2nd Quarter 2019 Review

Executive Summary

- U.S. and International stocks rose in the 2nd quarter, fighting off signs of contraction in the global economy and fears of further escalation in the trade wars.
- Rebounding from a very difficult 4th quarter of 2018, the S&P 500 Index has now recorded its best 1st half since 1997.
- Bond yields fell due to global trade concerns, falling consumer and business confidence, and signals from global central banks that they might take stimulative action. The amount of negatively yielding sovereign debt hit a record high. Money flows into fixed income exchange traded funds (ETFs) almost doubled those going into equity ETFs.
- VWG expects continuing volatility and uncertainty, but we are not becoming defensive on stocks and other assets generating quality, sustainable, and defendable cash flows. Negative investor sentiment, very low interest rates, prospects for further central bank easing, and an incumbent U.S. president seeking re-election - are all supportive to asset prices.
- Diversification and long-term focus are strong defenses amidst an endless flow of confusing and erratic economic and geopolitical events. An appropriate allocation to cash and liquid short-term bonds is required.

Review of the Markets

The S&P 500 Index gained 3.8% in the 2nd quarter. This year's 1st half rise of 17.3% marks its best since 1997. Over the trailing 12 months, the index has increased 8.2%. Smaller stocks also rose. The benchmark Russell 2000 index was up 1.9% in the quarter and has returned 16.8% for the year.
International stocks participated. The MSCI EAFE Index, a measure of equities domiciled in developed non-U.S. economies, increased 3.5% in the quarter. They are up 14.2% this year, but have only returned 1.3% over the trailing 12 months. Emerging markets stocks lagged. The MSCI Emerging Markets Index nudged 0.7% higher in the 2 nd quarter. It has gained 10.6% this year, but only 1.2% over the last 12 months.

Bond prices rose in the 2 nd quarter. Quite perverse to the 1 st half's strong rebound in stocks, the money flows going into fixed income ETFs have been almost twice the amount going into equity ETFs. The yield of the 10-year U.S. Treasury note fell from 2.41% to 2.01%. Accordingly, the benchmark Barclays Aggregate Bond Index produced a total return of 2.8% for the quarter. It has gained 5.8% this year. High yield bonds also participated in the chase for yield. The benchmark Barclays Aggregate Bond index gained 2.4% and has now returned 10.7% for the year. Municipal bonds followed in suit. The S&P National Municipal Bond Index increased 2.3% in the quarter. Its total return year to date is 4.8%.

Commodity markets were mixed. Oil prices were whipsawed, hurt by global trade fears, and boosted by tanker attacks in the Strait of Hormuz and heightened U.S. / Iran tensions. The NYMEX West Texas Intermediate Crude continuous futures increased 2.9%. Corn skyrocketed as widespread central U.S. flooding caused "historically the most amount of corn acres unplanted this late in the season," according to Peter Meyer of S&P Global Platts. The CBOT continuous corn futures contract rose 21.0%. Gold was a standout in the 2nd quarter, breaking out to a six-year high. The NYMEX Gold continuous futures contract gained 8.9%, sparked by the Federal Reserve's softening stance which led to a weakening in the U.S. dollar versus most foreign currencies.

There is No Alternative (T.I.N.A.) to Stocks Thesis Re-Emerges in a Growth-Starved World

The S&P 500 Index has earned a total return of 2.3% over the last 3 quarters. This slight gain has been painstakingly fought, marked by an endless torrent of economic and geopolitical negativity, accompanied by sharp price volatility. We have witnessed slowing global growth, prognostications of a forthcoming U.S. recession, imposition of tariffs and trade

blacklists by the U.S. on China (with reciprocation by the Chinese), the 35-day U.S. government shutdown, cautionary statements on forward visibility and capital expenditures by U.S. corporations due to global trade fears, unprecedented threats of tariffs on Mexican imports in response to illegal immigration passing through the country, and heightened tensions between the U.S. and Iran.

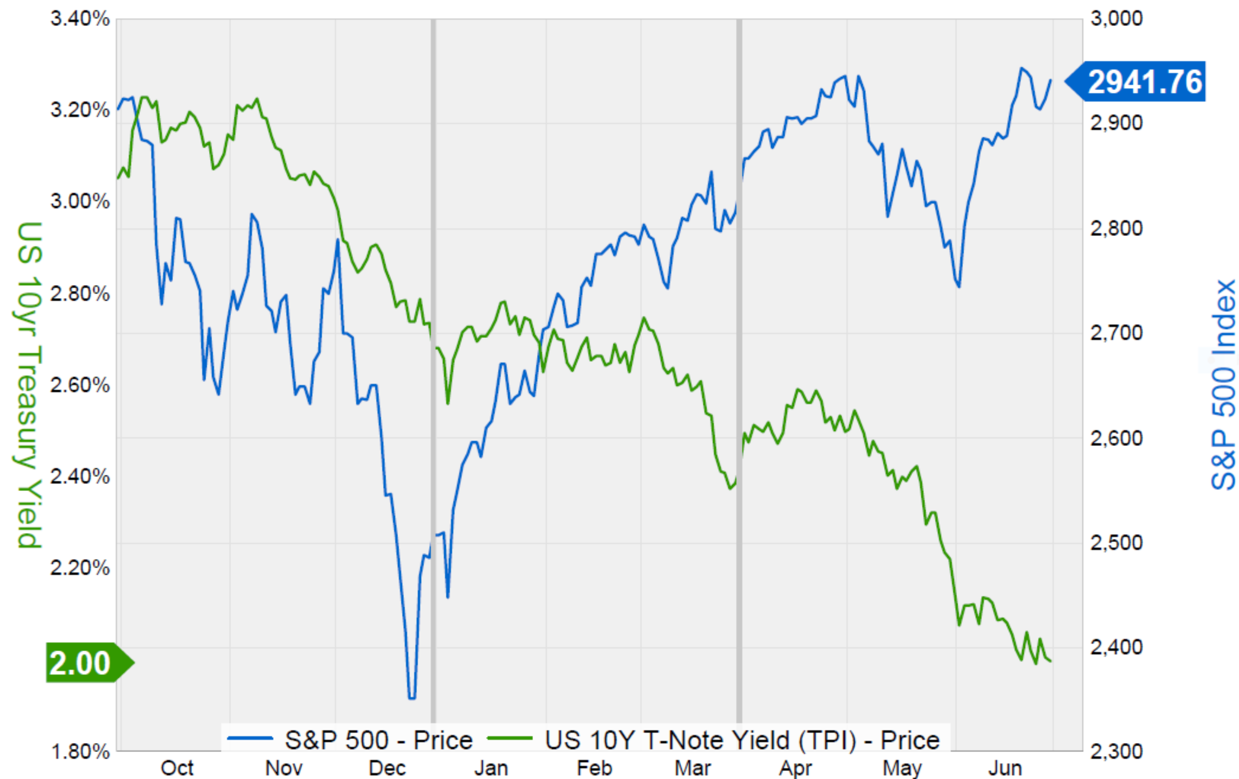

Chart and data courtesy of FactSet Reasearch

We modify the Wall Street proverb by observing that U.S. stocks have "shown remarkable resiliency amidst a wall of worry."

Bond prices have been even firmer. Stagnant economic conditions in Europe, fears of contraction due to reduced global trade, falling consumer and business confidence, and investor pessimism (flight to safety) have all pushed yields lower. In March the yield of the 10-year German bund fell below 0% for the first time since September 2016. On May 23 [rd] the U.S. Treasury 3-month/10-year yield curve again became inverted and remained so for the rest of the quarter. June 18 [th] marked a further leg down in global bond yields as European Central Bank (ECB) President Mario Draghi threatened additional stimulus if near-deflationary economic conditions do not improve. The next day the U.S. Federal Reserve added fuel to the bond fire citing "uncertainties in our outlook due to trade developments and global growth concerns." A record $12.5 trillion in sovereign global debt is now yielding less than 0%!

The topic of negative interest rates is complex. In brief, negative rates stem from central bank's attempts to further incent commercial banks to lend money, hopefully leading to economic stimulus. The problem is that when growth is so slow and global rates are so low, the benefits of such policy are questionable. The potential for longer-term, adverse unintended consequences grow. Morgan Stanley's Global Fixed Income Macro Strategist Jim Caron recently addressed this in a Bloomberg Surveillance interview:

> "The problem today (globally) is not that banks won't lend, it's that borrowers won't borrow. We call this a balance sheet recession. The potential economic growth rate is so low that the required rate of return on new investments is unacceptable. Thus, investors hold higher levels of cash, pushing yields even lower, causing a downward spiral. Yields this low eventually lead to investors and savers taking more risk, lowering quality to get any type of yield. This typically doesn't end well."

Strategas Global Rate Matrix - Present

	3 Month	1 Year	2 Year	5 Year	10 Year	30 Year
Australia	1.45	1.11	1.05	1.05	1.37	2.40
Belgium	-0.57	-	-0.66	-0.42	0.09	1.06
Canada	1.66	1.65	1.41	1.33	1.43	1.69
France	-0.56	-0.61	-0.68	-0.52	0.01	0.97
Germany	-0.57	-0.68	-0.76	-0.69	-0.32	0.27
Italy	-0.26	-0.02	0.24	1.39	2.12	3.15
Japan	-0.14	-0.17	-0.20	-0.23	-0.12	0.37
Netherlands	-0.56	-	-0.66	-0.65	-0.16	0.30
Norway	1.06	3.00	1.14	1.14	1.40	-
Spain	-0.44	-0.40	-0.44	-0.16	0.39	1.41
Sweden	-0.40	-	-0.63	-0.56	0.00	-
Switzerland	-	-0.82	-0.88	-0.86	-0.53	-0.01
U.K.	0.78	0.66	0.59	0.60	0.81	1.42
U.S.	2.21	2.08	1.86	1.83	2.06	2.55

Chart and data courtesy of Strategas Research Partners - June 19, 2019

Overall, the investment backdrop and macro-narrative is extremely confusing, and is subject to quick, unanticipated moves. The U.S. stock market is at record highs. Chinese equities have risen over 20%. Despite this, signs of damage to the global economy are pushing central banks to ease despite already extremely low yields. Strategas Research

Partners' Chris Verrone points out that the U.S. Economic Policy Uncertainty Index is now in the 99th percentile of all observations. This reading of "peak uncertainty" was last seen on the eve of Brexit in June 2016. How should investors be positioned?

VWG Wealth Management has many concerns beyond the gloom portrayed in global bond markets. We believe that both the U.S. and China want a near-term truce. However, we expect that global trade tensions, confrontations over intellectual property, and disputes over technology transfers (potentially compromising national security), will be with us for the longer term. The markers of U.S./China economic and ideological imbalances, the increase of populism, and the rise of autocracy, raise the question, "have we reached 'peak globalization?'" If this proves correct, the forward earnings of U.S multinationals will be altered, possibly dramatically. The core 'globalization' investment playbook that has been run for the past 40 years will require modification.

In the nearer-term, numerous issues threaten to spark volatility and further uncertainty. These include: intense scrutiny of economic data series, action (or inaction) by the Federal Reserve in executing and projecting interest rate policy, 2 nd quarter corporate earnings reports, further tensions with Iran, successful ratification by Congress of the USMCA (replacement of U.S./Mexico/Canada trade agreement), late September's required increase of the U.S. debt ceiling by Congress, and the onset of the 2020 U.S. Presidential campaign.

Despite all of this, VWG Wealth Management is maintaining a full *(but not over-weighted)* allocation to stocks. We expect continuing volatility and uncertainty, but we hold this stance for three major reasons:

1. Pessimism, market sentiment and money flows are negative. Jason Trennart of Strategas recently stated, "it's difficult to imagine a time when the market was hitting new highs and investors felt so indifferent, if not hostile, to basic market fundamentals." Negative sentiment and great uncertainty are contrarian indicators supportive to asset prices.
2. Central banks are signaling that they will do almost anything to fend off deflation. The Chinese will go to great lengths to ease an economic downturn. J.P. Morgan expects the ECB, the Bank of Japan, and 13 emerging market central banks to lower rates or take easing measures within the next 12 months. We heed the words of legendary Marty Zweig, "Don't fight the Fed." With interest rates already low, and more liquidity poised at the ready, the T.I.N.A. (there is no alternative to equities) thesis has reemerged.
3. The actions of an incumbent President seeking re-election should never be underestimated. The U.S. economy is growing, many business sectors are vibrant, employment is strong, and the stock market is healthy. It is in President Trump's best interests that these remain so through November 2020. We are certain he is focused on this, despite any distracting tactics or rhetoric.

Portfolio Strategy and Asset Positioning

The recent economic and geopolitical events, and the confusing range of potential forward outcomes, demand diversification. Attempting to tactically navigate through these challenging waters could be perilous – by either taking an overly aggressive or defensive posture. Ben Carlson in "A Wealth of Common Sense" writes, "diversification is the best way to admit you have no idea what's going to happen in the future. It's how you prepare a portfolio for a wide range of future possibilities."

VWG Wealth Management does have certainty in these investment tenants:

- A well-crafted and regularly updated financial plan should drive investment portfolio construction, and all major investment decisions.
- Paying close attention, and not becoming overly reactive, to one's sentiment, and the collective market's behavior, is critical for success.
- Diversification is a mandatory requirement of maintaining long-term focus. For VWG, this means the careful addition of client-appropriate non-stock and non-bond assets, and risk-defined structures apart from conventional stocks and bonds in portfolios.
- A compulsory component of diversification is maintaining a proper allocation of cash and liquid short-term bonds. These can be accessed for emergencies and unexpected needs. They can be deployed in the investment portfolio in events of significant asset mispricing.
- The cornerstone of almost all quality equity and debt instruments is their ability to produce sustainable, defendable cash flows, without the aid of excessive leverage or risk-taking.

We have our full attention focused on the global macroeconomic picture. We are relentlessly reading and listening to trusted experts, attempting to make sense of this complexity. We will be in touch if anything changes that needs your immediate attention. Please be sure to engage us if anything changes in your financial situation that merits discussion or re-thinking our longer-term planning assumptions. Thank you for your continued interest, engagement and support.

Best wishes to everyone for an active, fun summer!

We look forward to speaking with many of you over the coming months, and to learning of your travels, readings, adventures and exploits.

VWG Wealth Management

HighTower Advisors

Suzanne, Ashley, Lynette, Michelle, Rashmi, Kay, Justin, Christina, Sarah, Ryan, Delaney, Elana, Patricia, John, Rick and Jeff

Who We Are

** Index Data Sourced from FactSet Research, Morningstar, Bespoke Investment Group, Strategas Research Partners*

VWG Wealth Management is a team of investment professionals registered with HighTower Securities, LLC, member FINRA and SIPC, and with HighTower Advisors, LLC, a registered investment advisor with the SEC. Securities are offered through HighTower Securities, LLC; advisory services are offered through HighTower Advisors, LLC.

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