2019 Capital Markets Review

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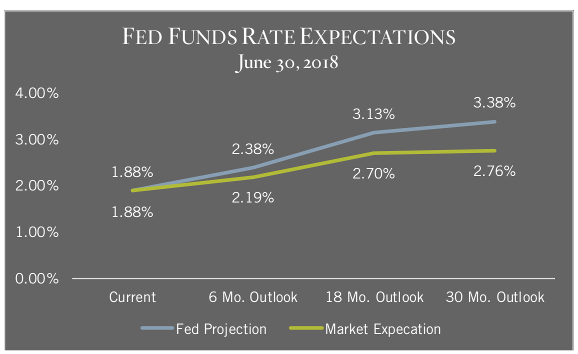
Chasing the Market

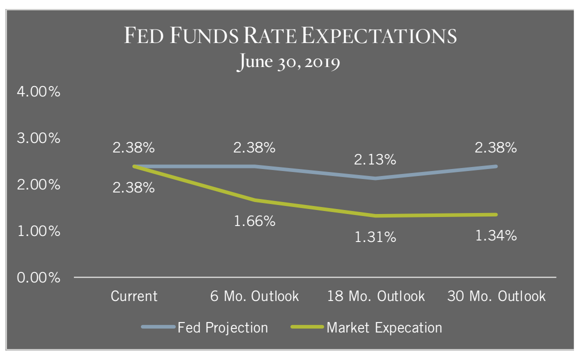
The Fed "dot plot" was created in 2011 when interest rates were near zero as a tool to provide forward guidance to investors. Each dot on the plot represents a Fed official's forecast for future rate targets while the median of these dots is often referenced as the Fed's projection for future fed funds rate levels.

Separately, in the investing world, Fed funds futures are contracts used by banks or other institutional buyers to hedge against fluctuations in the short-term interest rate market. The pricing of these forward contracts provide clarity into what the market expects future fed funds rate levels will be.

Rarely do Fed projections and market expectations align and over the last twelve months, the Federal Reserve has been chasing market expectations lower, creating a roller coaster ride for equity investors.

One of the catalysts for the S&P 500's 13.5% sell-off in the fourth quarter of 2018 stemmed from Fed Chairman Jerome Powell's statement that interest rates were a "long way" from neutral at a time when market interest rate expectations were moderating. The Federal Reserve eventually softened their outlook and equity markets soared in early 2019. In May, investors were no longer comfortable with stable interest rates and began pricing in rate declines as recession fears and trade tensions escalated, sending the S&P 500 down more than 6%. Again, the Federal Reserve responded, opening the door for possible rate cuts later this year, resulting in a full recovery for the S&P 500 in June.





This chase lower can be seen in the charts below which illustrate the falling interest rate expectations over the last year.

The market has priced in several interest rate cuts over the second half of 2019 while the official Fed projection remains unchanged. However, if history is any guide, the Fed will continue to chase the market, lowering the Fed Funds rate, starting at their meeting in late July.

Developed Equity Market Review

Growing concerns about a global economic slowdown rarely coincides with a stock market rally, but clearly equity investors have been encouraged by the accommodative messages expressed by global central banks (no matter the motivation – economic data, stock market drawdown, political pressure).

Domestic Markets

The S&P 500 ended the quarter up 4.3% bringing its year-to-date total return to a robust 18.5%. The

	Technology Sector	Growth Stocks	S&P 500	Value Stocks	Energy Sector
Cumulative 5-Year Return	134.0%	84.4%	66.3%	42.3%	-24.8%
S&P 500 Weighting	21.5%				5.0%
Russell Growth Weighting	33.5%				0.7%
Russel Value Weighting	9.7%				9.0%

Source: Morningstar Direct, Russell Indices, J.P. Morgan, Welch Hornsby, Inc.

mid-year gain marks the best first half result for the S&P 500 in over two decades.

Reviewing sector results, while Financials led the way during the second quarter, gaining 8.0%, longer-term performance continues to be dominated positively by the Technology sector and negatively by the Energy sector. This sector dispersion accounts for much of the premium generated by growth stocks over the last five years.

Capitalization and Style Performance

		Value	Core	Growth
Large	QTD	3.8%	4.3%	4.6%
	YTD	16.2%	18.8%	21.5%
	One Year	8.5%	10.0%	11.6%
Small	QTD	1.4%	2.1%	2.8%
	YTD	13.5%	17.0%	20.4%
	One Year	-6.2%	-3.3%	-0.5%

Source: Morningstar Direct, Russell Indices

U.S. small cap stocks have also rallied over the first half of 2019, gaining 2.1% for the quarter and 17.0% year-to-date. Despite the dramatic start to 2019, over the full twelve-month roller coaster ride, small cap stocks have failed to recover their 2018 year-end losses down 3.3% over the last year, dramatically underperforming their larger cap counterparts.

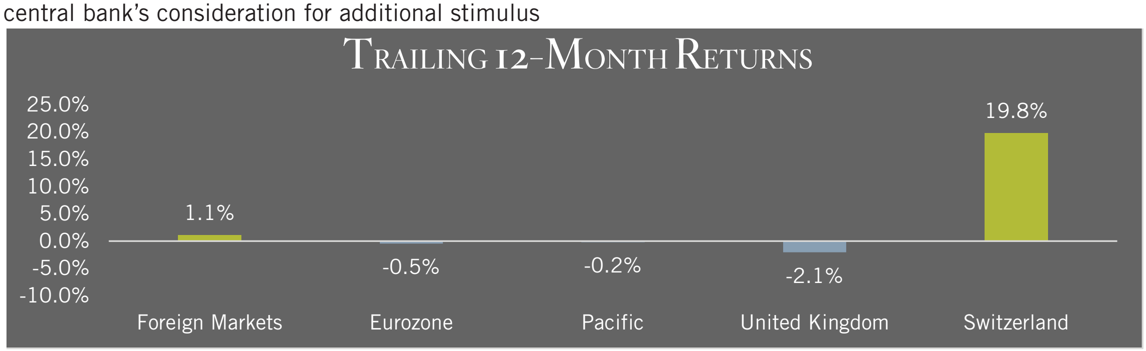
Foreign Markets

Foreign markets climbed 3.7% during the second quarter, as measured by the MSCI EAFE Index ($). Reviewing regional results, European Central Bank President Mario Draghi sent markets within the eurozone sharply higher after announcing the central bank's consideration for additional stimulus measures. For the quarter, eurozone markets climbed 5.5%, as measured by the MSCI EMU Index ($).

Outside of the eurozone, the United Kingdom did not fully participate in the broad European market rally as leaders again failed to reach an agreement to withdraw from the European Union. The dysfunction surrounding Brexit culminated in UK Prime Minister Theresa May resigning as leader of the ruling Conservative Party, weighing heavily on the British pound.

Finally, across the Pacific region, Japanese stocks posted modest declines during the quarter after export data continued to disappoint. However, the Bank of Japan held interest rates stable at its June meeting pushing the yen 2.7% higher against the U.S. dollar offsetting the stock losses for U.S. dollar-based investors.

Despite the strong 2019 results, performance by foreign markets over the trailing year has been negligible. The MSCI EAFE Index ($) is up 1.1%



Source: Morningstar Direct, MSCI ($)

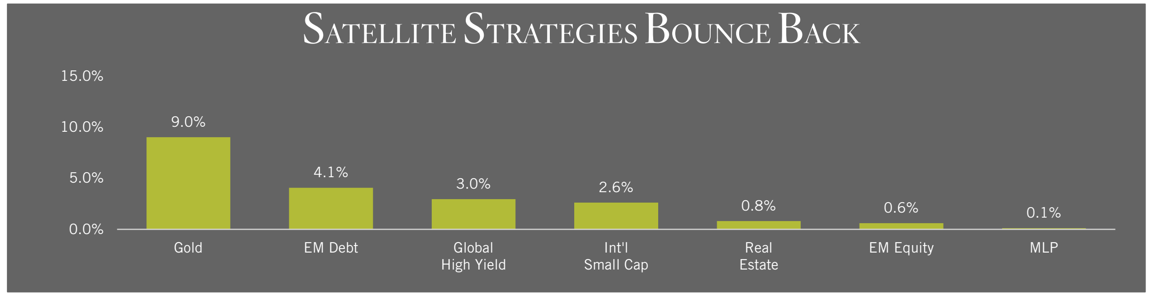
over the last twelve months buoyed by Switzerland's 19.8% return while most other major markets/ regions are underwater.

Fixed Income Review

Signs of a slowing economy, tepid inflation and an increasingly dovish tone by the Federal Reserve sent Treasury yields sharply lower during the second quarter, continuing the market chase which began last November. After reaching cycle highs in late 2018, Treasury yields have been rapidly falling, pushing Treasury prices higher. The decline in yields has been significant with longer maturity Treasury yields closer to cycle lows than cycle highs as of June 30th.

Outside of the Treasury sector, tightening credit spreads compounded falling yields resulting in the best first half for corporate credit since 1995. The Bloomberg Barclays Corporate Bond Index climbed 4.5% for the quarter and 9.9% year-to-date. The one investment-grade bond sector that did not fully benefit from the favorable interest rate environment were Mortgage-Backed bonds as lower interest rates increase prepayment risk. Overall, taxable investment grade bonds rose 3.1% during the quarter, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index.

Tax-exempt bonds have also enjoyed the supportive interest rate/credit spread environment. Additionally, tax law changes and muted new issuance have provided further tailwinds to the sector. The muni yield curve flattened during the quarter as long-term yields declined more than short-term yields. Consequently, tax-exempt bond investment results improved as maturities extended.



Source: Morningstar Direct, Welch Hornsby, Inc. - Emerging Mkt Equity: MSCI EM Index ($); Global High Yield: Barclays Global High Yield TR ($); MLPs - Alerian MLP TR ($); Emerging Market Debt - JPM EMBI Global Diversified TR ($); Int'l Small Cap: S&P Developed Ex US Small TR ($); Gold - S&P GSCI Gold ($); Real Estate: DJ US Select RESI ($)

Source: U.S. Treasury, Welch Hornsby, Inc.

Satellite Strategies

Gold soared to multi-year highs during the second quarter as geopolitical tensions escalated while the U.S. dollar weakened. The weakening dollar also supported emerging market bonds. For the quarter, EM debt returned 4.1% as the sector garnered strong inflows from income-oriented investors. On the opposite end of the spectrum, after a strong start to the year, falling oil prices left the MLP sector essentially unchanged for the quarter.

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