July 2019 Commentary

We are living through the longest bull market and business cycle in U.S. history. Ten years ago, in the wake of the global financial crisis, it would have been hard to imagine an uninterrupted market and economic expansion of this magnitude. While this cycle has seen its share of problems, this is simply how markets work: opportunities tend to present themselves when investors are most fearful. Even though this cycle is no longer as "unloved" as it once was, there is still ample investor skepticism and fear.

Indeed, for many investors, the first several years of this cycle felt tenuous and uneven. Concerns over Fed stimulus, the Eurozone crisis, U.S. debt problems, the fragility of the banking system, persistently low inflation and interest rates were but a few issues on investors' minds. And yet, with slow but steady economic growth, markets were able to reach historic levels. Those investors who stayed invested and diversified benefited.

The calendar played a role. 2019 happened to kick off on a weak note after last year's sell-off. The first half of the year ended on an extraordinarily strong note after rebounding from a short-term pullback. So, while investors can be thankful for this performance, they should also not expect similar numbers going forward.

The reversal of headlines that drove volatility over the past year resulted in the latest market rebound. The Fed, which was a main driver of investor concerns last year, not only paused its path of rate hikes, but is widely expected to begin cutting rates later this month.

The Fed appears to be exercising extreme caution while navigating political pressure. While this is a short-term positive for markets, investors should be wary of the long-term consequences. Even if the Fed can keep the party going, it can't address the fundamental reasons for a decelerating economy.

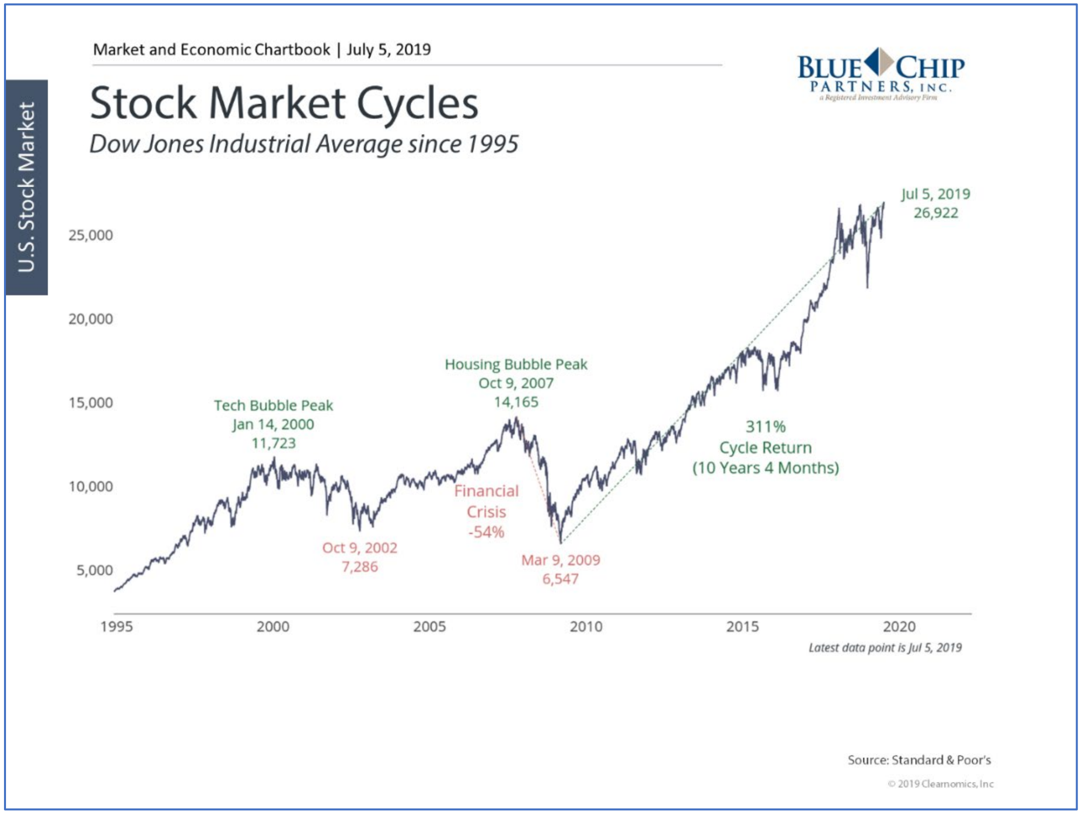
Trade is another investor concern that has spurred market volatility in both directions. Market volatility from May to June was arguably the result of China and Mexico trade headlines. The fact that some of these issues have stabilized helped to propel markets forward over the past month.

The reality is that trade will likely be an issue for some time. It could take many months, if not years, for a full trade agreement to be reached with China that addresses all of the administration's concerns. Even once a deal is reached, there are questions around implementation and on-going enforcement. In the meantime, the fact that tariffs appear to be stable has created a renewed sense of market calm.

Unfortunately for investors, these topics are unlikely to go away in the second half of 2019. Global economic uncertainty will likely persist, with markets reacting to major headlines. Interest rates will likely remain low due to these uncertainties.

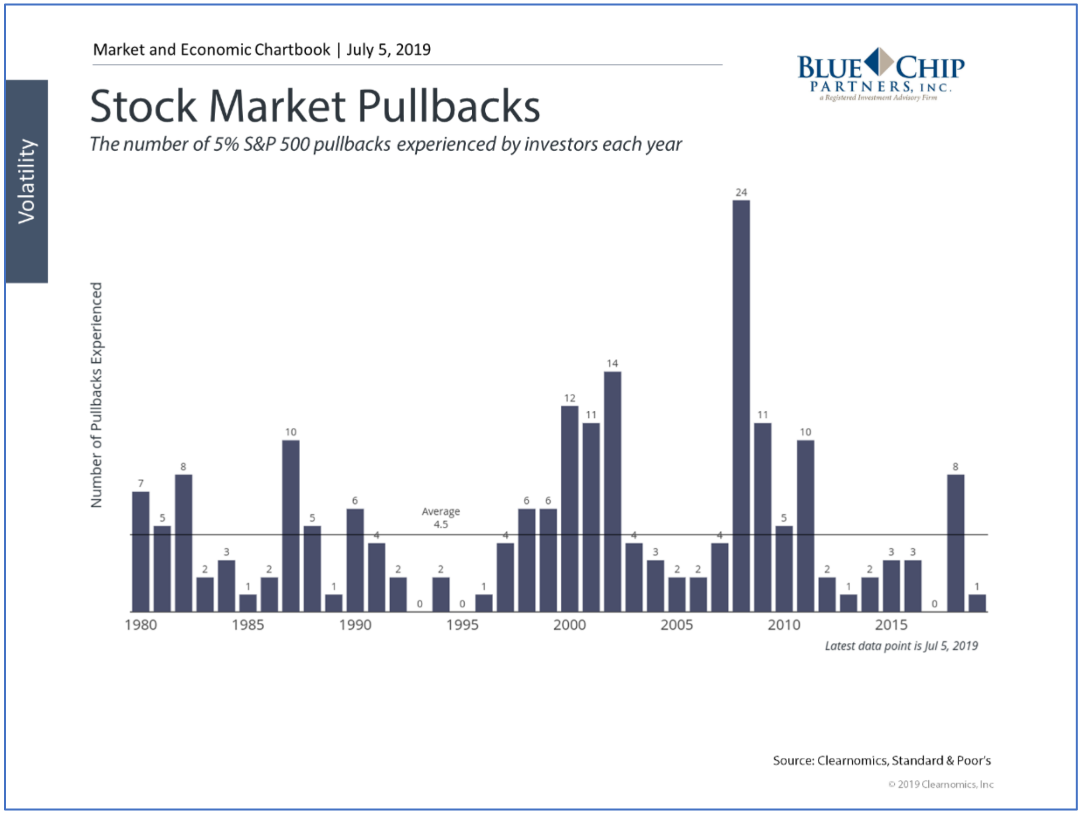
But at the same time, the economy is still healthy, even if growth is decelerating somewhat. Unemployment is extremely low, consumer balance sheets are strong and companies are still doing well. Earnings growth decelerated this year, alongside the broader economy, but is still sufficient to support stock returns. While investors should set proper expectations around future market returns, diversified portfolios can still experience positive growth in this environment.

1. This is the longest bull market in history



This bull market is the longest in history, having surpassed the historic 1990's bull run earlier this year. And yet, it's faced its share of uncertainty and volatility. As seen on the chart, pullbacks have occurred regularly over the past ten years. Ultimately, however, these are dwarfed by the strength of the overall cycle.

2. Volatility should continue as the cycle advances

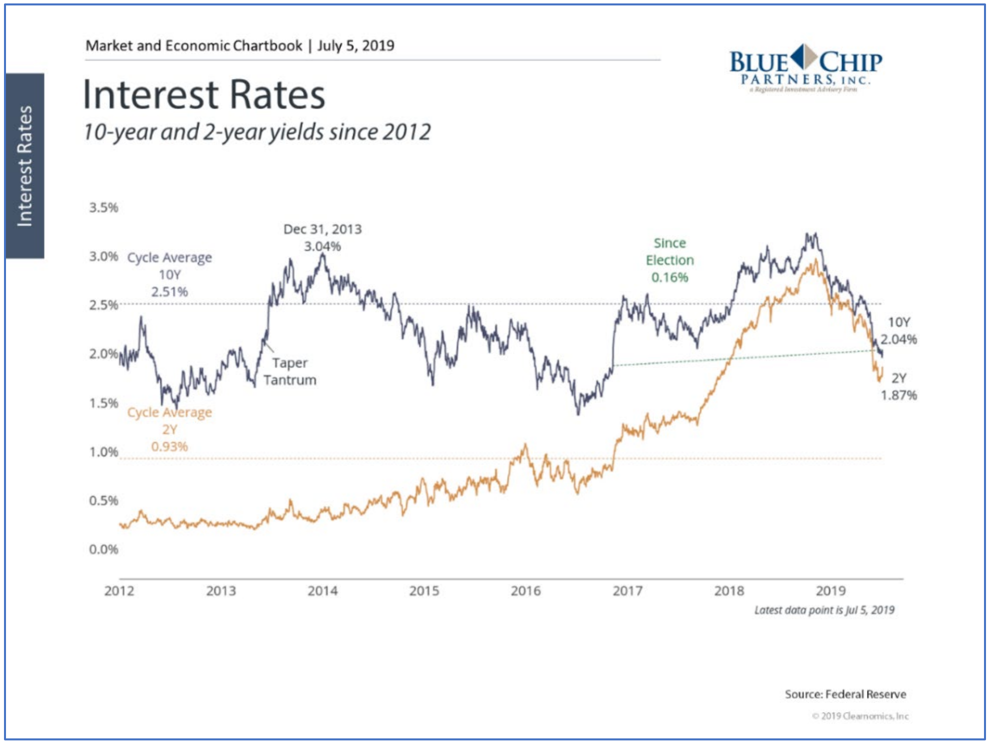


Like death and taxes, the fact that investors will experience market volatility is a certainty. The past year has been no exception. The true test of investor discipline is whether they can stay invested despite swings in the market.

The chart above shows the hypothetical number of 5% pullbacks experienced by investors each year. There has already been one in 2019 - the result of trade headlines. However, it's important to maintain perspective since each year tends to experience several such pullbacks. In other words, market volatility is normal and expected.

3. Interest rates are still historically low

Interest rates have continued to fall. Long-term rates have been pushed down due to factors such as growth concerns, trade headlines, and low international interest rates. Unlike prior periods, short-term rates have also fallen as the Fed has reversed course.



This continues to be a challenging environment for those investors who need portfolio income. Unfortunately, while some parts of the yield curve may steepen somewhat, interest rates are likely to remain low by historical standards. Investors will still need to find yield via unconventional sources.

The bottom line for investors? The first half of 2019 resulted in strong gains. As this historic market and economic cycle continues, investors should stay disciplined and diversified.

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