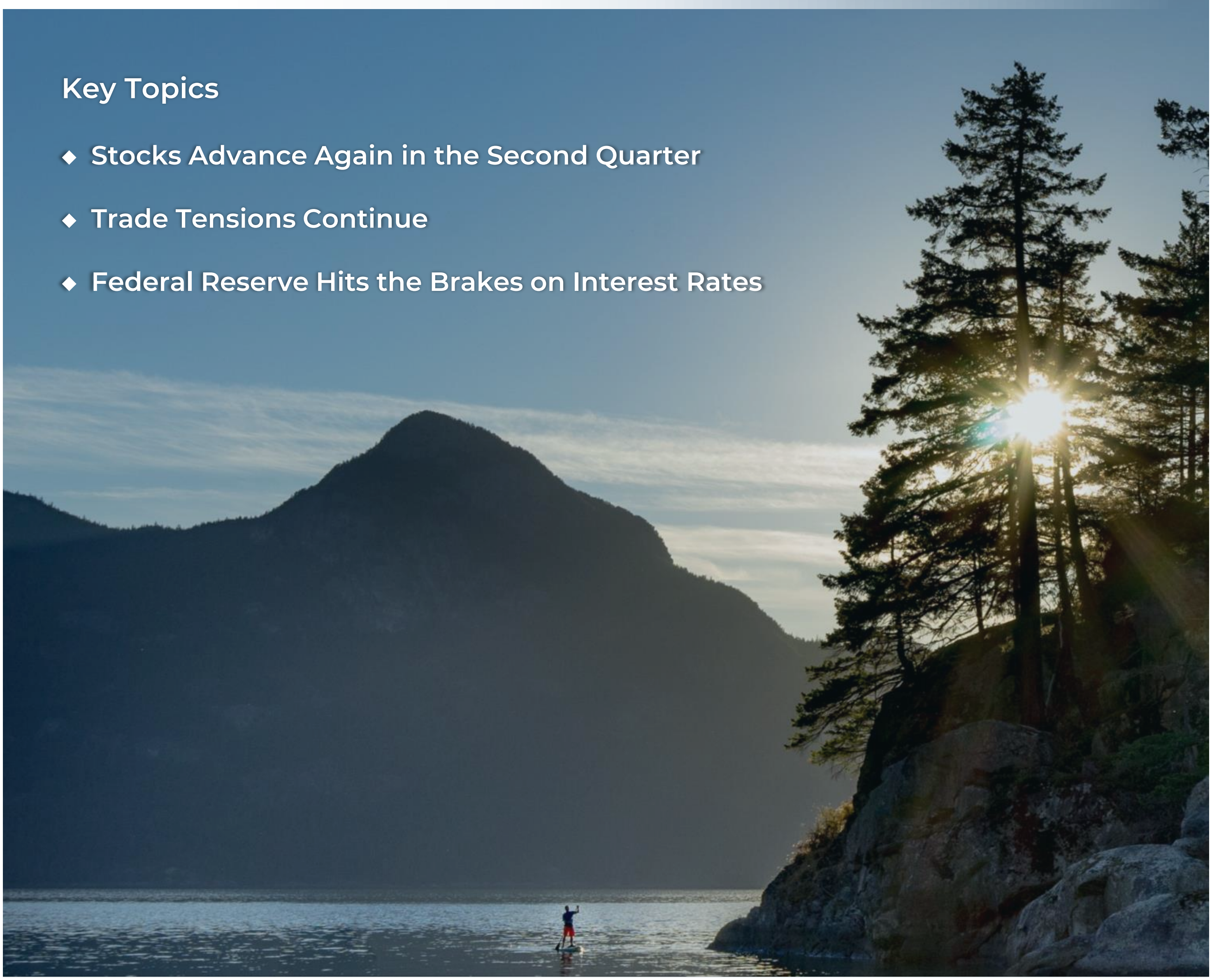
BlackDiamond Financial

INVESTMENT INSIGHTS

SECOND QUARTER 2019

Key Topics

- Stocks Advance Again in the Second Quarter
- Trade Tensions Continue
- Federal Reserve Hits the Brakes on Interest Rates



MARKET UPDATE

Stocks Advance Again in the Second Quarter

Declining Interest Rate Expectations Fuel Gains

Dovish statements from Jerome Powell and other Federal Reserve officials buoyed investor confidence that the Federal Reserve is prepared to lower interest rates to preserve the economic expansion. The Federal Reserve's increasingly accommodative stance helped stocks shrug off continued trade tensions, a rising risk of recession, and turmoil with Iran. The S&P 500 followed a bumpy path this quarter, including a 6.7% drop in May, to notch a 4.3% increase. As a result, the S&P 500 finished the first half of the year up 18.5%, its best first-half performance since 1997. Small capitalization and international stocks performed similarly and gained 2.1% and 3.0% in the quarter, respectively.

Interest rate sensitive investments shined in the second quarter, propelled by a drop in the 10-year Treasury yield to 2.0% from 2.4% in the prior quarter (bond yield and price are inversely related). Declining yields contributed to a healthy 3.1% gain for bonds, but lower yields imply less cash interest for investors going forward. Fueled by lower rates, real estate remained one of the top performing asset classes this year, posting a 17.8% return year-to-date.

Economic indicators slightly weakened this quarter including declines in manufacturing surveys, housing data, and new job growth. In addition, global economic growth is expected to soften over the next several quarters. However, consumer confidence remains high and European and Japanese central banks appear ready to provide further economic stimulus if growth continues to falter. Although stock market volatility will undoubtedly persist, over the long-run, stocks have historically been a tremendous wealth-building investment.

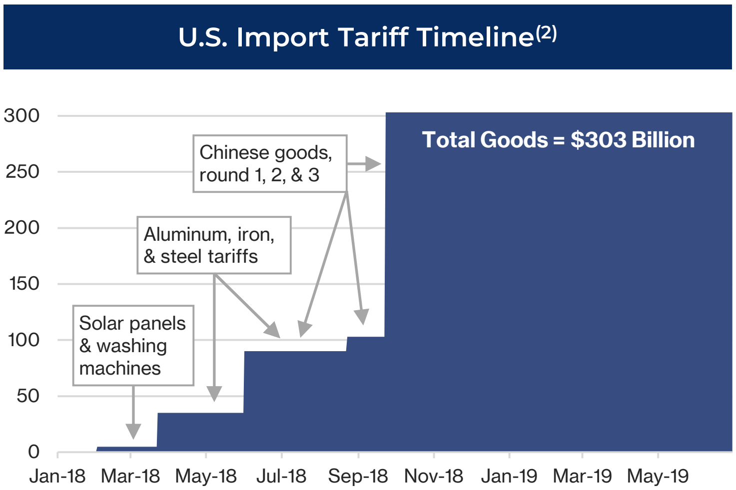
Comparative Returns

	Annualized Performance					
	Q2 2019	YTD	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks[1]	4.3%	18.5%	10.4%	14.2%	10.7%	14.7%
Small Cap U.S. Stocks[2]	2.1%	17.0%	(3.3%)	12.3%	7.1%	13.5%
International Stocks[3]	3.0%	13.6%	1.3%	9.4%	2.2%	6.5%
Real Estate[4]	1.3%	17.8%	11.1%	4.1%	7.8%	15.6%
U.S. Bonds[5]	3.1%	6.1%	7.9%	2.3%	3.0%	3.9%

(1) Measured by the S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy.
(2) Measured by the Russell 2000, which includes the 2000 smaller stocks of the Russell 3000 index.
(3) Measured by the MSCI ACWI ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets.
(4) Measured by the MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks.
(5) Measured by the Bloomberg Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market.

Trade Tensions Continue

Since early 2018, protectionist rhetoric and tariffs have escalated between the U.S. and China, dampening investor enthusiasm and suppressing upward stock market momentum. In fact, U.S. tariffs ranging from 10% to 50% have been levied on goods totaling $303 billion, amounting to 13% of total U.S. imports and causing an estimated $79 billion in annualized economic loss.[1]

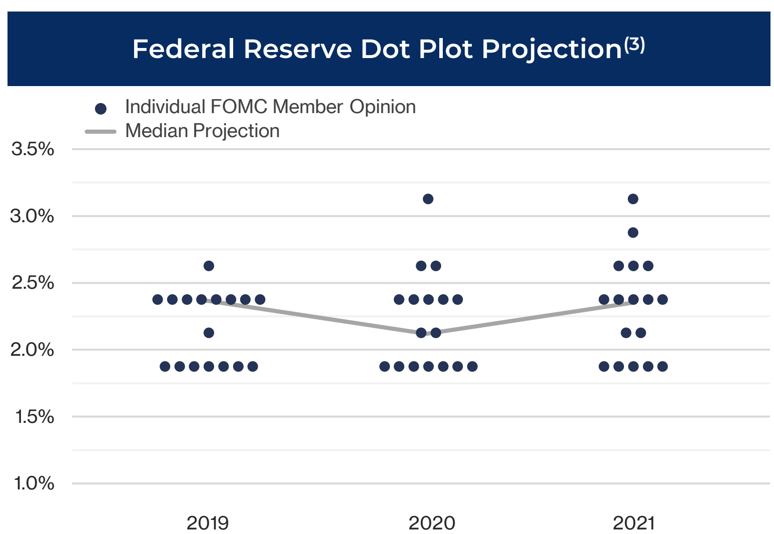


Economic theory suggests that tariffs act as a tax paid by consumers in the form of higher costs and cause negative economic consequences including higher inflation, slower growth, and lower employment. If a favorable deal can be reached with China, the global stock market should receive a tailwind from rising economic growth and corporate profits. President Trump and China's Xi Jinping recently made another truce in their trade war at the G-20 Summit, removing an immediate threat looming over the global economy even as a lasting peace remains elusive.

Federal Reserve Hits the Brakes on Interest Rates

The Federal Reserve's short-term interest rate projections have shifted dramatically over the last six months. In December, the consensus from the Fed was that they would raise rates twice in 2019 by a total of 0.5%. However, as illustrated below by the median "dot plot" expectations from its June meeting, the Fed's next move may be to reduce interest rates.

Each dot on the graph represents the interest rate expectation for one of the 17 Federal Open Market Committee Members for each year-end. The current target range for the Fed Funds rate is 2.25% to 2.50% and the median projection for year-end 2019 indicates maintaining this range; however, seven of the 17 members believe rates will decline by 0.5% by year-end. Furthermore, the median dot plot projection for 2020 dropped by 0.5% from the projections made at the Fed's March meeting. This about-face helped push stocks up 9% from their mid-quarter low in May by showing the Fed's willingness to be accommodative and help stimulate economic growth if necessary.



(1) Mary Amiti, Stephen Redding, and David Weinstein, "New China Tariffs Increase Costs to U.S. Households," Federal Reserve Bank of New York Liberty Street Economics, May 23, 2019.
(2) National Bureau of Economic Research, May 2019 Digest
(3) Federal Reserve June 2019 Projections

ABOUT US

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