8%	6.6%	6.3%	6.1%	6.0%
India	7.2%	7.1%	7.3%	7.5%	7.7%
Russia	1.6%	2.3%	1.6%	1.7%	1.7%
Brazil	1.1%	1.1%	2.1%	2.5%	2.2%
World	**3.8%**	**3.6%**	**3.3%**	**3.6%**	**3.6%**

International Monetary Fund; 2019 and beyond are estimates

IMF growth rate estimates across many developed and emerging countries are expected to be lower going forward. In particular, the U.S. and China's growth rates are set to contract, partially due to the extended trade conflict. Certain emerging market nations, such as India and Brazil, are expected to have higher growth rates from 2019 and beyond.



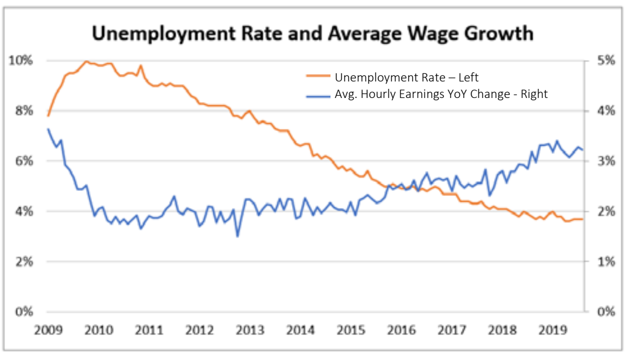
U.S. Federal Reserve and Bloomberg

The U.S. Dollar remains at an elevated level compared to other developed and emerging market currencies. This is partially attributable to higher interest rates available domestically relative to Europe and Japan where a considerable portion of rates are negative. Broader economic and political uncertainty are also at play as the U.S. Dollar remains the core reserve currency for the world.

The Consumer Confidence Index (CCI) displayed conflicting trends throughout the entire quarter and moved lower through September. Overall consumers were less positive when assessing current economic conditions, perhaps influenced by escalating trade and tariff conflicts that seem to dominate the headlines as of late. In contrast to the markets, which reached all-time highs during the quarter, the CCI may be indicative of the market peaking thus forecasting a bumpy road lies ahead.

In other areas of consumer data, auto sales slightly declined through the quarter. The year-over-year growth rate of this category ultimately turned negative in September. Additionally, the personal savings rate as a percentage of disposable income has remained above 8% after more recently climbing there at the end of 2018.

Employment figures remain very strong displayed by the national unemployment rate holding firm at 3.7%. This equates to a more specific yet impressive figure of only about 6 million people who are claiming unemployment. To put this amazing statistic into perspective, this low level of unemployment has not been approached since the year 2000, just shy of a 20-year record!



U.S. Bureau of Labor Statistics

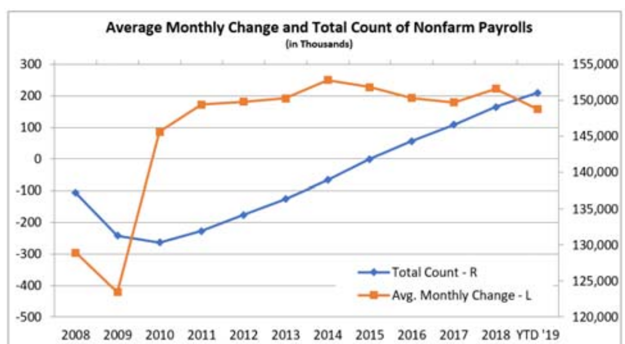
A declining unemployment rate level to sub-4% is supported by a slow but steadily increasing hourly earnings wage to above 3% on a year-over-year basis.

Conference Board

A volatile level of consumer confidence is subject to various external stimulants, but still suggests a positive outlook for consumer spending in the near-term.

U.S. Bureau of Labor Statistics

Since reaching the existing market cycle's low during 2013, the personal savings rate has slowly continued to climb to the current level above 8%.

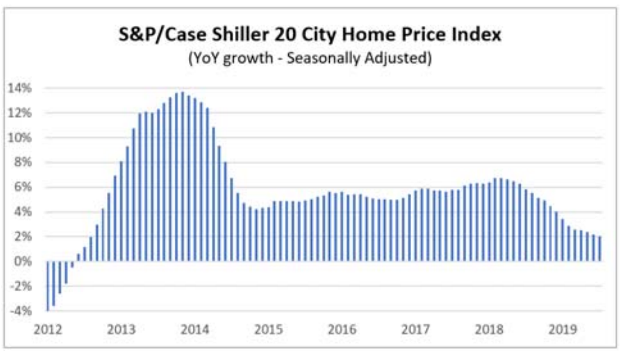


U.S. Bureau of Labor Statistics

The total nonfarm payroll listing has grown to over 150 million people nationwide and is on pace for the tenth consecutive year with a positive annual average figure.

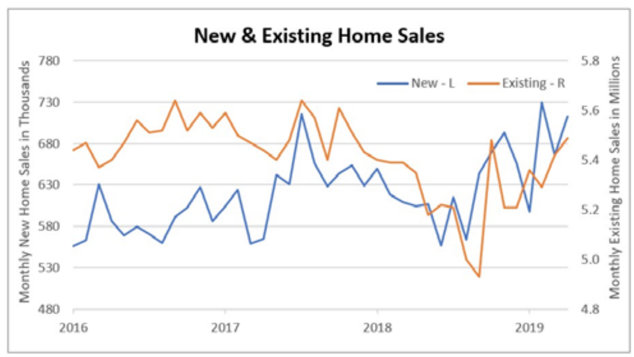
Multiple signs indicate that the U.S. housing market is stabilizing after a slowdown that began in early 2018. Although lower mortgage rates are likely the trigger for the recent improvement, decelerating price appreciation and a strong labor market with higher wage gains have made housing more affordable. Home builder sentiment also rebounded leading to a rise in building activity. Leading indicators such as building permits and housing starts suggest that the recovery will be sustained in the coming months. The recent supply of new homes has been largely driven by multifamily units, which increased over 30%, but single-family homes are also being built at a modest pace. On the downside, the inventory of available homes remains low and the typical house is on the market for roughly a month. The recent spurt in new housing activity should improve the supply situation but the low inventory available in the much larger existing home market inhibits expansion potential.

The commercial real estate market remains healthy, but valuations are on the high side after years of price appreciation. Operating income is surpassing inflation and most sectors are experiencing increases in rental income and stable tenant demand. The industrial sector, which is benefitting from the shift to e-commerce, and properties in lower cost regions with favorable demographics marked by rising populations and growing economies, have the most favorable fundamentals. New supply has picked up but is still well below levels experienced at the later stage of prior real estate cycles. Investors have been favoring defensive sectors such as health care and residential properties with reliable cash flows over more economically sensitive retail and hotel properties.



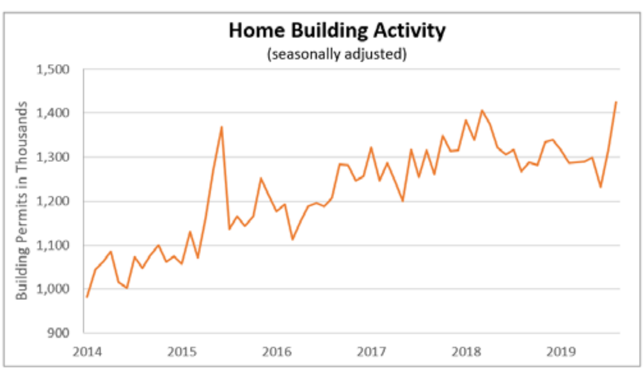
S&P/Case Shiller

U.S. home prices continue to rise but at the slowest pace since 2013. When adjusted for inflation, home prices are well below the peak reached in 2006. Home values are declining in some higher priced markets with poor affordability.



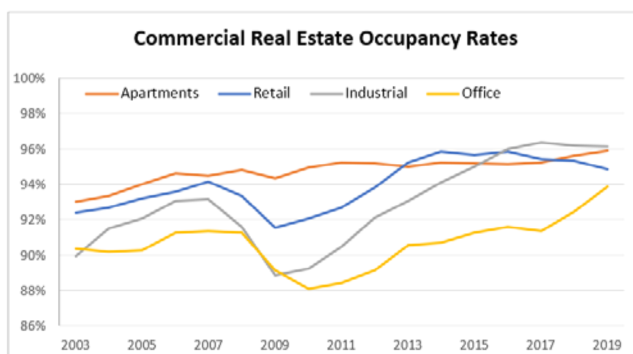
U.S. Bureau of the Census, U.S. Department of Housing and Urban Development and National Association of Realtors

Existing and new home sales have recovered from the slowdown experienced in 2018, reaching the highest levels since the financial crisis. Inventories remain low which should put a ceiling on the pace of future sales activity.



U.S. Bureau of the Census, U.S. Department of Housing and Urban Development

Building permits for new homes sharply accelerated in August, far surpassing expectations following more than a year of declining activity. The largest increase was in the northeast, where the number of new permits rose over 25%.



Nareit

Commercial real estate occupancy rates remain healthy overall. Modest supply is helping to tighten capacity in the office sector. The retail sector has been hampered by store closings and tenant insolvency.

MARKET INSIGHTS

Global equity markets were mixed throughout the third quarter, with most developed regions producing positive returns while emerging markets lagged behind with negative returns. This theme has played out for year-to-date returns as developed markets have significantly outperformed emerging markets. Also continuing the global trend this year, large-cap companies outperformed their small-cap counterparts, while value and growth styles performed relatively similarly in most markets during Q3.

Within the U.S., various market sectors were mixed with utilities leading the charge, while energy brought up the rear. Utilities have done well due to their defensive stance and sensitivity to slowing global economic growth, trade conflicts, and falling interest rates, all of which have been in the spotlight lately. Energy, however, paid the price due to the aforementioned slowing global economy.

U.S. equities, with no change to the trend since mid-2017, generally have higher valuations when compared to other developed and emerging markets. Some would argue that stronger fundamentals and the sector composition of the market makes higher valuations warranted.

U.S. equities continue to be more expensive relative to international markets based upon P/E multiples. The valuation gap between these markets continues to expand relative to historical levels. Similar to the last quarter, the U.S. and developed world markets led Q3 with positive returns. Emerging markets and most of Asia lagged behind with negative returns. Large-cap and mid-cap companies produced positive results for the quarter, while small-caps under-performed with negative results globally. The value versus growth differential has somewhat moderated for the quarter.

Duration within bond portfolios was once again rewarded as global yields fell meaningfully over the third quarter. The U.S. Treasury 10-year yield ended the period at roughly 1.7%, a stunning 40% below levels from the end of 2018. Declining U.S. rates reflected two rate cuts over the quarter, one at the end of July and another in mid-September. Futures markets are predicting at least one additional 0.25% cut before year-end. Yields outside of the U.S. also declined and the amount of negatively yielding debt outstanding continues to balloon. Most bond asset classes had positive returns, directly benefiting from the fall in rates. Within the corporate market, investment grade results bested high yield as spreads widened marginally. Municipal bond performance remained strong stemming from insatiable demand paired with constrained new issuance.

Hedge funds had a disappointing quarter, underperforming most stock and bonds indexes. Year-to-date results for this alternative asset class are closer in-line with bond returns versus stocks. Real estate has been a standout performer so far this year, strongly benefiting from falling yields which fueled lower borrowing costs. Commodities remained highly volatile, having been caught up in unpredictable disruptions in supply and geopolitics.

Barclays Capital

After rising late in 2018, corporate high yield spreads ended the quarter at roughly 4%, below the historical 10-year average. The narrow level of spreads reflects a benign default environment paired with an aggressive demand globally for yield as rates have fallen across the board. While spreads are low, there are some worrisome signs within the credit markets including increasing issuance of covenant light debt.

Bloomberg

Sovereign yields declined across the board over the quarter as a result of additional monetary policy amidst global growth scares. While U.S. rates remain in positive territory, the Eurozone joined Japan in having negative yielding 10-year bonds. Negative debt has been a growing phenomenon globally and is starting to cause some dissent within central bank committees.

U.S. Department of the Treasury

U.S. inflation expectations dropped again over the quarter but remain within a reasonable range of the Fed's 2% target. Concerns over slowing growth more than fully offset potential inflationary pressures from the lowering of policy rates. Inflation expectations have also come down outside of the U.S., particularly in Europe and Japan.

U.S. Energy Information Administration

The oil market had a volatile quarter. The largest shock came in mid-September, when two major Saudi oil installations were attacked by a drone strike. The supply disruption immediately caused the price of oil to spike by more than 10%. Following the strike, repairs were quickly made and supply restored and WTI prices have stabilized around the $55-$60 per barrel range.