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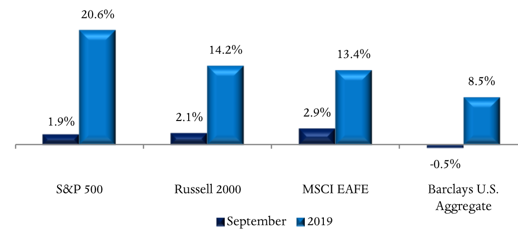
Markets

Investors returned from their summer holidays and drove equities higher in September, leaving global equities better off for the third quarter, and solidly higher for 2019. During the month, stocks witnessed a very strong technical rotation away from growth and momentum and into value, especially cyclicals. Previous strong performing stocks were sold and weak stocks were bought, perhaps linked to the fact that growth had outperformed value by a historical measure, both in terms of magnitude and duration. From a fundamental perspective, the past quarter was marked by a continued slowdown in global economic data, amidst trade tensions, offset by further monetary easing from the US and Europe. In turn, the S&P 500 index advanced +1.9% in September (+1.7% in Q3; +20.6% ytd), while the smaller capitalization Russell 2000 index rose +2.1% last month (-2.4% in Q3; +14.2% ytd). During the aforementioned September rotation, value stocks outperformed broad markets by approximately 3%. Overseas stocks also fared well last month as seen by the MSCI EAFE index's +2.9% rise (-1.0% in Q3; +13.4% ytd). The Euro Stoxx 600 index performed solidly in September, rising +3.7% (+2.7% in Q3; +20.3% ytd). Asian markets also rebounded. Shanghai stocks were +0.8% in September; -1.4% in Q3; +19.3% ytd, while the Japanese Nikkei 225 index was the star performer in September, rising +5.9% (+3.1% in Q3 and +10.9% ytd).

The US Federal Reserve preemptively cut short term interest rates in September, for the second time in 2019, even as the economy continues to grow, and inflation is below the central bank's 2% target. Helped by easy monetary policy and rising concerns about the global growth outlook, the 10-year US Treasury note continued its decline, bottoming at a yield of 1.46% before recovering to end the quarter at 1.66%. Notably, there were periods of time when yields at the shorter end of the US yield curve exceeded those at the longer end, presaging an economic slowdown. The Bloomberg Barclays US Aggregate index pulled back -0.5% in September but added +2.3% in Q3, and +8.5% ytd).



Energy markets were rattled last month, when Saudi Arabia's oil production and related infrastructure were attacked. There are indications that the weapons used were Iranian, as Yemeni Houthi rebels, who enjoy Tehran's backing, claimed responsibility for the strikes. Given the large scale of damage, Brent crude initially spiked from \$60 to \$70 per barrel, subsequently retracing the move to end the month at \$60.78 (+0.6% in September; -8.7% in Q3; +13.0% ytd), as repairs may be completed earlier than originally feared.

Geopolitics

A US Presidential impeachment inquiry was launched last month after reports about controversial interactions between Trump and the country of Ukraine came to the fore. It was questioned whether Trump and his personal attorney, Rudy Giuliani, pressed the Ukrainian government to investigate Hunter Biden, the son of 2020 presidential candidate Joe Biden (allegedly to hurt his campaign). In July, Trump had issued a hold on US military aid scheduled to be sent to Ukraine, only releasing it in September after these revelations (leading to speculation that the withholding was intended to force Ukraine to cooperate). In another noteworthy US political development, Elizabeth Warren has risen in the polls as she vies for the Democratic party's nomination

for the 2020 Presidential election.

In the UK, the Brexit saga continues, with parliament passing legislation that will force the government to ask for an extension if it can't agree to a deal with the EU. To gain freer reign in the negotiations, PM Boris Johnson had suspended parliament, only for it to be ruled unlawful. It appears that a highly unpredictable election remains the most likely outcome unless a deal is reached in the coming weeks.

September 2019 Economic Statistics

	Sep-19	Dec-18	Dec-17
Federal Funds Target Rate	*1.75-2.00%*	2.25-2.50%	1.25-1.50%
Consumer Confidence Index	*125.1*	128.1	122.1
Manufacturing PMI Index	*47.8%*	*54.1%*	59.7%
Unemployment Rate	*3.5%*	*3.9%*	4.1%
JPY/USD	*108.06*	*109.56*	112.67
USD/EUR	*1.0898*	*1.1469*	1.1996
Gold/oz.	*$1,472.00*	*$1,282.73*	$1,302.45
Oil (WTI)/bbl	*$54.07*	*$45.41*	$60.42

United States

The ISM US manufacturing purchasing managers' index came in at 47.8% in September, the lowest since June 2009, marking the second consecutive month of contraction. In addition, the new export orders index dropped to only 41%, the lowest level since March 2009, amid escalating tariffs and fears of more to come. In addition to taxes on imported Chinese goods, Washington will enact 10% tariffs on European industrial items such as Airbus planes, and 25% duties on French wine, Scotch and Irish whiskies, as well as cheeses from across the continent, as punishment for EU subsidies to Airbus. The strong US Dollar is also expected to have a dampening effect on second half results and capex budgets of American multinational companies. Outside of manufacturing, the US services sector continued its expansion, with the latest reading coming in at 52.6%, but this was a considerably slower pace than expected, and the lowest data point since August 2016.

In September, 136,000 jobs were added, leading the unemployment rate to drop to 3.5%, a 50-year low. Over the past 12 months, average hourly earnings have increased by 2.9%, though little changed over last month. While the economy continues to add workers, the rate has been decelerating (job gains have averaged 157,000 over the last 3 months), and the pace of growth of aggregate hours worked in the economy has slowed. Consumer confidence has, in-turn, begun to decline, albeit from elevated levels. In light of these trends, the Federal Reserve decided to cut the Fed Funds rate by a further quarter point, in an attempt to extend the economic cycle. Looking ahead, the implied market probability of an additional rate cut at the end of this month has risen to approximately 85%. In addition, the central bank has indicated that they are monitoring softer data points such as the receding effects of the 2018 tax cut, the repercussions of the US-China trade war, and the plunge in long-term interest rates.

Europe

The EU continued to exhibit slowing economic growth, with business surveys for September corroborating this view. In Germany, manufacturing woes bled into the greater economy, magnifying fears of a looming recession. The composite purchasing managers' index for the eurozone's largest economy showed a contraction for the first time in six years. Germany's economy shrank 0.1% cent in the second quarter, with consensus forecasting a similar performance in the third, which would qualify as a technical recession.

Against this backdrop, the European Central Bank responded by cutting interest rates further into negative territory (to -0.5% from -0.4%), restarting quantitative easing (by planning to print €20 billion per month commencing in November) and committing to continue with asset purchases until it achieves its inflation target. This shift from a time-oriented to a growth-oriented form of forward guidance is significant in that it could lead to a large expansion in the total size of assets purchased, leading pundits to dub the program QE-infinity. In addition, there has been discussion of fiscal stimulus from the economies that can afford it, to help support growth, but the timing of such action re-

mains uncertain.

Bucking the global trend, the Bank of England took no monetary policy action, as Brexit uncertainty continued to cloud the outlook for the UK economy. With wage growth at 4%, policymakers are conscious that if global and Brexit-related risks subside they actually need to raise rates, whereas if the downside risks highlighted by some of the business surveys materialize they will need to follow their overseas counterparts and lower rates.

Asia

China's economy continued to decelerate, with industrial production growing at 4.4%, down from approximately 7.0% just under two years ago. Retail sales have also slowed, to 7.5% from close to 10.0% during the same period. Even with local economic growth still comfortably outstripping global averages, there are governmental concerns about future prospects, especially in light of the power conflict with the United States, as well as potential contagion of social unrest originating from Hong Kong. In this respect, it is interesting to note that China's official manufacturing PMI data has contracted during four separate periods since the global financial crisis, indicating that the current situation may be yet another cyclical pull back in the context of a long-tem secular growth trend.

In Japan, a consumption tax increase has gone into effect, posing a risk to an economy that is significantly geared to the effects of the global slowdown in manufacturing. In turn, Japanese consumer confidence continued to decline last quarter. The Bank of Japan, however, resisted the temptation to join in further easing monetary policy, but signaled that it might expand its stimulus measures as soon as its next meeting at the end of this month.

Outlook

Economic growth and global trade continue to dominate investor attention. While ISM data has underwhelmed of late, it has been slightly offset by solid hiring trends. Investors continue to ponder the implications that recent data may have on US-China trade relations (does slowing growth improve the chances that the coming trade negotiations lead to a deal?). Further, how will Fed policy be affected (is the central bank likely to respond more aggressively?). While trade expectations are positively skewed at the moment, further tariffs are due to come into place by the end of the year unless progress is made. Notwithstanding that the Chinese have indicated a willingness to purchase more American commodities, they have thus far refused to agree on eliminating support for state-owned enterprises, and intellectual property protection, two of the Trump administration's most important objectives. There is also a budding trade and tariff tiff going on between the US and Europe. The first salvo led to manageable levies of $7.5 billion on select European imports into the US. The bigger concern revolves around auto tariffs (covering circa $100B worth of goods), which President Trump is expected to make a decision on, in mid-November. Failure to reverse pending tariffs, or the enactment of additional ones, would likely hurt the global economy so some vigilance is warranted.

With regard to equities, September saw a momentous divergence between value and momentum stocks, only seen twice before. The long-momentum, short-value trade rapidly reversed, coinciding with the 10-year US Treasury Note yield bottoming at 1.43% (reversing sharply to 1.76%). This caused the historically large spread between value and growth stocks to converge. Interestingly, thus far the move has only represented a small reversion to the mean. While it is difficult to forecast the end of an economic cycle, or a long-term shift in trends, it is important to maintain a sense of objectivity and remain focused on set goals. As such, we continue to recommend a conservative stance through exposure to high quality equities, especially multi-nationals offering solid dividend yields. With fixed income markets at historical extremes (circa $14 trillion of bonds offer negative returns), we continue to recommend that investors avoid reaching for excess yield. In the current environment, alpha generation and portfolio diversification can instead be achieved via select alternative strategies, including direct private opportunities. Such investments are poised to offer non-market correlated appreciation potential, while offering balance to traditional asset classes.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal