TFC FINANCIAL
The Financial Counselors

COMMENTARY | 3Q 2019
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OUR VIEW

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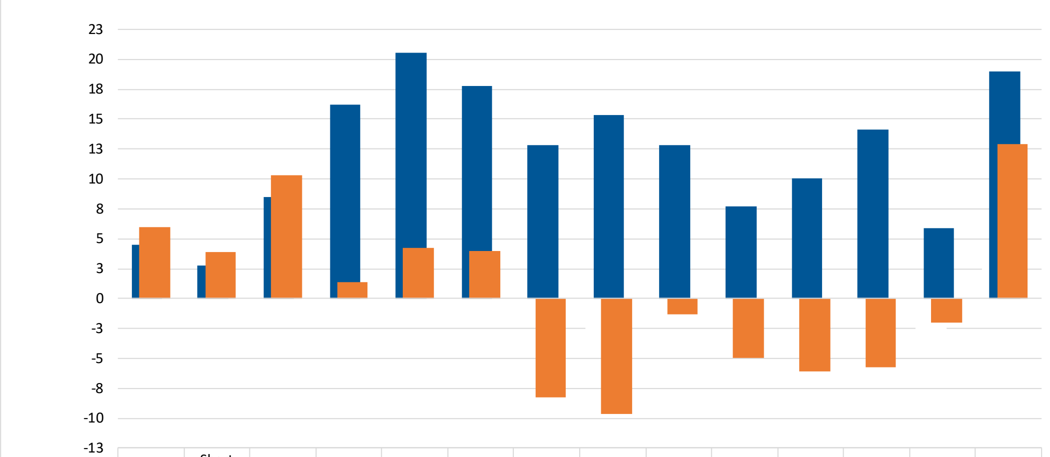
Q3 Market Performance

Global equities declined slightly during the third quarter, with markets unable to move decisively in an environment of heightened uncertainty.

Global equities, as represented by the MSCI All Country World Index, were flat during the third quarter but have gained 16.2% year-to-date through September 30th. U.S. large company stocks led the way, returning 1.7% for the quarter and 20.5% year-to-date. U.S. small company stocks have gained more than 14% year-to-date but fell 2.4% during the quarter. Emerging markets stocks declined 4.2% for the quarter, hurt by tariff fears and worries about global growth. Large company value stocks rebounded strongly in December but still trail growth stocks year-to-date. Bonds were a solid counterweight to equity volatility, providing income and market appreciation as interest rates fell. Longer-term bonds particularly benefited from falling interest rates, with the Bloomberg Barclays Aggregate Index returning 2.2% for the quarter and gaining more than 8% year-to-date.

Defensive stocks were standouts within the S&P 500 during for the quarter, with Utilities, Real Estate and Consumer Staples the leading sectors. Energy, Healthcare and Materials lagged with negative returns for the quarter. The Technology and Real Estate sectors are the performance leaders year-to-date. Healthcare and Energy are the worst performing sectors year-to-date.

Quarter To Date Returns 9/30/2019



	Short Term Bonds	Short Term Muni Bonds	Barclays Agg.	Global Equities	S&P 500	US Large Value	US Small Value	US Small Growth	Intl. Large Core	Intl. Large Value	Intl. Small Value	Intl. Small Growth	EM	Global Real Estate
QTD	0.9	0.3	2.3	0.0	1.7	1.4	-0.6	-4.2	-1.1	-1.7	0.1	-0.9	-4.2	3.5
YTD	4.5	2.8	8.5	16.2	20.6	17.8	12.8	15.3	12.8	7.7	10.0	14.2	5.9	19.0
12M	6.0	3.9	10.3	1.4	4.3	4.0	-8.2	-9.6	-1.3	-4.9	-6.1	-5.8	-2.0	13.0
Full Cycle*	2.7	2.4	4.2	3.9	8.0	6.2	6.0	7.6	1.0	-0.3	3.1	3.6	0.0	3.4

* Full Cycle is the annualized return from October 2007 peak to present.

TFC client portfolios ended the quarter roughly in line with where they started the quarter, despite significant intra-quarter volatility. Gains in TFC's bond holdings helped offset some of the weaker performing equity holdings. U.S. small company stocks were notably weak during the quarter. Year-to-date through September 30th, TFC's portfolios benefited from rising stock and bond markets. In relative terms, however, TFC portfolios have trailed client benchmarks. TFC's value stock holdings have been the primary detractors from relative performance.

From the market peak 12 months ago, long dated bonds and real estate led most asset classes with double digit gains. U.S. small stocks and international stocks performance was negative while U.S. large stocks were up about 4%.

Market Outlook

The "stop-go" pattern of trading in recent weeks is an indication of investor uncertainty about several key issues. Slowing global growth, particularly in manufacturing, amplifies fears that the longest economic expansion in U.S. history is nearing an end.

U.S. equities have struggled to break out of a narrow trading range in recent weeks. Despite strong year-to-date returns, U.S. equities are only slightly above the level reached before last fall's selloff. The "stop-go" pattern of trading in recent weeks is an indication of investor uncertainty about several key issues. Slowing global growth, particularly in manufacturing, amplifies fears that the longest economic expansion in U.S. history is nearing an end. Bullish investors think that Chinese reflation, a pause in trade tensions and dovish central banks will be enough to keep the expansion going; bearish investors are skeptical about the likelihood of a trade deal and the willingness of the Fed to extend mid-cycle rate reductions into next year. Within equities, long-suffering value investors are hoping that the recent strength of value stocks represents a turning point in market leadership. The fog of uncertainty may not clear anytime soon, given the likelihood that the coming months may offer only partial resolution of the major issues influencing equity markets:

A "grand bargain" between China and the U.S. is unlikely. An economy in recession is not a recipe for re-election, which provides powerful motivation for President Donald Trump to de-escalate tensions with China before the 2020 election. However, the trade deal between the U.S. and China reportedly reached last Friday represents a temporary cease-fire rather than the comprehensive deal desired by investors and corporate CEOs. A comprehensive deal is unlikely before the election, as frustration with China is seemingly one of the few issues in which Democratic and Republican voters are in agreement. Trump runs the risk of being portrayed as "soft on China" by Democratic opponents if he enters into a comprehensive deal with China. Chinese leader Xi Jinping faces his own set of constraints. Nationalist sentiment is high in China and Xi is not likely to make concessions in the trade negotiations that alter its state-led economic model and the Party's control of the organs of the Chinese state.

Chinese economic stimulus is likely to fall short of investor expectations. Chinese economic stimulus provided an important boost to global growth following the Global Financial Crisis. Today China is prioritizing financial stabilization over reflation, with fiscal stimulus and easing of monetary policy relatively restrained in comparison to prior efforts. Xi is concerned that another round of excessive debt creation would add to economic imbalances and hinder efforts to build a more sustainable economic model for China. Consequently, China's leadership is willing to accept slower economic growth in order to slow the growth in leverage. Trump's trade policies and attacks on China provide a convenient scapegoat for a slowing economy, with nationalist sentiment keeping dissent in check on the mainland. Although Chinese stimulus should provide some spillover benefits to the rest of the world, the boost to global growth will probably be far less meaningful than was the case in 2009 or 2016.

The Fed may also disappoint investors. The Fed and ECB are setting the tone in a world in which central banks implement expansionary monetary policies. However, the Fed may not provide as much monetary stimulus as is priced into the market today. Fed Chair Jerome Powell faces a delicate balancing act within the Fed, given three dissents in the most recent vote to cut rates.

Kansas City Fed President Esther George and Boston Fed President Eric Rosengren voted to keep rates unchanged, with low unemployment and the rising stock market among the factors motivating their dissent. St. Louis Fed President James Bullard voted against the 25 basis point rate cut, favoring a deeper 50 basis point cut. Among 17 FOMC members, 7 expect to cut the fed funds rate once more this year and 8 expect a still-lower policy rate in 2018. The median estimate is for no more rate cuts this year. In addition, equity selloffs in response to negative developments on trade policy is a reminder that monetary policy isn't a universal cure for what ails the global economy. Trade policy is the primary cause of slow business investment, not the cost of capital. The latest round of tariffs will hurt U.S. consumers harder than any prior trade actions, underlining the diminishing effectiveness of tariffs as a policy instrument. Worst case outcomes on trade would have a direct bottom-line impact for many companies and impose significant costs on companies forced to reconfigure their supply chains.

Portfolio Positioning

We expect global growth to slow but not stall, helped by dovish central bank policies, Chinese stimulus and a temporary easing of trade tensions. Given the level of uncertainty, we think a portfolio balanced between "offense and defense" is appropriate.

Ultimately, bulls and bears may both be disappointed. Escalation of the trade war between the U.S. and China is likely to be postponed until after the election, with longer-term strategic conflict between the U.S. and China remaining unresolved. The divided Fed makes it unlikely that investors will be satisfied with Fed policy moves. Consumer spending and the labor market remain relatively strong, providing grounds for optimism that the economic expansion will continue into 2020. However, tepid economic growth may be as good as it gets for the next year. The combination of tepid growth and geopolitical uncertainty is a recipe for a continuation of the stop-go market of recent months.

TFC is positioned roughly in line with long-term strategic targets for stocks. We expect global growth to slow but not stall, helped by dovish central bank policies, Chinese stimulus and a temporary easing of trade tensions. Given the level of uncertainty, we think a portfolio balanced between "offense and defense" is appropriate. A well-diversified portfolio of equities should do well if the economy continues to grow, while high quality bonds should provide a necessary counterweight to equities in the event that economic growth deteriorates further.

We monitor the market environment and will incrementally adjust the portfolio based on new information. TFC's headline allocation to stocks is important, but it is important to note that we have intentionally reduced equity risk within the portfolio over the past year by adding several investments that we expect to be more resilient in an economic downturn.

As always, we welcome your comments and questions. Please contact me or your TFC advisor should you have any questions or concerns.

Please join Michelle Soufan and me for the quarterly TFC webinar, scheduled for Thursday, November 7th at 11:30 am. We'll post the webinar on our website for those unable to attend live.

Sincerely,

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