

Third Quarter 2019 Market Commentary

October 2, 2019

Key Takeaways:

- Healthy consumer spending is helping to fuel steady economic growth in the U.S.
- Of all the developed markets, Germany is most at risk for a recession and may already be in one.
- China may need to rely on fiscal and monetary policies to offset the impact of the trade war.
- The Fed will likely cut rates a third time in the coming months.

The summer may have been hot and hazy, but it certainly wasn't lazy when it came to the global markets. The ebbs and flows throughout the third quarter were primarily due to new and ongoing geopolitical issues. Once again, the trade war between the U.S. and China dominated the headlines, and uncertainty continued to swirl around the U.K. as the new administration attempted to finalize the country's withdrawal from the European Union. Towards the end of the quarter, tensions boiled over in the Middle East after a surprise drone attack destroyed a large portion of Saudi Arabia's oil production.

With all these cross currents and increased intraday volatility, global equity markets ended the quarter flat and were able to hold most of the gains generated throughout the first half of the year. Bond yields declined thanks in part to the Federal Reserve and other central banks intensifying their monetary easing and the markets' acceptance of a structurally low-inflation environment. This somewhat surprising and incongruous performance was likely due to the continued strength of the U.S. economy.

U.S. Growth: Slow but Steady

While U.S. economic growth has slowed from last year, it appears far from falling into a recession any time soon. Second quarter GDP was 2.0% and is expected to be around that level when third-quarter figures are released at the end of October. The U.S. consumer is currently the dominant engine of the economy. Job and wage growth have combined with a fully rebuilt savings rate to drive healthy increases in retail sales. The housing sector, which has lagged throughout this economic expansion, is beginning to see an uptick. Lower mortgage rates and a greater supply of more affordable homes are enticing buyers.

The biggest constraint to stronger growth is the lack of business spending on long-term capital investments. The 2017 corporate tax cut produced the expected explosion in corporate earnings, but the secondary effect on the purchase of productivity-enhancing business equipment has not materialized. The intensification of the trade war and the decrease in oil prices have caused capital spending to be flat. There is one bright spot; spending on intellectual property is expected to rise around 5% like it did in the second quarter. This type of spending typically increases workforce productivity and could allow this historically long expansion to continue for a few more years.

Developed Markets: Slower than U.S. but Generally Okay

Even though economies in the developed international markets are not faring as favorably as the U.S., they should not fall into recession. The notable exception is Germany, which will likely have its second straight quarter of negative GDP growth. China and the U.K are two of the country's largest export destinations, so geopolitical issues are impacting Germany more than other countries. The potential extension of the U.S. trade war to include tariffs on European goods would be another headwind for the region.

Index Performance Data								
	3Q 2019	YTD	3-Year Annualized		3Q 2019	YTD	3-Year Annualized	
Equity Index Returns				Fixed Income Returns				
Dow Jones	1.83%	17.51%	16.44%	Barclays Aggregate Bond Index	2.27%	8.52%	2.92%	
S&P 500	1.70%	20.55%	13.39%	Barclays 1-10 Year Municipal Bond	0.81%	4.73%	2.37%	
Russell 2500	-1.28%	17.72%	9.51%	Merrill Lynch High Yield Master II	1.22%	11.50%	6.07%	
MSCI ACWI	-0.03%	16.20%	9.71%	Citi World Government Bond Index	3.11%	9.20%	3.63%	
MSCI EAFE	-1.07%	12.80%	6.48%	JPM Emerging Markets Bond Index Global	1.34%	12.08%	3.84%	
MSCI Emerging Markets	-4.25%	5.89%	5.97%	Barclays TIPS	1.35%	7.58%	2.21%	
				Citi U.S. 3-Month T-Bill	0.56%	1.78%	1.52%	
Other Index Returns								
MSCI U.S. REIT	7.69%	26.82%	7.26%					
Bloomberg Commodity Index	-1.84%	3.13%	-1.50%					
HFRI FoF Index	-0.30%	5.85%	3.48%					

Source: FactSet
*HFRI FoF Index Performance as of 8/31/2019
**Returns are total returns except for the Dow Jones & MSCI US REIT (price returns)
***Citi World Government Bond Index is the hedged index

China's GDP: Feeling the Effects of the Trade War

The trade conflict with the U.S. is starting to impact China's economic growth. However, the government's fiscal and monetary response has helped control the magnitude of the slowdown. A notable development in the quarter was the breaking of the supposedly psychologically important barrier of 7.0 Chinese renminbi/U.S. dollar. While the U.S. administration claimed currency manipulation, the breakthrough hasn't yet provoked the feared capital outflow from China, which could roil markets if it does. An added element of pressure is the uncertainty around the economic impact of the protests in Hong Kong and more importantly, the Chinese government's response.

Monetary Easing: Fed Leads the Way

The Federal Reserve cut interest rates by 0.25% (25 basis points) in July and September. After Chairman Powell termed the first cut a "mid-cycle adjustment," the market delivered a strong message that the Fed needed to continue loosening its policy. The most impactful signal was the inversion of the two- to ten-year portion of the Treasury yield curve in mid-August. Based on comments from the Fed's annual meeting, the bank appears willing to take its cues from the bond market, which is calling for at least one more cut. We believe the Fed will accede to this demand.

Other central banks have followed or implied that they will soon follow the Fed in easing rates. With some of these banks still in negative rate territory, the effectiveness of additional cuts is questionable. Regardless, any easing moves tend to propel equity prices higher as the yield on fixed-income alternatives become less attractive.

Gold prices spiked higher in the quarter due to the monetary easing initiatives of the Fed and other central banks. Although there does not appear to be any near-term inflationary threats, investors are turning to gold as countries continue to debase their currencies through excessive money supply growth.

What to Watch in the Coming Months

Market volatility will likely continue as the impeachment proceedings and other domestic and geopolitical issues play out in the media. Going into the fourth quarter, trade tensions appear to have eased once again. China has begun to purchase more U.S. pork and soybeans. The U.S. has indicated it may delay certain tariff increases and dial back restrictions on the Huawei Corporation. Investors appear hopeful that these actions may be the beginning of a trade resolution, but a full resolution is unlikely any time soon.

While the attack on Saudi Arabia's oil facilities demonstrated the strength of American shale production, it also revealed the vulnerabilities of certain supply sources. The markets may factor in the possibility of further attacks.

In the U.S. equity markets, we have likely finished the third straight quarter where actual earnings of S&P 500 companies surpass consensus estimates, which were anticipating a decline. This outcome has allowed valuation multiples to be maintained and may set the stage for some multiple expansion. However, the strength of the dollar, which has risen to 21st century highs against most other global currencies, could impact the earnings and sales of U.S. multinational companies over the coming quarters.

As events in the world unfold, it's important to keep them in perspective and not let short-term developments derail your long-term financial goals. Maintaining a well-diversified portfolio is key for weathering the markets' ups and downs.

For more insights, contact a Cerity Partners advisor or visit ceritypartners.com.

Ben Pace is the Chief Investment Officer and a member of the Investment Committee. Prior to joining Cerity Partners, Benjamin Pace was Chief Investment Officer and Head of Global Investment Solutions for Deutsche Bank Private Wealth Management in the U.S. Ben has more than 25 years of experience in investment management. Prior to joining Deutsche Bank in 1994, he managed equity income funds for two investment organizations.



Third Quarter Market Summary

		Annualized								
		4Q18	1Q19	2Q19	3Q19	YTD	1-Year	3-Year	5-Year	10-Year
U.S. Equity Benchmarks		Price								
Dow Jones Industrial	26,917	(11.31)	11.81	3.21	1.83	17.51	4.21	16.44	12.28	13.56
NASDAQ Index Composite	7,999	(17.29)	16.81	3.87	0.18	21.54	0.52	15.88	13.51	15.49
S&P 500	2,977	(13.52)	13.65	4.30	1.70	20.55	4.25	13.39	10.84	13.24
Russell 1000 (Large Cap)	1,644	(13.82)	14.00	4.25	1.42	20.53	3.87	13.19	10.62	13.23
Russell 1000 Growth	1,605	(15.89)	16.10	4.64	1.49	23.30	3.71	16.89	13.39	14.94
Russell 1000 Value	1,263	(11.72)	11.93	3.84	1.36	17.81	4.00	9.43	7.79	11.46
Russell Mid Cap	2,235	(15.37)	16.54	4.13	0.48	21.93	3.19	10.69	9.10	13.07
Russell Mid Cap Growth	1,139	(15.99)	19.62	5.40	(0.67)	25.23	5.20	14.50	11.12	14.08
Russell Mid Cap Value	2,066	(14.95)	14.37	3.19	1.22	19.47	1.60	7.82	7.55	12.29
Russell 2000 (Small Cap)	1,523	(20.20)	14.58	2.10	(2.40)	14.18	(8.89)	8.23	8.19	11.19
Russell 2000 Growth	978	(21.65)	17.14	2.75	(4.17)	15.34	(9.63)	9.79	9.08	12.25
Russell 2000 Value	1,786	(18.67)	11.93	1.38	(0.57)	12.82	(8.24)	6.54	7.17	10.06
S&P GICS Sectors		Weight								
Consumer Discretionary	10.1%	(16.42)	15.73	5.28	0.51	22.46	2.36	15.82	14.03	17.68
Consumer Staples	7.6%	(5.21)	12.01	3.72	6.11	23.28	16.85	7.89	9.26	12.29
Energy Sector	4.5%	(23.78)	16.43	(2.83)	(6.30)	6.00	(19.21)	(2.67)	(5.06)	3.33
Financials	12.9%	(13.11)	8.56	8.00	2.01	19.60	3.92	15.46	10.51	10.77
Health Care	13.6%	(8.72)	6.59	1.38	(2.25)	5.64	(3.57)	9.64	8.95	14.21
Industrials	9.4%	(17.29)	17.20	3.57	0.99	22.58	1.39	11.31	9.73	13.43
Information Technology	22.0%	(17.34)	19.86	6.06	3.34	31.37	8.59	22.55	18.21	17.11
Materials	2.7%	(12.31)	10.30	6.31	(0.12)	17.11	2.70	9.01	5.37	9.23
Communication Services	10.4%	(13.19)	13.98	4.49	2.22	21.74	5.69	3.28	5.17	9.49
Utilities	3.6%	1.36	10.84	3.48	9.33	25.40	27.10	13.59	12.89	12.51
Real Estate	3.2%	(3.83)	17.53	2.46	7.71	29.71	24.74	10.36	11.60	14.72
Global Equity Benchmarks		Price								
MSCI ACWI	2,180	(12.75)	12.18	3.61	(0.03)	16.20	1.38	9.71	6.65	8.35
MSCI AC World x-USA	278	(11.46)	10.31	2.98	(1.80)	11.56	(1.23)	6.33	2.90	4.45
MSCI EAFE	1,889	(12.54)	9.98	3.68	(1.07)	12.80	(1.34)	6.48	3.27	4.90
MSCI EAFE Growth	1,656	(13.33)	12.04	5.73	(0.45)	17.94	2.21	7.77	5.49	6.52
MSCI EAFE Value	2,620	(11.70)	7.92	1.54	(1.74)	7.67	(4.92)	5.10	0.99	3.23
MSCI Emerging Markets	1,001	(7.46)	9.92	0.61	(4.25)	5.89	(2.02)	5.97	2.33	3.37
MSCI BRIC	302	(5.30)	13.99	(0.22)	(4.56)	8.55	2.79	8.63	4.39	2.63
MSCI Japan	3,198	(14.23)	6.66	1.02	3.13	11.12	(4.69)	6.22	5.61	5.51

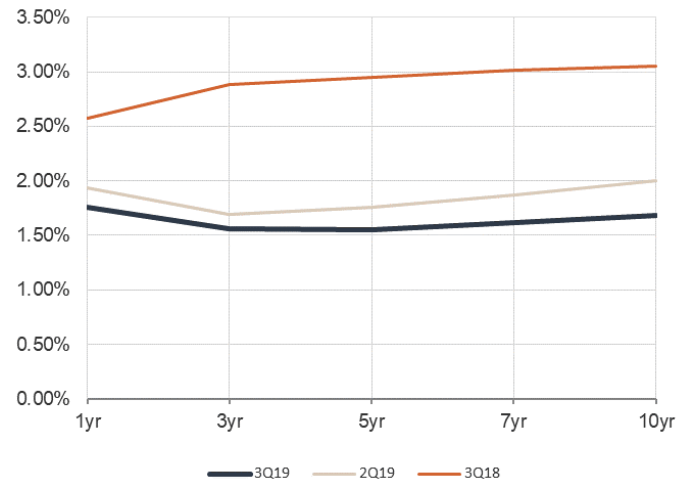
		Annualized								
		4Q18	1Q19	2Q19	3Q19	YTD	1-Year	3-Year	5-Year	10-Year
Interest Rates		Yield								
3m Treasury Bill	1.82	0.58	0.58	0.57	0.50	1.66	2.25	1.54	0.98	0.52
U.S. LIBOR 3m	2.09	0.66	0.66	0.62	0.55	1.84	2.50	1.88	1.30	0.81
U.S. Treasury 3m	1.56	0.71	0.60	0.52	0.41	1.53	2.25	2.01	1.60	1.17
U.S. Treasury 10yr	1.68	0.76	0.65	0.58	0.45	1.68	2.45	2.48	2.29	2.44
U.S. Treasury 30yr	2.12	0.81	0.73	0.69	0.57	2.00	2.84	2.91	2.84	3.24
Fixed Income		Price								
Citi 3-month T-bill	653	0.57	0.60	0.61	0.56	1.78	2.36	1.52	0.96	0.52
BC U.S. Gov't & Related 5-7	106	2.03	3.37	3.19	2.15	8.96	11.17	3.58	3.64	4.22
BC Municipal Bond 1-10 Year	112	1.61	2.21	1.64	0.81	4.73	6.42	2.37	2.54	3.05
BC TIPS	105	(0.42)	3.19	2.86	1.35	7.58	7.13	2.21	2.45	3.46
BC Aggregate	106	1.64	2.94	3.08	2.27	8.52	10.30	2.92	3.38	3.75
ML High Yield Master II	99	(4.67)	7.40	2.57	1.22	11.50	6.30	6.07	5.36	7.85
Citi World Gov't Bond Index	937	2.38	2.73	3.09	3.11	9.20	11.80	3.63	4.31	4.04
JPMorgan EMBI Global	864	(1.19)	6.59	3.76	1.34	12.08	10.74	3.84	5.10	6.51
Real Estate		Price								
MSCI U.S. REIT	1,302	(6.72)	16.27	1.29	7.69	26.82	18.31	7.26	10.11	13.00
FTSE EPRA/NAREIT Europe	1,888	(10.04)	11.73	(2.50)	4.16	13.47	2.08	5.20	5.47	7.14
Commodities										
Bloomberg Commodity Index	78	(9.41)	6.32	(1.19)	(1.84)	3.13	(6.57)	(1.50)	(7.18)	(4.32)
Energy	34	(25.78)	15.93	(4.56)	(4.53)	5.63	(21.61)	(0.82)	(16.84)	(11.90)
Agriculturals	39	0.15	(3.18)	4.50	(6.15)	(5.04)	(4.89)	(9.64)	(7.27)	(3.60)
Livestock	27	0.69	4.69	(11.01)	0.77	(6.13)	(5.48)	5.85	(6.58)	(1.44)
Softs	29	0.73	0.42	(0.29)	(8.61)	(8.49)	(7.82)	(18.66)	(11.45)	(6.17)
Industrial Metals	115	(8.69)	12.85	(7.23)	2.44	7.24	(2.07)	5.84	(1.68)	(2.00)
Precious Metals	181	6.82	0.02	7.15	5.28	12.85	20.52	0.88	2.17	2.32
Private Equity / Hedge Funds		Price								
Red Rocks Global Listed PE Index	12	(18.56)	14.17	5.62	1.40	22.27	(0.42)	10.13	7.85	9.34
HFRI FOF Index	6,269	(4.94)	4.60	1.50	(0.30)	5.85	0.42	3.48	2.03	2.91
Currencies		Price								
ICE Dollar Index	99	1.09	1.16	(1.19)	3.38	3.33	4.46	1.36	2.95	2.63
Euro / U.S. Dollar	1	(1.58)	(1.78)	1.42	(4.27)	(4.63)	(6.14)	(1.01)	(2.90)	(2.89)
Pound / U.S. Dollar	1	(2.34)	2.31	(2.33)	(3.17)	(3.24)	(5.50)	(1.74)	(5.34)	(2.57)
U.S. Dollar / Yen	108	(3.41)	0.88	(2.66)	0.31	(1.49)	(4.85)	2.19	(0.30)	1.90

Source: Factset, Morningstar Direct, iShares website

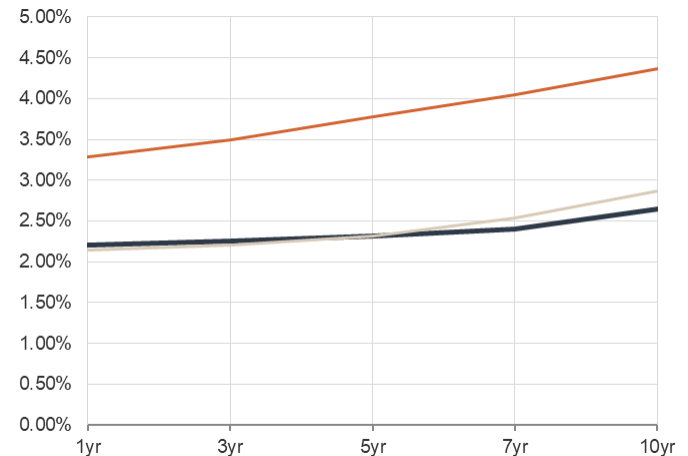
Note: HFRI FOF Index returns as of 8/31/2019

Global Equity Valuation Summary	2Q19	3Q19	QoQ
S&P 500			
Price	2,941.76	2,976.74	34.98
Trailing P/E	18.89	19.08	0.20
Est P/E	16.79	16.86	0.07
Trailing 12m Earnings	152.35	152.60	0.26
Est Forward 12m Earnings	175.69	176.92	1.23
Implied 1yr Earnings Growth	15.32%	15.93%	0.6%
Russell Mid Cap			
Price	55.87	55.95	0.08
Trailing P/E	19.23	19.11	(0.13)
Est P/E	17.11	16.89	(0.22)
Trailing 12m Earnings	2.55	2.53	(0.01)
Est Forward 12m Earnings	3.28	3.32	0.04
Implied 1yr Earnings Growth	28.66%	30.99%	2.3%
Russell 2000			
Price	155.50	151.34	(4.16)
Trailing P/E	17.06	16.55	(0.50)
Est P/E	21.22	21.41	0.19
Trailing 12m Earnings	4.42	3.68	(0.73)
Est Forward 12m Earnings	7.41	7.18	(0.23)
Implied 1yr Earnings Growth	67.92%	94.96%	27.0%
MSCI EAFE			
Price	65.73	65.21	(0.52)
Trailing P/E	14.92	14.50	(0.41)
Est P/E	13.62	13.76	0.15
Trailing 12m Earnings	4.29	4.33	0.05
Est Forward 12m Earnings	4.83	4.74	(0.09)
Implied 1yr Earnings Growth	12.76%	9.43%	-3.3%
MSCI EM			
Price	42.91	40.87	(2.04)
Trailing P/E	13.18	12.66	(0.52)
Est P/E	12.23	12.01	(0.22)
Trailing 12m Earnings	3.09	3.07	(0.02)
Est Forward 12m Earnings	3.52	3.41	(0.11)
Implied 1yr Earnings Growth	14.00%	11.32%	-2.7%

U.S. Treasuries



Municipal Bonds



Source: FactSet

Notes: Municipal yields tax adjusted, assumes a 37% tax rate

Munis use the Bloomberg Barclays Municipal GO indexes and yield to worst

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