3rd Quarter 2019 Review

Executive Summary

- Large U.S. stocks edged higher in the 3rd Year-to-date, the S&P 500 Index has gained 20.4%, marking the first year since 1997 that it has returned more than 20% in the first nine months of the year. The S&P 500's 4.1% trailing 12-month performance is more sobering, marked by 2018's difficult 4th quarter.
- Small U.S. stocks and large international stocks slipped mildly. The MSCI Emerging Markets Index, dominated by Chinese, Taiwanese and South Korean stocks, lost 4.7%.
- U.S. and international bond yields continued their fall, buffeted by global recession and trade war fears. The yield of the 10-year U.S. Treasury Note traded to a sobering inter-quarter low of 1.46%. At the end of August, the U.S. Treasury 2-year / 10-year yield curve inverted for the first time since 2007.
- The quarter was marked by an astounding and seemingly endless flow of mostly negative geopolitical news events and economic data.
- Despite negative investor sentiment, and faltering global business and consumer confidence, asset markets were surprisingly resilient.
- VWG recommends long-term investors maintain moderately positioned, well-diversified portfolios. We do not believe it is prudent to take excess risk at this time. In the face of dramatic geopolitical uncertainty, investors should avoid the urge to act in response to quickly changing macro events.

Review of the Markets

The S&P 500 Index continued its positive 2019 performance in the 3rd quarter, rising 1.8%. Over the past 12 months, the U.S. large cap stock index has increased 4.1%. In stark contrast, small U.S. stocks fell and continued their underperformance of the past three years. The benchmark Russell 2000 index fell 2.3% in the 3rd quarter. It has declined 9.0% over the past 12 months.

International stocks suffered mild losses. The benchmark MSCI EAFE Index, dominated by European and Japanese stocks, fell 0.8%. Over the past 12 month it has slid 1.0%. Emerging markets stocks, expected to be more exposed to global trade pressures, fared worse in the 3rd quarter. The MSCI Emerging Markets Index lost 4.7%. Surprisingly, it is down only 2.6% for the past year.

Bond prices continued their 2019 rise, as global yields plunged. The yield of the 10-year U.S. Treasury ended the quarter at 1.68% after rebounding from a staggering 1.46% seen at the end of August. The benchmark Barclays Bond Index earned a total return of 2.3% for the quarter. In a rare occurrence, its trailing 12-months return of 10.3% has more than doubled that of large U.S. stocks (S&P 500 Index). High yield and municipal bonds followed suit. The Bloomberg Barclays High Yield Bond Index gained 1.2% in the quarter. The S&P National Municipal Bond Index increased 1.5%.

Gold's strength persisted, partly assisted by the large drop in global rates. The NYMEX Gold continuous futures contract rose 4.2%. It has gained 8.9% in 2019 and is now trading at its highest level since the spring of 2013. Most other commodity markets slumped. Oil fell despite attacks on oil tankers and two major Saudi oil installations. The NYMEX West Texas Intermediate Crude Oil continuous futures lost 7.5%. Echoing global growth concerns, the NYMEX Copper continuous futures contract dropped 4.8%.

Macro Mess

The relentless flow of global macro events witnessed during the past three months was astounding:

- Hong Kong citizens held a series of protests over proposed legislation that would allow extraditions to mainland China.
- Robert Mueller testified before the House about his report on Russian interference in the 2016 Presidential election.
- Reversing the trend of steady rate increases since 2016, the Federal Reserve cut interest rates by 25bps on July 31, and again on September 18.
- President Trump repeatedly directed Twitter attacks on Federal Reserve Chairman Powell, calling for a 0% Federal Funds rate.
- The amount of global debt trading at negative yields eclipsed a record $16 trillion.
- Despite solid U.S. employment and consumer spending, the 10-year Treasury traded to a near-record low yield of 1.50%. The U.S. 2-year / 10-year yield curve inverted for the first time since 2007.
- Boris Johnson asked Queen Elizabeth II to prorogate (suspend) Parliament in a gambit to force a final path to Brexit. Less than a month later, this was overruled by Britain's Supreme Court, as the October 31 Brexit deadline loomed.
- Category 5 Hurricane Dorian devastated the Bahamas, and narrowly missed the U.S.
- 15% tariffs on about $112 billion of Chinese imports became effective on September 1.
- President Trump called China's President Xi Jinping a "great leader" at the Group of 7 Summit on August 26, just three days after branding him as an "enemy" of the United States.
- Armed drones attacked the world's largest oil processing facility in Saudi Arabia, potentially disrupting 5% of the world's daily crude supply.
- In September, the Eurozone and German manufacturing purchasing managers index (PMI) fell to their worst levels in 7 and 10 years, respectively.
- Temporary liquidity tightness at some primary U.S. dealer banks forced the Federal Reserve to increase injections into the overnight repurchase system.
- U.S. Congress initiated a formal impeachment inquiry after a whistleblower in the intelligence community called attention to conversations between President Trump and Ukraine's President Zelensky.

Portfolio Strategy and Asset Positioning

It is hard to comprehend that all these events occurred in just the past 92 days. It is even more amazing that stock, bond and commodity markets were relatively stable in this period. Even a casual observer would be expected to view a number of these as seriously threatening the prospects for stability and growth. Significant volatility should have been seen if investors and traders were positioned too optimistically. Quite to the contrary, asset markets and particularly equities, have been remarkably resilient.

VWG Wealth Management is not currently recommending aggressive asset positioning. We do not believe investors will be compensated for taking excess risk. At the same time, we do not recommend that properly allocated long-term investors drastically alter their asset mix in response to macro events. It is obvious that there is a lot of pessimism already priced into markets.

During times of great uncertainty, the most enduring investment strategy is owning a moderately positioned, well-diversified portfolio. It should feature managers and strategies that have proven to be resilient, and even opportunistic, during past periods of duress. With this in place, investors should refrain from attempting to take action when chaos arises. "Achieve more by doing less." Turn off the incessant, distracting media barrage. Get some fresh air, take a walk, or pick up a great book.

VWG will remain vigilant. We will let you know if any significant action needs to be taken.

Best wishes to you, your family and friends for a beautiful, invigorating autumn!

VWG Wealth Management

HighTower Advisors

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

Who We Are

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

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