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ASSET MANAGEMENT

2019 – 3rd Quarter Review & Outlook

Economic and Investment Review

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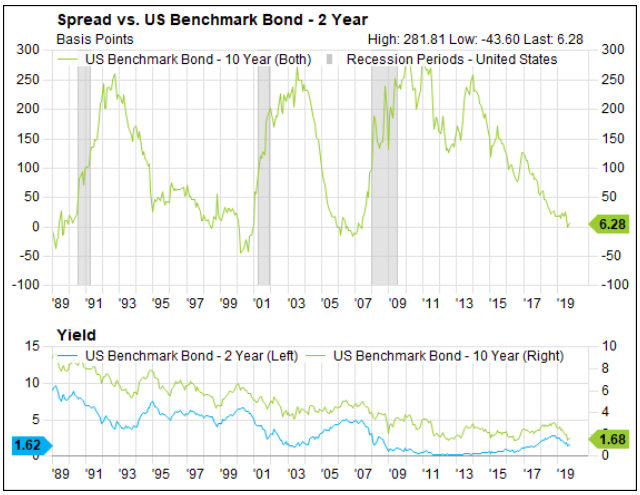
Economic Growth: U.S. economic growth continues to moderate from 2018 and the first quarter of 2019. The Gross Domestic Product (GDP) for the second quarter was 2.0% compared with 2.9% for 2018 and 3.1% for the first quarter of the current year. The consensus estimates for the third and fourth quarters continue to edge down to 1.9% and 1.8% respectively. The current estimate for 2019 is 2.30% and 1.70% for 2020. Most economists and strategists continue to forecast that the U.S. will be able to avoid recession; however, 42.5% of economists recently surveyed by the Wall Street Journal expect a recession in 2020.

Dr. David Kelly, Chief Global Strategist for JPMorgan, is included in those expecting the economy to avoid recession in 2020. He points to three reasons to support his position. "First, none of the cyclical sectors of the economy, such as autos, housing, business investment spending or inventories appear over-extended, nor does there appear to be a particularly dangerous area of financial excess. Second, despite a very tight labor market and stable inflation, the Federal Reserve is now in easing mode and long-term interest rates are very low. Finally, while political polarization is generally a negative, it may actually provide the economy with some stability today."

Many of those who expect a recession point to the U.S. Treasury yield curve inversion. This is a condition where long-term notes and bonds have a lower yield than short-term bills and notes. The chart below displays periods of recession following an inverted yield curve, or spreads less than zero, over the past thirty years.

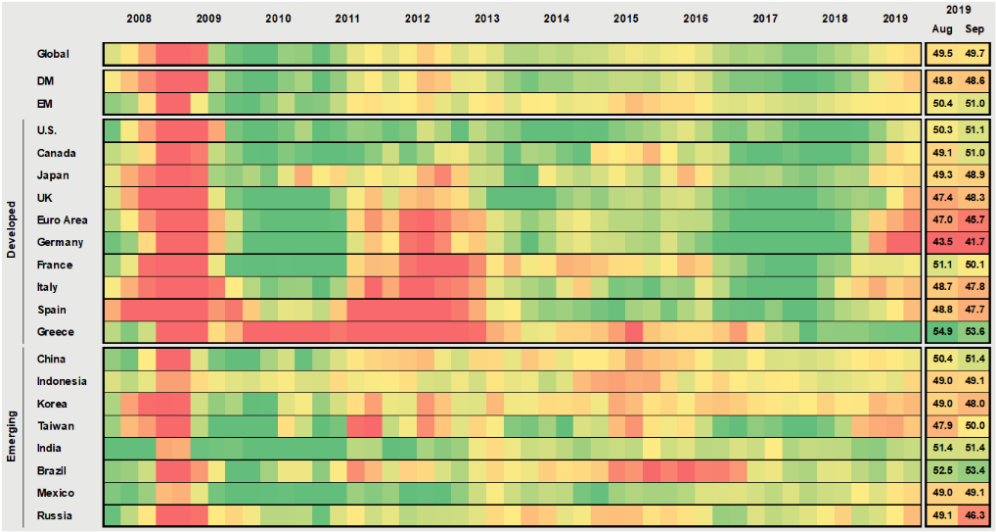


Source: FactSet

Inversions historically precede a recession by about 22 months. However, Dr. Kelly holds the belief that the yield curve inversion is not as clear a recession signal as it has been in the past because the yield curve has been distorted by unprecedented central banks buying of long-term bonds. Also, even though domestic bond yields are historically low, they are still relatively attractive to many foreign buyers because yields in their home markets are likely lower and perhaps even negative.

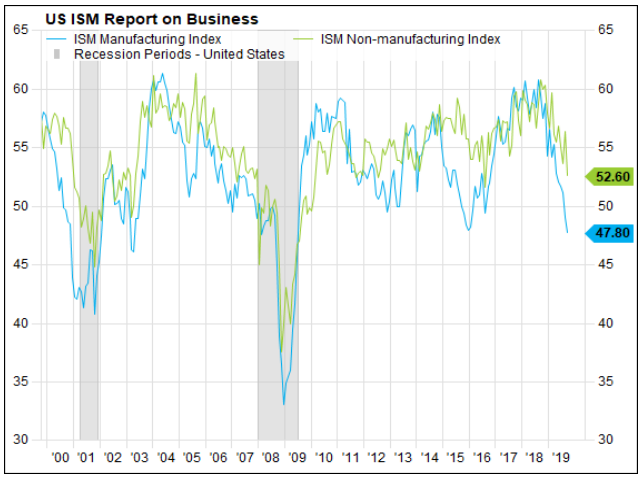
The U.S. consumer accounts for about two thirds of GDP and is a key component in moving the global economy. The Wall Street Journal reported that "American shoppers pulled back on spending in September, signaling a key support for the U.S. economy this year could be softening amid a

broader global economic slowdown." However, one month of data should be taken with a grain of salt as there has generally been steady growth during the year. Consumer confidence remains high as wage growth has improved and unemployment is near 50-year lows.



Source: J.P.Morgan Asset Management

The trade war with China and potentially with Europe has caused individuals to pause as they reconsider their consumption/savings balance. Business spending has declined as companies face trade uncertainty. The ISM (Institute for Supply Management) report for September indicated contraction in U.S. Manufacturing for the first time in three years. The number for September was 47.8. Anything below 50.0 indicates contraction. The



Source: FactSet

services index continued to expand but at a less rapid rate.

The Global Purchasing Managers' Index heat map that follows indicates that global expansion has slowed in the last 18 months. Europe continues to barely keep its head above the recession waters and other areas of the world, including both developed and emerging markets, are being negatively impacted by U.S. – China trade issues. Global growth will continue to be constrained until trade tensions are lessened or resolved.

Equity Markets

Equities prices have been fairly volatile so far this year but have still been able to sail through the headwinds to reach very good year-to-date returns.

Source: FactSet

Part of the reason for the strong returns is the rebound from the sell-off that took place at the end of 2018. One-year returns remain below long-term averages. None-the-less, equities have largely overcome headwinds of slowing earnings growth, flattening-to-declining margins, slower global growth, trade wars and a polarized and toxic U.S. political environment. Tailwinds of strong employment, improving wages, the expectation of stronger earnings growth in 2020, an

accommodative Fed and strong consumer spending have been enough to push equities higher.

The S&P 500 was up 1.7% for the quarter and 20.6% year-to-date through September. However, one-year returns for the index remained in the mid-single digits at 4.3%.

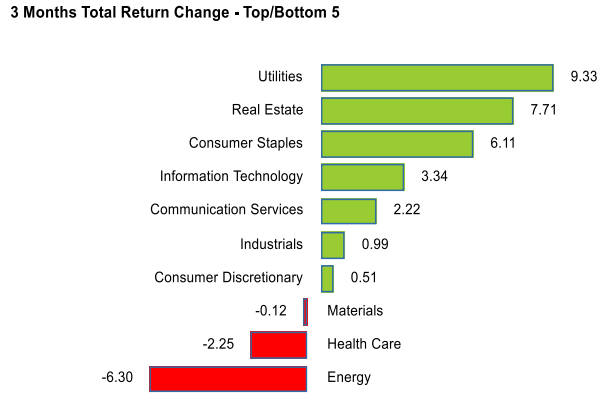
Mid Cap stocks were relatively flat for the quarter but only trail the large-cap S&P 500 index slightly at 18.0% YTD. Small Cap stocks continued to trail large-cap stocks by nearly 7% at 13.7% YTD and remained in negative territory for one year.

Developed international stocks, as represented by the MSCI EFA index, were slightly negative for the quarter and one year through September but moved up 12.8% YTD. The MSCI Emerging Markets index was slightly positive for the quarter and one year and returned 10.6% YTD. Value stocks rose up from their slumber to take the lead over growth stocks for the quarter and for one year but continue to trail over the three-year period.

2019 Q3 Returns				
EQUITY	Q3 2019	YTD 9.30.19	1 Year 9.30.19	3 Years Annualized
S&P 500	1.70	20.55	4.25	13.39
S&P 500 Value	2.83	20.01	5.56	10.61
S&P 500 Growth	0.72	21.06	3.25	15.73
Dow Jones Ind Avg	1.37	20.36	3.52	13.04
S&P Mid Cap 400	-0.09	17.97	1.36	10.90
S&P Small Cap 600	-0.20	13.69	-4.88	11.97
MSCI EAFE	-1.07	12.80	-1.34	6.48
MSCI Emerging Mkts	0.61	10.59	1.21	10.66

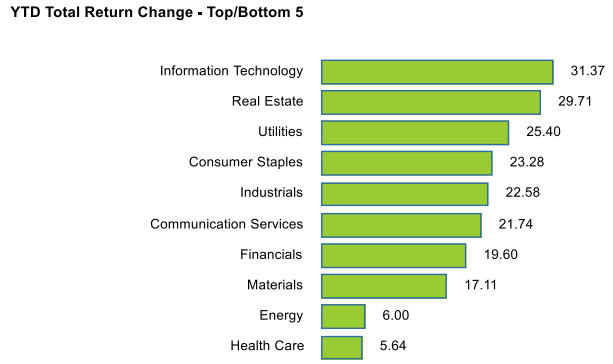
Source: FactSet

The high-income producing sectors, including Utilities and Real Estate, posted the highest returns for the quarter. The Energy sector responded negatively to higher inventories and slower demand and the Health Care sector continued to suffer from the political slings and arrows.



Source: FactSet

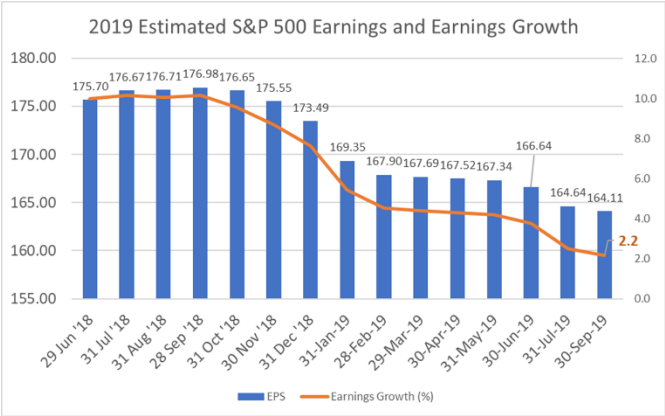
All sectors were positive on a year-to-date basis, led by Information Technology and Real Estate. Health Care and Energy were the biggest laggards.



Source: FactSet

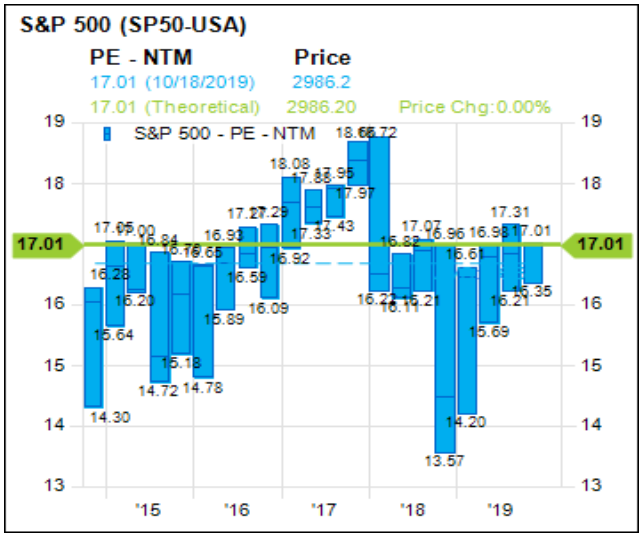
Only 15% of companies in the S&P 500 have reported results for the quarter so far but 84% of those companies have reported a positive EPS surprise and 64% have reported a positive revenue surprise. However, it appears that earnings will have declined year-over-year. If this is the final result for the quarter, FactSet reports that it will mark the first time the index has reported three straight quarters of year-over-year earnings declines since Q4 2015 through Q2 2016.

Earnings growth estimates for 2019 have declined from over 10% in mid-2018 to 2.2% currently.



Source: FactSet

Despite strong returns YTD, the S&P 500 is trading at 17.0x P/E for next-twelve-months earnings compared with the 5-year average of 16.7x.



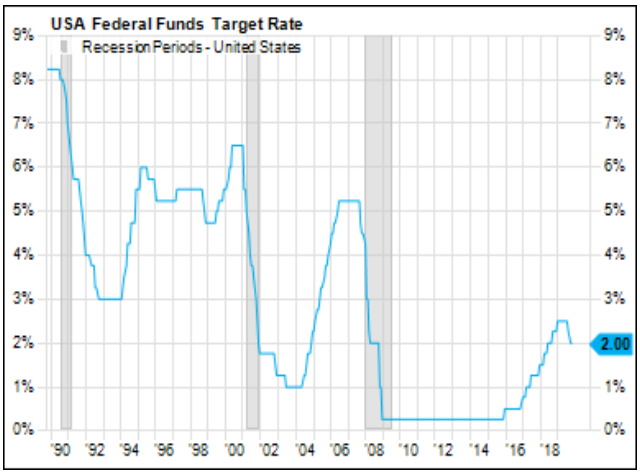
Source: FactSet

Our 12-month forecast for the S&P 500 is 3,100, indicating a fairly limited upside unless trade disputes are settled and earnings growth accelerates.

Developed International and Emerging Market stocks have not performed as well as domestic stocks but appear to be less expensive than U.S. stocks on a direct comparison and relative to their own long-term history. Strength of the U.S. dollar and investor hesitance related to the trade war has acted to hinder investor interest. Emerging markets should benefit from a stable dollar and easier monetary policy.

Fixed Income Markets

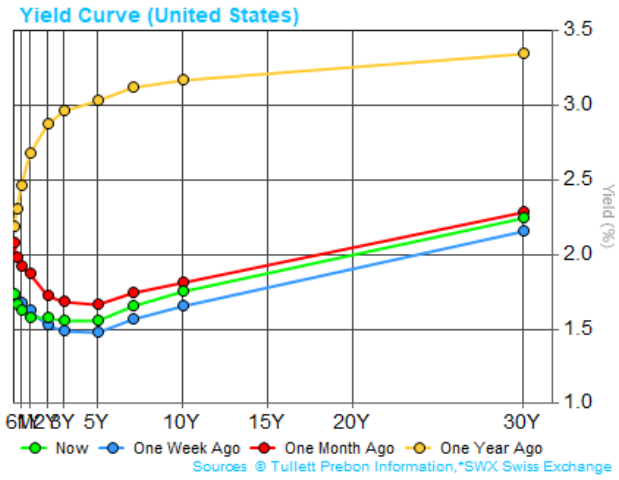
The 10-year U.S. Treasury yield declined for the quarter and year-to-date. Interest rates declined over the quarter as the Fed reduced the Fed Funds target rate in two 25 basis point (0.25%) increments over the quarter to a range of 1.75 – 2.00%. The Fed felt empowered to change course due to the lack of inflation and slowing global growth.



Source: FactSet

At least one additional rate cut is expected before the end of the year.

The U.S. Treasury Yield Curve shifted down on the short-intermediate end as result of the Fed Funds rate cuts and remains well below last year's levels. The curve moved out of inverted status as a result of the rate cuts.



Source: FactSet

The Bloomberg Barclays US Aggregate Bond Index was up 2.8%% for the quarter, 8.5% YTD and up 10.3% for one year through September 30. Municipal bonds, as measured by the Bloomberg Barclays Municipal Bond Index, were up 1.6% for the quarter, 6.8% year-to-date and 8.6% for one year.

The High Yield Corporate Composite Index was up 1.8% in the third quarter, 11.9% YTD and 8.2% for one year through September 30th.

Disclosures