ECONOMIC AND MARKETS REVIEW AND COMMENTARY

THIRD QUARTER 2019

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Gary Ran, Chairman/Chief Executive Officer
Direct: (248) 827-1800 • gran@telemus.com

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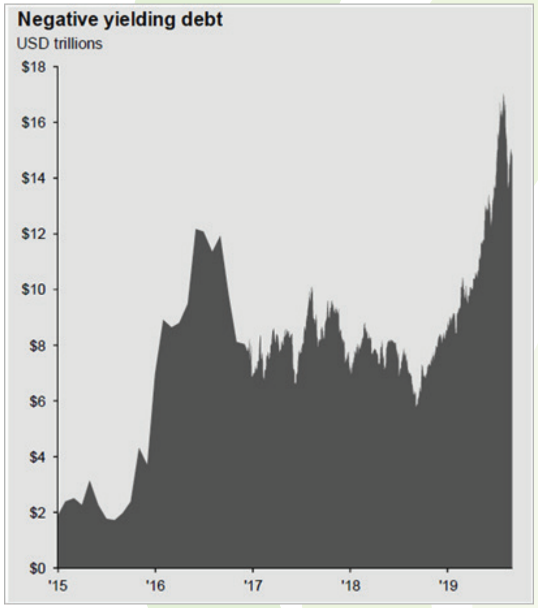
THIRD QUARTER HIGHLIGHTS

"SOME THINGS NEVER CHANGE"

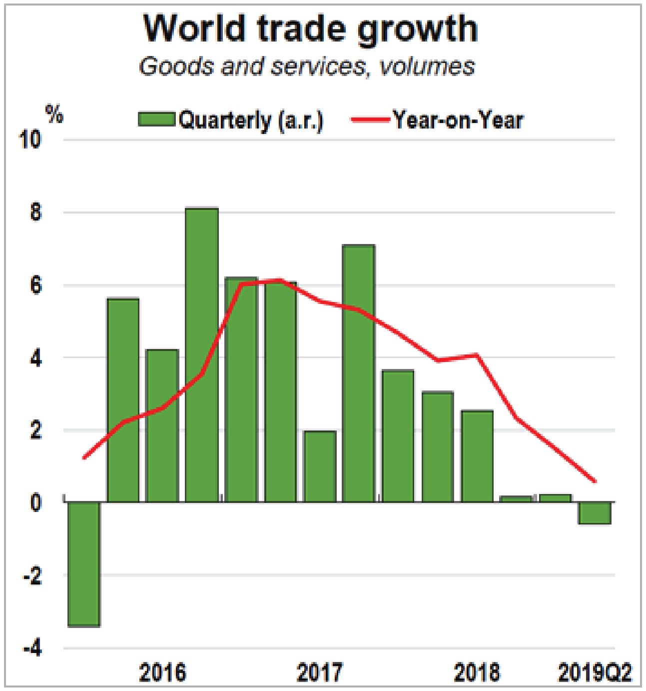
- As expected, economies around the world continued to chug along albeit at a slower pace in Q3 than earlier in the year. It was pretty much the same narrative as last quarter – the ongoing trade battle with China and Brexit dominated the news. What was unexpected this quarter was the attack on Saudi Arabia's oil infrastructure that luckily turned out to be a non-event along with the formal impeachment proceedings launched against President Trump.
- Equity markets ended up slightly ahead of where they started in the third quarter. In the U.S., stocks moved higher led by the S&P500 which gained 1.7%. Value stocks edged out growth, while small caps continued to underperform their large cap brethren losing -2.5%. Overseas developed markets lost -1.1% for the quarter and emerging markets lost -4.3%.
- Fixed income markets once again enjoyed positive returns in Q3 as central banks around the world continued their move away from tightening monetary conditions to easing them. The yield on the 10-year U.S. Treasury note fell from 2% to as low as 1.45% during the quarter before ending at 1.67%. Globally the amount of bonds trading at negative yields continued to grow in Q3 to approximately $15 trillion.
- The U.S. dollar strengthened against a basket of foreign currencies in the third quarter.
- Oil prices fell during the third quarter on concerns over the supply and demand for crude despite a brief spike higher after the Saudi attack. Gold performed well as investors continued to seek out safer havens. Most other commodity prices declined slightly for the quarter.



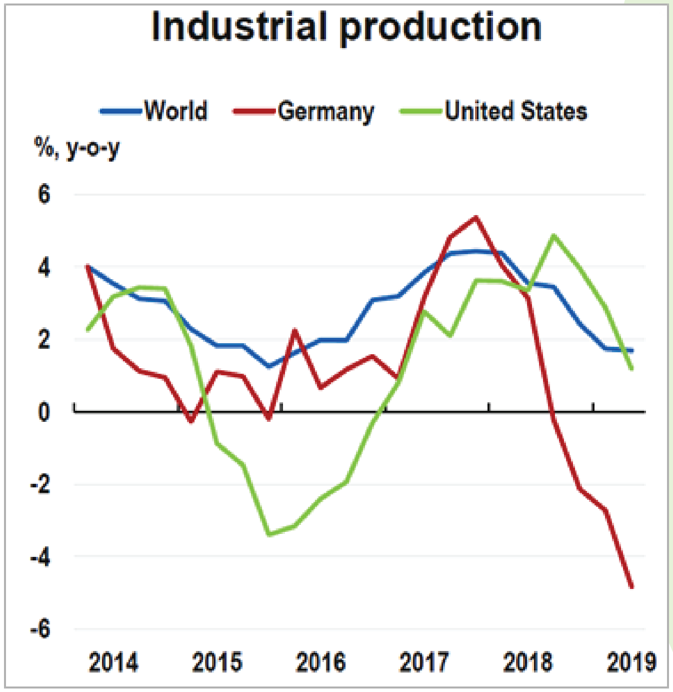
Source: J.P. Morgan

ECONOMY

The global economy continued to slowly chug along in the third quarter with plenty of help from the world's central banks. In a repeat of the second quarter much of the headline economic data being reported in the U.S. and elsewhere shows the trade war with China is not only affecting global financial markets, it's chilling business investment, confidence and trade flows across the world resulting in slower economic growth.



Source: OECD Economic Outlook



Source: OECD Economic Outlook

ECONOMY

The U.S. remains the beacon of hope in the global economy. Economic data was largely stable during the quarter, albeit it continued to moderate from the second quarter and the start of the year. As a result the Fed moved to shore up economic growth by lowering interest rates twice during the quarter. Weak exports and business investment weighed on the economy even as consumer spending remained healthy. With the unemployment rate near historic lows at 3.7% consumer spending should remain intact, at least for the foreseeable future.

OECD Interim Economic Outlook projections

%, year-on-year. Arrows indicate the direction of revisions since May 2019.

downward by 0.6 pp and more — downward by 0.3 to 0.6 pp — downward by less than 0.3 pp — no revision — upward

	2018	2019	2020		2018	2019	2020
World	3.6	2.9	3.0	**G20**	3.8	3.1	3.2
Australia	2.7	1.7	2.0	**Argentina**	-2.5	-2.7	-1.8
Canada	1.9	1.5	1.6	**Brazil**	1.1	0.8	1.7
Euro area	1.9	1.1	1.0	**China**	6.6	6.1	5.7
Germany	1.5	0.5	0.6	**India**[1]	6.8	5.9	6.3
France	1.7	1.3	1.2	**Indonesia**	5.2	5.0	5.0
Italy	0.7	0.0	0.4	**Mexico**	2.0	0.5	1.5
Japan	0.8	1.0	0.6	**Russia**	2.3	0.9	1.6
Korea	2.7	2.1	2.3	**Saudi Arabia**	2.2	1.5	1.5
United Kingdom	1.4	1.0	0.9	**South Africa**	0.8	0.5	1.1
United States	2.9	2.4	2.0	**Turkey**	2.8	-0.3	1.6

Note: Difference in percentage points based on rounded figures. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.
1. Fiscal years starting in April.
Source: OECD Economic Outlook database; and OECD calculations.

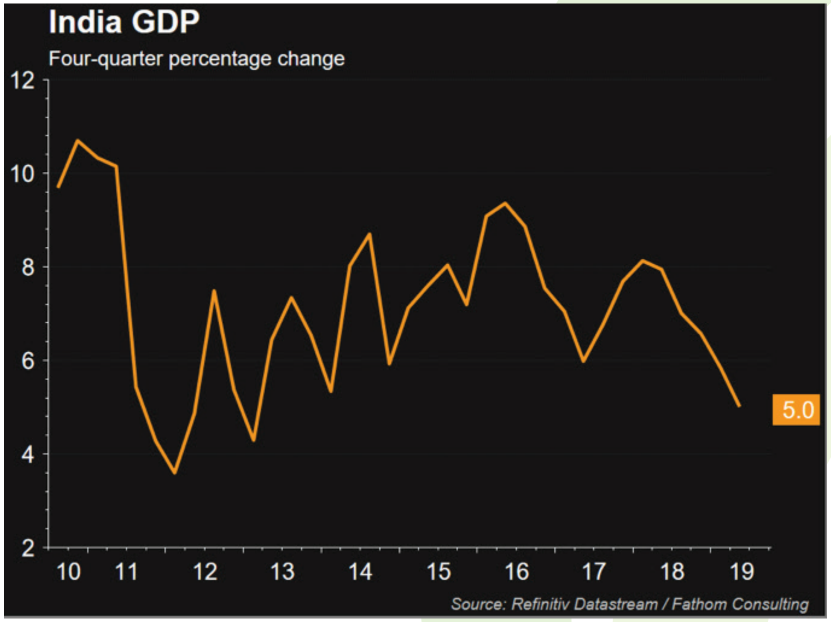
Source: OECD Economic Outlook

Economic data remained lackluster most everywhere else around the globe. In Europe growth remains weak overall. Soft economic data from Germany is an indication of the challenges facing most major European economies. In September, the European Central Bank (ECB) took steps to boost the flagging European economy, including restarting quantitative easing and committing to buying assets until its inflation target is reached. Christine Lagarde, head of the International Monetary Fund, was nominated to replace Mario Draghi as president of the ECB when his term ends on October 31st. In the U.K., Brexit and domestic political and economic uncertainty remained elevated as Boris Johnson took over as the U.K.'s new prime minister on a "do or die" pledge to achieve Brexit.

ECONOMY

In Asia and Japan the trade war has impacted economic growth overall. As in Europe, most Asian central banks are on an easing path. China took several policy steps during the quarter including lowering the range they allow their currency to trade to stimulate economic growth. In Japan the recent cut in US interest rates has again raised expectations for additional easing moves by the Bank of Japan. India joined the rate cutting bandwagon as economic growth has slowed there as well, evident by its GDP growth of 5% last quarter, its slowest rate of growth since 2013. Elsewhere most economies currently face a headwind from either falling crude prices, the trade war, or idiosyncratic events like the political turmoil and water crisis in South Africa.

After years of quantitative easing (QE) the global economy is still struggling to gain escape velocity. The trade war with China is hampering the economic progression. As we write this there's hope that a truce has been agreed to and we can go back to worrying about all the other problems the world faces that we've highlighted previously – global debt, slowing population growth, etc. – and the trade war will be old news.



Source: Refinitiv

EQUITIES

Returns were mixed this quarter and not much to write home about. Size played a significant role in U.S. equity performance, with the large cap dominated S&P 500 index gaining 1.7% while the small cap Russell 2000 index lost -2.5% and the Russell Microcap index lost -5.5%. Among large cap stocks, growth and value performed roughly in line with each other, the first time that's happened in a while. The same was not true for smaller sized companies where the Russell 2000 Value fell -0.6% versus a -4.2% decline in the Russell 2000 Growth. Much has been made about the September rotation from growth into value. Many market participants expect this recent trend of value outperformance to be here for a while.

U.S. equity markets leaned toward defensive oriented securities with the more stable utilities and consumer staples sectors leading the way, up 8.4% and 5.4% respectively. Low interest rates served as a benefit to the real estate sector, which gained 6.9%. Energy stocks were volatile in tandem with oil prices and ended up being the worst performing sector for the second quarter in a row with a decline of -7.3%.

International equities struggled in Q3. Developed markets fell -1.1% while emerging markets dropped -4.3% as the strong U.S. dollar served as a headwind to returns. Among developed markets, Japan was the best performing country, gaining +3.6%, while Hong Kong declined -12% on fallout from protests. Disappointing industrial activity led to a -4% drop in German markets. Within emerging markets, Taiwan was the sole positive performer, up 5.2%, driven by gains in Taiwan Semiconductor. On the other end of the spectrum South Africa dropped -12.6% as the country faces protracted political and economic challenges.

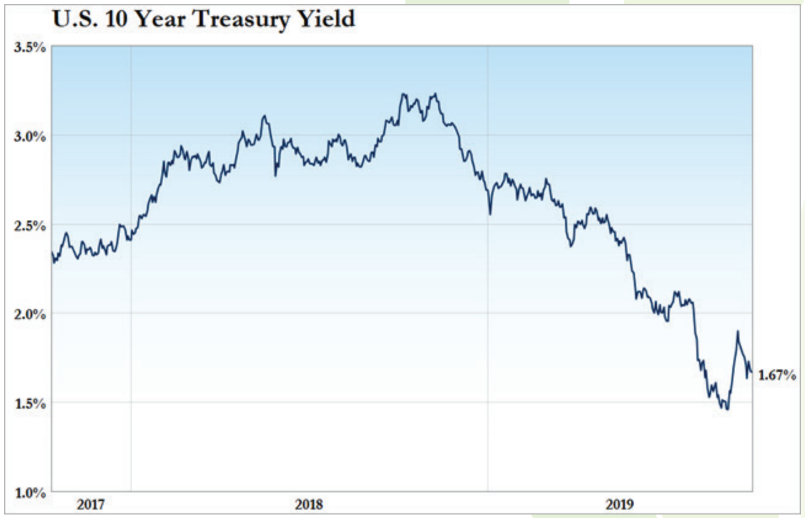
US Indices	Q3	Q2	Q1	YTD
S&P 500	1.70%	4.30%	13.50%	20.40%
Dow Jones Industrials	1.83%	3.21%	11.72%	17.41%
NASDAQ Composite	0.18%	3.88%	16.27%	21.00%
S&P Midcap 400	-0.09%	3.03%	14.84%	18.22%
Russell 2000	-2.46%	2.09%	13.95%	13.53%
Russell Microcap	-5.46%	0.92%	11.00%	5.90%

S&P 500 Sectors	Q3	Q2	Q1	YTD
Utilities	8.40%	2.67%	11.86%	24.50%
REITS	6.88%	1.58%	19.36%	29.59%
Staples	5.36%	2.97%	11.63%	21.11%
Technology	2.97%	5.65%	19.29%	29.78%
Communications	1.84%	4.15%	12.21%	19.02%
Financials	1.44%	7.43%	7.11%	16.73%
Industrials	0.49%	3.06%	16.12%	20.25%
Consumer Disc.	0.18%	4.92%	14.26%	20.10%
Basic Materials	-0.68%	5.72%	9.19%	14.65%
Healthcare	-2.71%	0.94%	7.57%	5.64%
Energy	-7.25%	-3.71%	13.08%	0.99%

FIXED INCOME

The broad U.S. bond market, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, was up a solid 2.3% benefiting from a change in rates. Following the Fed's rate cut in late July, U.S. interest rates fell as trade tensions heightened and global economic growth expectations declined. These concerns led to increased demand for high quality fixed income investments, such as U.S. Treasuries. The Fed cut again in September which served as reinforcement for the concern over economic growth. Demand for U.S. Treasuries pushed rates to levels not seen since 2016. The 2-year Treasury yield ended the quarter at 1.63%, while the 10-year Treasury yield fell 33 basis points in the quarter to end at 1.67%. The 30-year Treasury closed out at a yield of 2.12%. In early September short-term funding rates ballooned higher including the overnight fed funds rate reaching 3%, despite the Fed's then 2% - 2.25% target range. The Fed has since been forced to implement daily repurchase operations in order to stabilize the short-term funding market.

Source: Refinitiv



Source: Refinitiv

FIXED INCOME

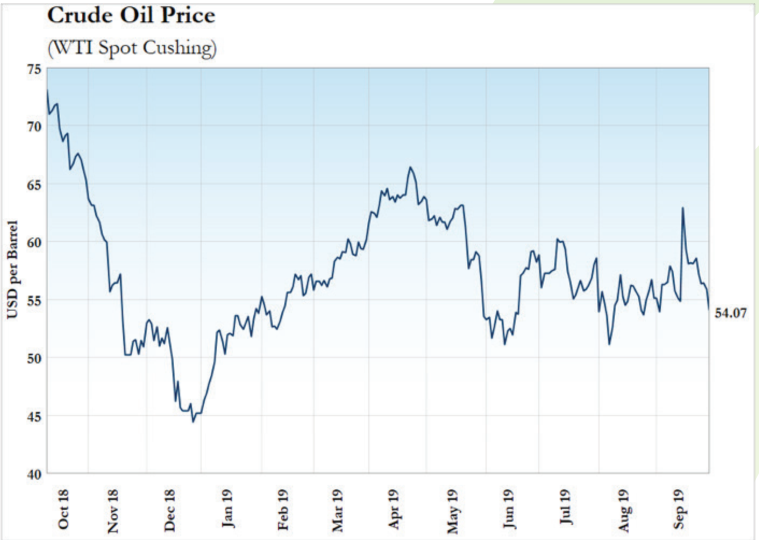
In the taxable bond market investment grade and high yield corporates delivered solid returns in Q3, gaining 3.1% and 1.3% respectively. High yield corporates, rated CCC or below, fell -2.3%, lagging their high yield peers. These declines stemmed from wider interest rate spreads among riskier securities. Municipal bonds rose 1.6% in Q3 as measured by the Bloomberg Barclays Municipal Bond Index. Strong flows into municipal bond funds and strong fundamental trends helped to fuel the positive performance. High yield municipal bonds were the top performing sector for the quarter increasing 2.8%.

In Europe, the 10 year Bund yield fell 24 basis points to finish even deeper in negative territory at -0.57%. The Italian 10 year yield saw a substantial move, falling 126 basis points to 0.82% due to anticipation, and ultimately announcement of new stimulus measures and a calmer political backdrop. The U.K. saw further escalation in Brexit uncertainty. The 10-year U.K. yield fell 34 basis points over the quarter, with most of this occurring in July.

COMMODITIES

OIL

Oil prices took a wild ride in the third quarter. WTI crude, which ended the second quarter at roughly $59 a barrel, dropped to as low as $51 in early August and then spiked briefly over $62 in September after the attack on a Saudi Arabian oil installation. After it turned out the damage wasn't as great as initially feared, oil prices returned back near pre-attack levels, ending the quarter at approximately $54 a barrel.



Source: Refinitiv

GOLD

Gold continued its climb in Q3 appreciating roughly 4%. Expectations for lower interest rates among global central banks, as well as geopolitical concerns continued to drive safe haven demand for the precious metal. Silver was a big winner in the third quarter gaining over 10%. The white metal's lagging price performance in recent months had resulted in it trading at its biggest discount to gold in three decades.

Source: Refinitiv

OTHER

In other commodity markets sugar, soybean and corn have been stellar performers this quarter while lean hogs, orange juice and cattle have been the worst.

LOOKING AHEAD

Not much has changed in the world since our last quarterly commentary and the global economy is still chugging along, albeit at a slower pace than the start of the year and with plenty of help still from central bank stimulus both here and overseas. Global financial markets continue to move moderately higher on lower interest rates, investor hope for a comprehensive trade deal, and a resumption of global economic growth.

As we said in last quarter's commentary, now is not the time in our eyes to be aggressive. With the current economic expansion in the U.S., the longest on record, the S&P500 Index trading at the upper end of its historical valuation range and the 10-year U.S. Treasury note barely yielding 1.7% we are being increasingly cautious about opportunities here at home. Overseas things aren't much better. As a result better safe than sorry. While we remain confident in the diversified nature of our portfolios, we are focused on the seemingly ever changing financial markets and more recently the political landscape to determine if, and when, appropriate changes are needed or necessary. Our defense first, offense second investment approach continues to serve us well when things turn volatile as they have of late. Additionally our allocations to investments not correlated with the equity or fixed income markets serve as additional protection. With that said, we are staying disciplined and rebalancing portfolios when the opportunities present themselves.

CONCLUSION

As always we thank our clients for their partnership and welcome any comments or questions. For those of you who are not our clients feel free to contact us as well.

Telemus Investment Committee

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