Forward Focus
July 2019

Quarterly Market Review

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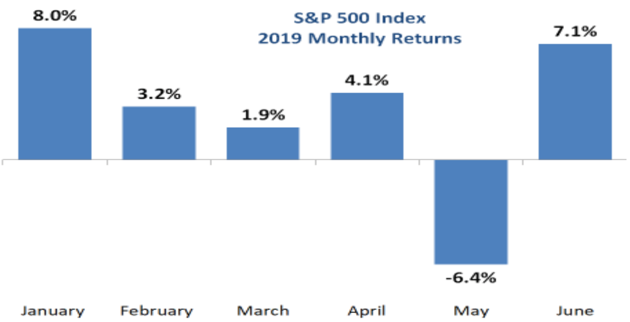
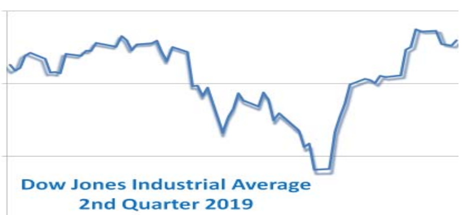
After a 1st quarter rally that continued on into April, markets fell in May on fears of a prolonged trade war and uncertainty regarding Fed rate cuts. As the bar chart below indicates, markets came back to life in June as trade fears eased and anticipation of a Fed rate cut in July rose to 90%. Despite the dip in May, the S&P 500 posted its best first half in 22 years! As we start the second half, markets are at all-time highs.



Internationally, the MSCI World EAFE index (which measures international developed markets) gained 3.5% and the MSCI Emerging Market Index rose 1.6% for the quarter. The Chinese Shanghai Composite Index declined 3.6% as trade fears weighed on the economy.

Although a solid quarter, 37% of the stocks in the Dow Jones Industrial Average posted losses, with Intel, 3M and Walgreens all posting double-digit declines. The best performing sectors were Financials (+7.9%) and Materials (+6.0%) and the worst performing sectors were Energy (-2.8%) and Telecom (-0.4%).



After hitting 1.98% toward the end of June, the 10-year Treasury yield closed the quarter at 2.0%, the lowest level since 2016. Lower yields pushed 30-year fixed rate mortage down to 3.73% from near 5.0% last November.

Here is a summary list of events that occurred during the quarter: U.K. & E.U. delay Brexit until October • Katie Bouman takes first ever photograph of a black hole • WikiLeaks founder, Julian Assange arrested in London • Ohio, Alabama, Missouri and Louisiana sign heartbeat-style bills • AT&T sells 10% stake in Hulu • Notre Dame Cathedral fire in Paris • Special Counsel Mueller Report released • ISIS attacks churches and hotels in Sri Lanka, killing hundreds on Easter Sunday • Sinclair buys Fox Sports Network for $10.6 Billion • Mississippi River flooding • Contested Kentucky Derby winner • Duchess Meghan and Prince Harry have first child, a boy named Archie Harrison Mountbatten-Windsor • Steel and Alumium tarrifs lifted for Mexico and Canada • Dressbarn to close all 650 stores • Volodymyr Zelensky, a former comedian, becomes 6th President of Ukraine • Merck to buy Peloton Therapeutics for $1.05 Billion • Virginia Beach shootings • Hong Kong Protests draw over 1 million people • Iran shoots down U.S. drone • AbbVie to buy Allergan for $63 Billion • Democratic debates begin in Miami, Florida • G20 meeting in Osaka, Japan • President Trump visits North Korea • 10-Year Treasury at 2.00% • S&P 500 posts best first half in 22 years • Dow posts best June since 1938 • Oil ends at $58.47/bbl • 30-year fixed-rate mortgage at 3.73% • Median existing home price increase hit 87 straight months of year over year gains • Unemployment rate at 3.6% • U.S. Dollar at $96.10 • Volatility index closes at 15.1 • S&P 500 Forward P/E ratio at 16.7 • Global ex-U.S. Forward P/E at 13.2 • Growth outperformed Value • Fed left rates unchanged • U.S. currently in longest economic expansion at 120 months •

Second Quarter 2019

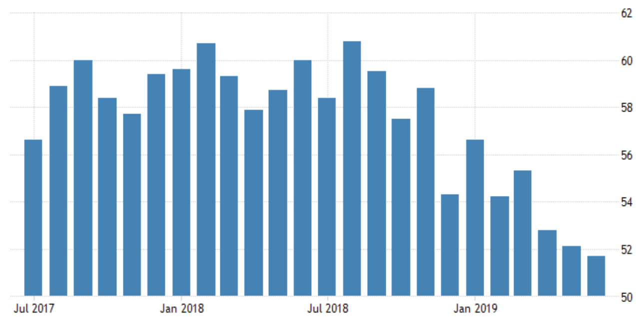
Dow Jones Industrial Average 2.6% ● S&P 500 4.3% ● MSCI EAFE (International) 3.5%
Russell 2000 (Small Cap) 1.7% ● MSCI EMI (Emerging) 0.7% ● Barclays Capital Aggregate Bond 3.1%

US Flag Image courtesy of nixxphotography/FreeDigitalPhotos.net

PMI : Slower Global Growth

In order to get an idea of how businesses are doing and whether they are expanding or contracting, a survey is conducted each and every month. It is called the Purchasing Managers Index or PMI.

The Purchasing Managers Index (PMI) survey asks whether conditions have changed from the previous month in 5 main areas (production levels, new orders, supplier deliveries, inventories, employment levels). These questions are asked of senior executives in over 400 companies in 19 industries. This information is then weighted and calculated utilizing a formula. The end result is a number between 0 and 100. A reading ABOVE 50 means businesses are expanding and a reading BELOW 50 means businesses are contracting. This is a useful indicator of the health of the economy and businesses. Since it provides current insight into business activitity it is called a Leading Economic Indicator (LEI).



As you can see in the chart on the right, the most recent PMI reading continues a trend lower. Within the report, new orders index dropped to the lowest since December 2015, indicating growing caution about the future.

The Global PMI picture looks similar, showing the weakest readings since 2016, after falling for 14 straight months.

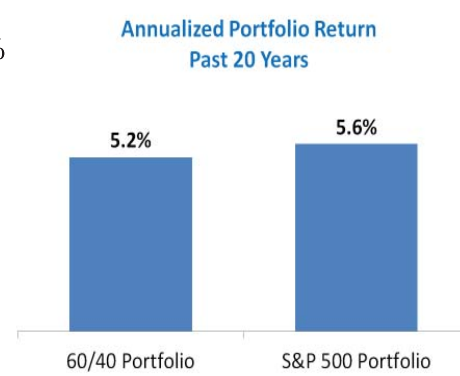
While this indicates growth is clearly slowing, this does not mean all signs point in the same direction....yet. Consumer confidence is up, wages are up, unemployment is down, inflation is in check, consumers are spending, and stock valuations remain fairly valued. Economic indicators are still expanding (above 50), but **Forward** notes it is "growing, but slowing". We continue to look at economic indicators for signs of further stress or weakness and have proactively begun the process of protecting capital in the most overvalued areas of the market.

Investing for the Long-Term

According to research by Dalbar, Inc., the S&P 500 has had an annualized return of 5.6% per year over the past 20 years (1998-2018). This in spite of two massive declines of 50% during that period. That 5.6% annualized return over 20 years would have turned a $10,000 investment into almost $30,000 (a near 200% return!). However, patience, discipline, a few sleepless nights, and a pallet full of antacids were likely also required.

The chart on the left shows the S&P 500 over the past 20 years (1998-2018). The first small looking dip was the bursting of the Tech Bubble (2000-2002) and the second decline in the middle of the chart is the Great Financial Crisis (2008-2009). The recent dip at the top right was the almost 20% drop 6 months ago in December 2018. As of now (July 2019) we are again at all-time highs!

So everyone knows, at least intellectually, that investing for the long-term pays off. However, we all want to avoid the wild drops and excessive volatility. Moving from an aggressive growth portfolio of 75% to 100% stocks to a more moderate one is one way to accomplish that. In fact, a portfolio of 60% stocks and 40% bonds has returned 5.2% over the past 20 years. That's right, by taking 40% less stock risk, the difference was a mere 0.4%. Wow!



Forward is not saying that a 60/40 portfolio is always better, we are just saying that staying invested and reducing risk is smart and jumping in and out of the market based upon fear or a market decline is, well... dumb (there, I said it). Case in point: Over the past 20 years, the average investor that jumped in and out ended up with a paltry 1.9% annualized return.