LASSUS WHERLEY
A Subsidiary of Peapack-Gladstone Bank
...a View from the Top
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Will It Be Up or Down?

Here's our current View from the Top. We provide our thoughts on recent happenings in the financial markets.

The answer to the question "will it be up or down" is yes. Yes we expect the roller coaster to continue based on the many different factors that drive financial market performance. Yes we will see more downside movement if companies miss forecast earnings as they report or reduce their future earnings forecasts. Yes we will see upward movement if earnings are good or we have more than a short-term truce with China. And we have certainly seen some of the down side with China retaliating against Trump's new tariff threats. We will discuss this more later in the VFT. It really depends on all those moving parts we monitor on an ongoing basis. And then we have the Federal Reserve cutting interest rates a quarter point to a range of 2.0 to 2.25% last week and a negative reaction from the markets because of Chairman Powell's comments. See below for more discussion on this.

Looking back over the last year we have seen every type of event we could think of that impacts financial markets. We have seen fires, floods, a slowing economy, many fights in Washington and on the border, and falling interest rates. What we haven't seen is a significant change in the trend in the markets based on these events. Everything is intertwined and viewing it overall is incredibly difficult.

When you review the past year vs. year-to-date performance it really reflects how much the sell off in the last quarter of 2018 impacted the overall performance of the equity markets.

Taking a look at the last year and how asset classes have performed is really a tale of quarters. The last quarter of 2018 was pretty ugly resulting in annual performance for the year ending June 30, 2019 of 10.42% for the S&P 500, -3.31% for the Russell 2000 and 1.08% for the EAFE or international index. We also experienced 1.21% for the

MSCI Emerging Markets index. Last but not least we saw a 10.05% return for the S&P Global REITs or real estate funds.

These annual returns really reflect the negative returns experienced in that last quarter of 2018. When you compare that performance with the year-to-date performance as of June 30, 2019 it is clearly reflected. The S&P 500 YTD returned 18.54% while the Russell 2000 returned 16.98% YTD through June 30, 2019. The MSCI EAFE international index returned 14.03% YTD while the Emerging Markets index returned 10.58%. The S&P Global REITs performed well returning 16.19% YTD. Overall performance through June 30 was pretty good including bond fund performance.

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We meandered through July with little change in performance but August has certainly started with increased volatility driven primarily by the threats of an escalating trade war between the US and China.

The Federal Reserve

The Federal Reserve's (Fed) monetary policy continued to be the focus of the markets during the second quarter. While some economists and Federal Open Market Committee (FOMC) members had pushed for a rate cut in late April, most investors had ruled out this possibility and were proven correct when the committee voted in favor of leaving the rates unchanged. The FOMC pointed to continuing low unemployment and slow but stable inflation as the main factors in their decision. However, they maintained their stance from their previous meetings statement about exercising patience when moving to cut rates, suggesting that a more substantial decline would be necessary to warrant such a change.

In mid-June, the FOMC again decided to hold rates steady but changed the tone of their statement, suggesting that they would act "appropriately" as risks to the economy began to materialize. Their statement, "In light of these uncertainties and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion…", suggested that the committee will be vigilant of the risks to the economy. At this point they weren't quite ready to cut rates but were obviously thinking about it.

At his semi-annual address to Congress in early July, Chairman Jerome Powell strongly signaled that the central bank could cut interest rates later in the month to sustain the economic expansion. As the global economy became more sluggish and the risks and impacts of tariffs have become more pronounced, the Fed made it clear that the intention is to "act as appropriate to sustain the expansion".

The markets have reacted dramati-

cally to these signals, with the 10-year treasury yield declining to below 2% in mid-June. This is in stark contrast to the highs seen in October of 2018 of over 3%. While this decline in yields is reflective of an assumed rate cut, which is also generally a sign of slowing economic conditions, it has benefited consumers looking to buy real estate with average rates for conventional 30-year fixed loans falling close to 4% by the end of the quarter. Unfortunately falling interest rates are hurting savers and retirees who are using fixed income vehicles including CDs.

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Given all the discussion and the clear signals from the Fed it wasn't a surprise when Chairman Powell announced the quarter-point interest rate cut last week. His initial comments that it was a midcycle cut sent the markets down when traders assumed he meant this cut would be one and done. He later clarified his statement by saying it wouldn't necessarily be one and done which caused the financial markets to reverse the losses and turned into a rally.

At this point the market appears to expect several more rate cuts this year. Given the concern with a slowing economy it makes sense for the Fed to consider further action.

Unemployment

One of the Fed's most quoted economic metrics used to determine policy is the low unemployment rate. As we have mentioned in previous editions of the VFT, unemployment has been steadily falling since 2009 and reached its lowest level since 1969 in early April. But there continues to be a wide skills gap in the US. With 7.3 million job openings as of July 9 (bls.gov), there is a vast difference between what types of talent companies are looking for and the actual capabilities of unemployed Americans. Even with such low unemployment, the US economy has struggled to maintain stable inflation above 2%, the Federal Reserve's policy target. On July 11, in his address to Congress, Chairman Powell stated the relationship between inflation and low unemployment has faded. Historically, as unemployment in the US declined, wages began to grow. This increase in wages would increase consumer's disposable income and drive inflation upward. While this relationship is widely accepted among many economists, it has not proven true in the US, where unemployment levels have reached incredible lows without much wage growth at all. Powell's acknowledgement of this disconnect points further towards additional rate cuts in the near future.

Trade Talks

The quarter ended with the highly anticipated meeting between President Trump and President Xi at the 2019 G20 Summit in Osaka, Japan the last weekend of June. While many other important meetings were held

between various international powers, the markets eyes were all turned to that between the US and China.

Prior to the meeting, both leaders stated that they would come to the table, open to the possibility of a deal but neither side was willing to move from the current position. Trump stated, "I actually think we were very close and then something happened where it slipped a little bit and now we're getting a little bit closer". Xi stated, "Forty years on, enormous change has taken place in the international situation and China-U.S. relations, but one basic fact remains unchanged: China and the United States both benefit from cooperation and lose in confrontation". We have certainly begun to see the consequences of this impasse in economic and political impacts. We are still waiting for positive signs coming from this meeting. Although the meeting lasted 80 minutes it resulted in what can only be described as a very short-term truce.

While the civility of the talks and the temporary improvement of the trade situation seemed to be a small step in the right direction for the global economy, many economists warned that without any sort of tangible resolution to the conflict, these global trade risks still act as a significant drag on the global economy. Many companies have found it easier and less risky, to just defer investment until the conflict is resolved. With reduced capital expenditures, we have already begun to see a decline in global GDP growth. The impacts of the trade war have also begun to materialize for many multinational US companies, most notably Apple, Boeing, and Intel who each derive more than half of their revenue from overseas.

Recent developments have created major uncertainty around whether a trade agreement can be reached. Trump has continued to threaten additional tariffs and China is starting to retaliate. This will not end well for either country if they aren't able to reach some type of agreement soon. We continue to be cognizant of the risks posed to economic growth both domestically and abroad by the continued uncertainty.

What's Next

As I stated in the introduction there are many moving parts and every day we will see new headlines. The heartbreaking mass shootings over the weekend really made many of us think hard about what we believe is important in our country today. I encourage everyone to get involved in areas you believe are worth fighting for. We can't expect others to fight for what we believe if we aren't willing to stand up. So…...pick a candidate or an issue and get involved. Knock on doors and get the message out. Being active and voting are absolutely one the most important things we can do.

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The Mueller Report

In the meantime, the financial markets will continue the current day to day volatility based on headlines. And speaking of headlines, the release of the Mueller Report certainly created a lot of headlines. It will be interesting to see how Congress handles the report and whether or not there will be impeachment hearings. If there are hearings the open question is how will the financial markets react or even if they will react.

And as has been true over the last few years we will continue to review and rebalance as needed to keep portfolios in line with their strategic target asset allocations and maintain cash levels as needed. Our crystal ball still remains a little hazy but we know diversification works and we know periodic rebalancing is a good strategy in uncertain financial markets.

Please keep in touch and remember that you are a long-term investor regardless of what happens in the financial markets in the short term. You know our mantra. We are long-term investors!!!!

Let us know if your cash needs have changed or there is something else we can help with. Please let us know if you have any questions. And remember to practice that deep breathing when the world starts to get to you.

Enjoy the welcome sunshine!

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