



**CLARITY**  
CAPITAL MANAGEMENT

OCTOBER 2019

# QUARTERLY MARKET COMMENTARY

THIRD QUARTER 2019

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### Markets Rise Modestly in the Third Quarter of 2019 as the Fed Cuts Rates and China Saga Continues

The U.S. stock market indices increased modestly in the third quarter, propelling the S&P 500 and the DJIA to their best three-quarter starts to the year since 1997 and NASDAQ to its best three-quarter start since 2013 – all while further extending what is the longest bull market on record.

The broader S&P 500 enters the final three months of the year with a gain of close to 19% – its best performance in over two decades – as the third quarter's return of 1.18% padded its yearly return. The S&P 500 is just a hair shy of its all-time high reached on July 26th, but if you look at the performance over the past year, it has moved a paltry 2%, mostly as a result of the selloff in stocks toward the end of 2018.

<i>Index Returns</i>	<i>Close</i>	<i>3Q19</i>
DJIA	26,917	1.19%
S&P 500	2,977	1.18%
NASDAQ	7,999	- 0.08%
MSCI EAFE	1,899	1.71%
Bond Index*	2,210.00	2.27%
10-Yr Treasury Yield	1.67%	- 0.34%

\*Source: Bonds represented by the Bloomberg Barclays US Aggregate Bond TR USD. This chart is for illustrative purposes only and does not represent the performance of any specific security. Past performance cannot guarantee future results

Ryan Mohr, CFP®

[info@claritycapitalmgmt.com](mailto:info@claritycapitalmgmt.com)

503.388.5781

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But stocks were not the only good performer as there was a brief flight to quality causing a rally in bonds and some of the defensive sectors during the third quarter too.

Interestingly, the same news events that dominated the second quarter continued to dominate the third quarter, but there were some twists. Once again, there were two main themes that kept influencing the markets: hopes of a trade truce between the U.S. and China and a decided shift by the Federal Reserve with respect to short-term rates.

During the third quarter, investors saw:

- On July 31st, the Federal Reserve cut rates for the first time since 2008;
- On August 5th, the DJIA suffered its worst trading day of the year;
- On August 14th, the 30-year Treasury yield hit a record low;
- On September 16th, Brent crude oil had its biggest one-day gain;
- On September 18th, the Federal Reserve cut rates for the second time this year; and
- On September 30th, both the S&P 500 and DJIA posted their best three-quarter starts to the year since 1997 and NASDAQ posted its best three-quarter start since 2013.
- On September 16th, Brent crude oil had its biggest one-day gain;
- On September 18th, the Federal Reserve cut rates for the second time this year; and
- On September 30th, both the S&P 500 and DJIA posted their best three-quarter starts to the year since 1997 and NASDAQ posted its best three-quarter start since 2013.

## The Fed Signaled No 2019 Rate Moves, Then Cut Rates

Two days before the second quarter ended, the Fed held the line on interest rates and formally suggested that no cuts were coming in 2019. Then in July, the Fed cut rates for the first time since 2008 and then cut rates again in September.

Yet, despite the Fed's stance, the rate cuts did not exactly catch Wall Street by surprise, as the fed funds futures market pointed to a 100% chance of an easing of monetary policy for most of the month preceding the first rate-cut.

## The U.S. and China

The investing world continued to feel the tensions between the U.S. and China throughout the quarter, as it has since the summer of 2018. Traders were bombarded with news about the U.S. and China trade dispute and the news was as clear as mud. For example:

- Investors cheered Treasury Secretary Steven Mnuchin's announcement that trade talks with China were set to resume in early October and when China announced new waivers for imports of U.S. soybeans.
- Within 24 hours, however, President Trump told the United Nations of China's "theft of intellectual property and also trade secrets on a grand scale" while pledging that he would "not accept a bad deal."
- Then within 24 hours after that, President Trump told reporters that a truce with China might happen "sooner than you think." Then 48 hours later, traders grimaced when news



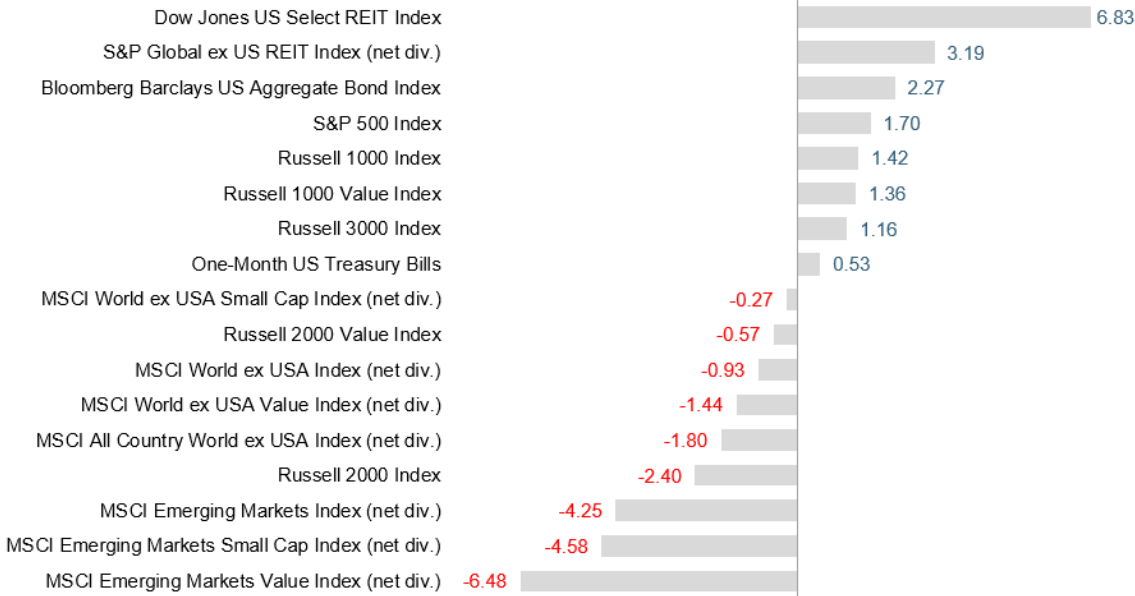
trickled out that the White House was considering restricting U.S. investment in China and forcing U.S. exchanges to delist shares of Chinese companies. Not surprisingly, shares in many Chinese companies dropped sharply.

## World Asset Classes Third Quarter Index Returns

Looking at broad market indices, US equities outperformed non-US developed and emerging markets during the third quarter. Value stocks outperformed growth stocks in the US but underperformed in non-US and emerging markets. Small caps outperformed large caps in non-US markets but underperformed in the US and emerging markets. REIT indices outperformed equity market indices in both the US and non-US developed markets.

## General Motors Hit by Striking UAW

Toward the end of the third quarter, approximately 46,000 General Motors workers went on strike, effectively halting GM's production in the United States. The last GM strike happened in 2007, a full year before the U.S. government bailed out the auto industry and before the global financial crisis was at its worst. Reports that negotiators have been talking into the wee hours of the mornings could be a signal that a tentative agreement is soon reached. But the strike is already the longest strike faced by GM since 1970.



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## House Democrats Move to Impeachment Inquiries

House Democrats moved toward a formal impeachment inquiry of President Trump and most pundits expect that the investigations into President Trump are likely to continue through the 2020 elections. What's still uncertain is the impact that these investigations will have on the stock market. After rallying since Trump's election victory in November 2016, the S&P 500 Index has done pretty well, but it has stumbled at times too:

- Ending 2016 up 9.54%;
- Zooming up 19.42% in 2017;
- Dropping 6.24% in 2018; and
- Up more than 18% so far year-to-date at the end of the third-quarter in 2019.

Although stocks have rewarded investors with healthy returns, investors seem more nervous that Trump will be impeached because not only will his pro-business agenda be stalled, but the chaos could send the markets into a tailspin. At least that's the worry. And although no one has a crystal ball to tell us how the Trump investigations will end, investors would be smart to tune them out. Here are a few reasons why.

## Data Matters More than Tweets

Economics and data matter way more than politics to the stock market. Trump's tweets and speeches get all the media attention, and while the market might seem to react a little bit at times, the reality is that boring economic numbers drive the markets one way or the other.

And consider these numbers:

- Unemployment is at 3.7%, one-tenth of a percent from the lowest level in over 50 years.
- We have seen 107 consecutive months of job growth, the longest streak ever.
- Wages have risen 3.2% this year, the strongest year in over a decade.
- Inflation has run below the Fed's intended longer-term 2% target for most of this 10-year expansion and core inflation has averaged 2.1% so far this year.
- Consumer spending came in much higher than expected with a 4.7% annualized growth number, the highest gain in 4 years.

## Estimated Earnings and Revenue Growth to Decline in Q3?

As outlined in the FactSet press release:

- The estimated earnings decline for the S&P 500 for Q3 2019 is -3.6% and
  - For companies that generate more than 50% of sales inside the U.S., the estimated earnings growth rate is 0.4%
  - For companies that generate less than 50% of sales inside the U.S., the estimated earnings decline is -10.7%
- The estimated revenue growth rate for the S&P 500 for Q3 2019 is 2.9% and
  - For companies that generate more than 50% of sales inside the U.S., the estimated revenue growth rate is 4.7%
  - For companies that generate less than 50% of sales inside the U.S., the estimated revenue decline is -1.7%

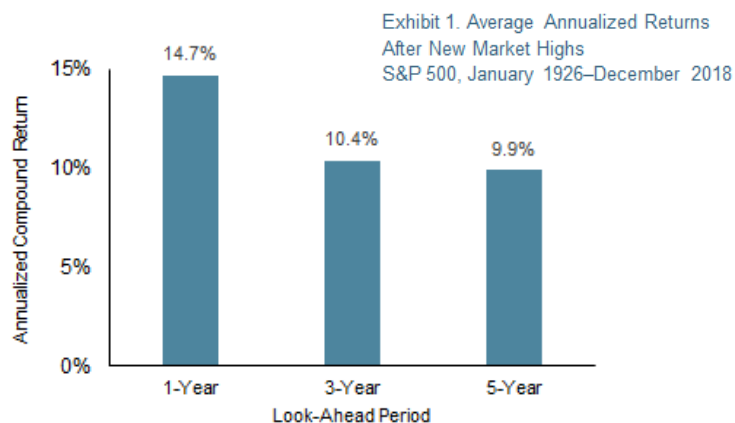


## Glass Half-Full or Half-Empty?

- The Conference Board Consumer Confidence Index decreased in September, following a decline in August
- Personal spending rose only 0.1% in August, the slowest pace since February
- Jobless claims inched higher for the final three weeks to end the quarter
- The annual pace of new home sales for August was one of the highest readings since October 2007
- Pending home sales rebounded 1.6%
- Personal incomes rose a healthy 0.4%

## Time And The Market

The S&P 500 Index has logged an incredible decade. Should this result impact investors' allocations to equities? Exhibit 1 suggests that new market highs have not been a harbinger of negative returns to come. The S&P 500 went on to provide positive average annualized returns over one, three, and five years following new market highs.



In US dollars. Past performance is no guarantee of future results. New market highs are defined as months ending with the market above all previous levels for the sample period. Annualized compound returns are computed for the relevant time periods subsequent to new market highs and averaged across all new market high observations. There were 1,115 observation months in the sample. January 1990–December 2018: S&P 500 Total Returns Index. S&P data © 2019 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. January 1926–December 1989: S&P 500 Total Return Index, Stocks, Bonds, Bills and Inflation Yearbook™, Ibbotson Associates, Chicago. For illustrative purposes only. Index is not available for direct investment; therefore, its performance does not reflect the expenses associated with the management of an actual portfolio. There is always a risk that an investor may lose money.

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Ryan Mohr, CFP®

[info@claritycapitalmgmt.com](mailto:info@claritycapitalmgmt.com)

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