MONTH IN REVIEW

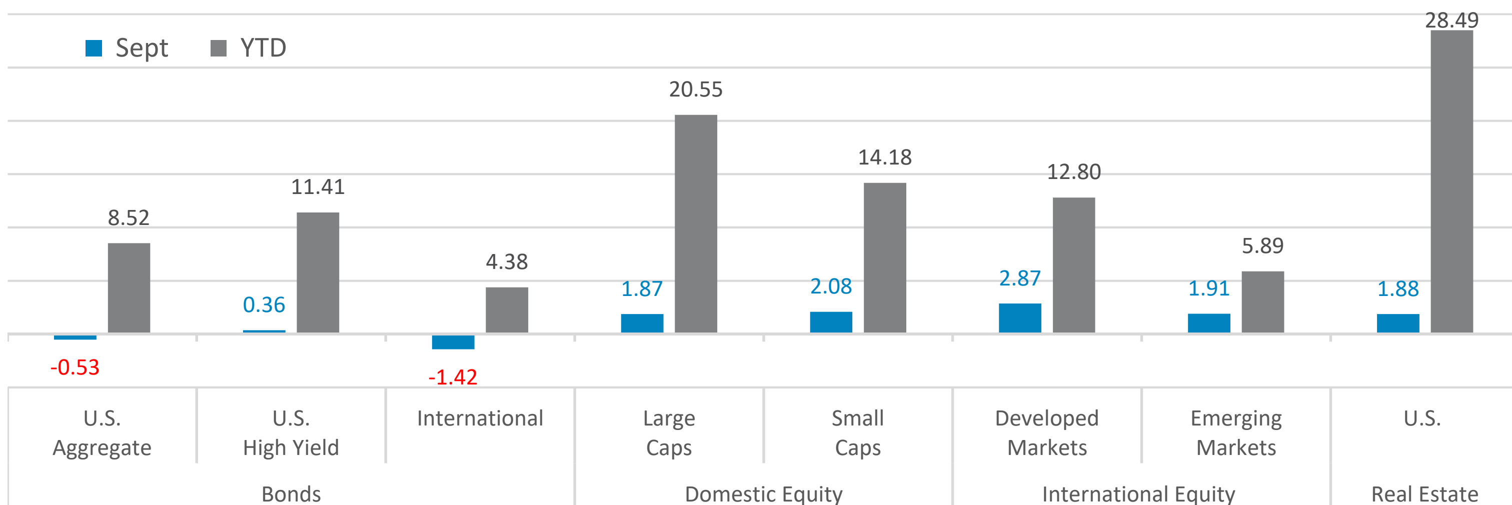
September 2019

Quick Takes

- **Winning ways.** U.S. stocks got back to their winning ways in September after only the second monthly loss of 2019 in August. The S&P 500 advanced +1.87% for the month, including dividends, bringing the index's year-to-date return to over +20%.
- **Surprise.** Until recently, economic indicators had been weak relative to economists expectations, but in early September the number of economic readings that are better than expected turned positive for the first time since February.
- **Every dog has its ~~day~~ month.** Value was the big winner in September, especially among small caps. Value indices rose about +4%, and small value was up +5% -- almost offsetting the -5.6% August loss. It was the first month small value has been the top performer in 2019, its been the worst three times.
- **Low vol.** After soaring in August, volatility dropped back to moderate levels in September. The VIX volatility index was as high as 25 in August, and averaged 19 – well above an average of 13 in July. In September the VIX average fell back to 15.5.

Asset Class Performance

September flipped the script from August as risk assets rebounded and defensive bonds lost ground. The U.S. and International Aggregate bond indices were both negative for the month, while international stocks and U.S. small cap stock indices led September asset class performance. Real Estate continued to pad its year-to-date leading gains.



Source: Bloomberg, as of September 30, 2019. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Barclays U.S. Aggregate Bond TR), U.S. High Yield (Barclays U.S. HY 2% Issuer-Capped TR), International Bonds (Barclays Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small Caps (Russell 2000 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR).

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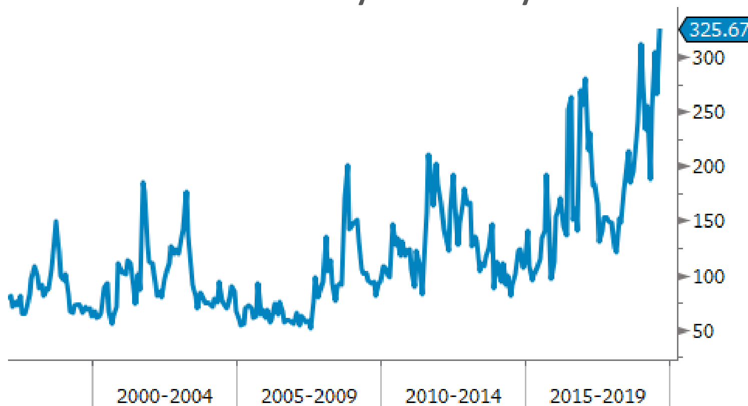
Macroeconomic Machinations

Incremental risks continue to mount, but recession still not the base case

The summer quarter closed officially on an upbeat note for stocks with September gains, but there is no shortage of threatening signs. The S&P 500 enters the final quarter with year-to-date return of 20% -- its best performance for the first three quarters of a year since 1997. But the third quarter was still a turbulent period, as escalating trade tensions and a worsening global growth slowdown worried investors. In addition, September brought some new headwinds for markets to grapple with. On the political front there is a newfound push towards impeachment. On the geopolitical front, oil prices surged after an attack on Saudi Arabian oil processing facilities. On the market structure front, the rate for overnight collateralized repurchase agreements, the so-called repo market, spiked to a record 10% forcing the Federal Reserve Bank of New York to intervene and provide liquidity.

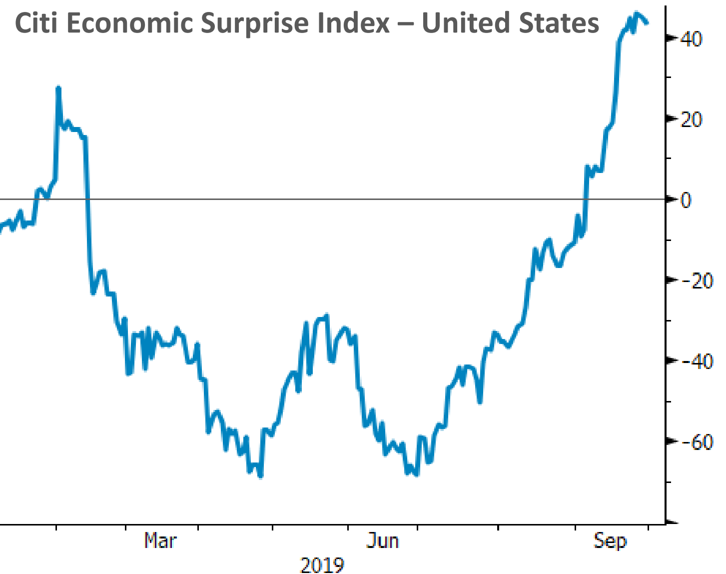
Global Economic Policy Uncertainty Index



Source: Bloomberg; Baker, Bloom & Davis

The global economic outlook continues to be hampered by uncertainties stemming from the U.S.-China trade conflict. The Baker, Bloom & Davis policy uncertainty composite index shown above reflects the frequency of newspaper references to policy uncertainty and highlights the impact that trade concerns are having on markets. Investors loathe uncertainty and sharp rises in the index may foreshadow declines in investment, output and employment. Fortunately the U.S. job market remains strong. Jobless claims continue to be consistently good and the unemployment rate remains near 50-year lows. As a result, the American consumer has continued to spend which is keeping the U.S. economy growing at, or near, 2%. That is not the 3%+ growth many hoped for, but it is enough to keep the economy healthy and out of recession. As shown in the chart above, until recently, economic indicators had been weak relative to economists expectations. However, since July, economic data has been increasingly beating expectations. In early September the number of economic readings that are better than expected actually turned positive for the first time since February. The Conference Board's Leading Economic Indicators has lost some ground but shows no evidence of imminent recession. Building activity and home sales have also been robust. And with the Fed back to easing, after last year's tightening, mortgage rates should remain attractive. Historically the Fed easing before the economy is already deteriorating has seen the economy, and markets, benefit – like they did in the late-1990s. Third-quarter earnings season is getting underway and is expected to show another quarter of lower profits. A return to easing monetary policy should also help corporate earnings beat their 2018 comparables.

Citi Economic Surprise Index – United States



Source: Bloomberg; Citigroup Global Markets

Bottom Line: **Overall, the economy and markets are facing rising risks. But even with the heavier headwinds, recession odds are still relatively low. Bloomberg Economics' U.S. recession probability indicator shows the chance of a downturn within the next 12 months is about 25%. Robust consumption should continue to support the economy close to its potential. However, the longer uncertainty remains at these elevated levels, the more likely that a slowdown may spread from manufacturing to consumers.**

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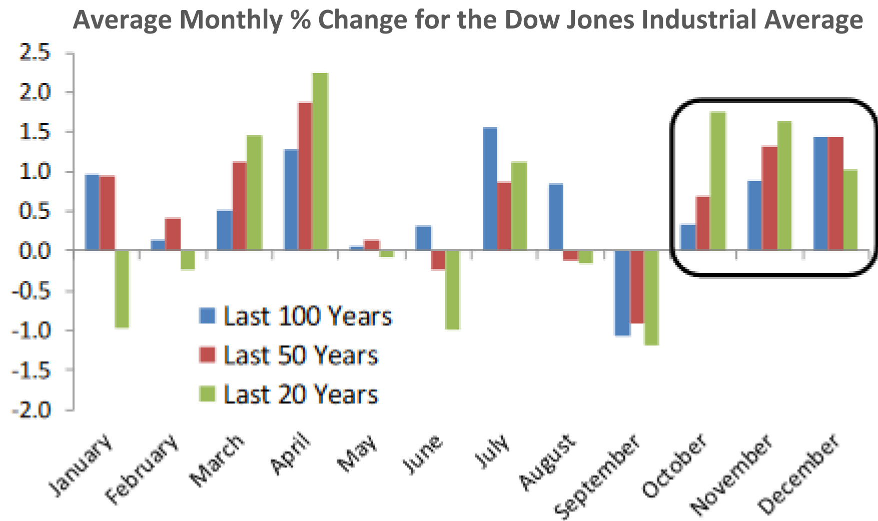
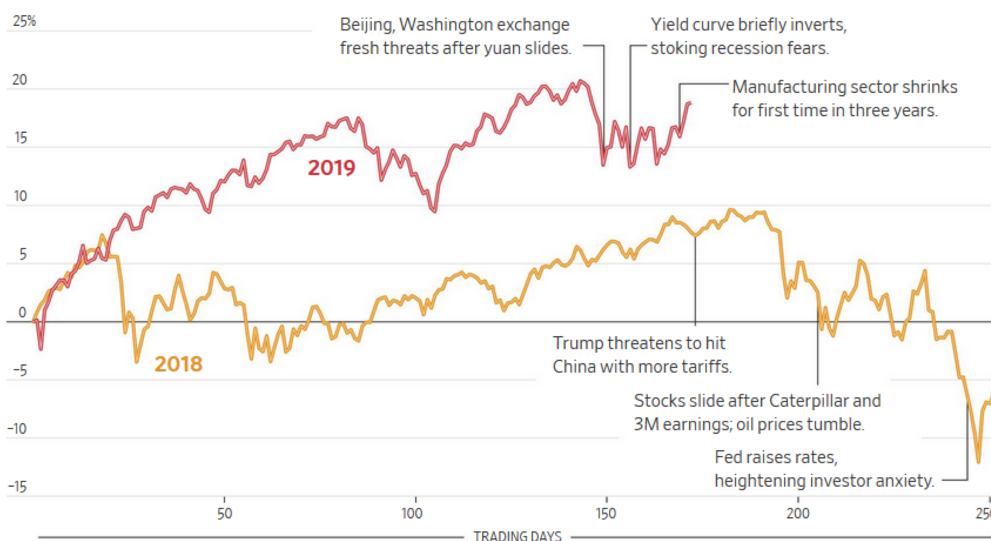
Stocks are near records, but October, and memories of 2018, leave investors uneasy

As hard as it is to believe, we're three quarters of the way through 2019 already. The sun is setting much earlier and temperatures are dropping to the typical cooler autumn levels. It was late September just over a year ago that U.S. equity markets reached their 2018 highs before nearly falling into bear market territory with a -19.8% decline through Christmas Eve. But that was an exception to the usual market seasonality, as the final three months of the year tend to be the most favorable. As the chart to the right shows, the August-September period has been the worst two month stretch of the year for stocks and the October-December stretch is the best three month period of the year. In fact, analysis of the Dow Jones Industrial Average by Bespoke Investment Group shows that over the last 20 years the probability for a positive result for each of the months of October and November has been 70%. December isn't far behind at 65%. Over the trailing 20 years, for each of the final three months the Dow has averaged a gain of more than 1%. October brings Halloween, the scariest of holidays, but it is often associated with scary memories for investors as well. And its not just because of recency bias from last October's slump… the stock market crashes of 1929 and 1987, as well as a good portion of the 2008 turmoil, have given October a bad rap. However, since the Global Financial Crisis, the VIX volatility index has tended to peak in August. That has been the case, so far, in 2019 too. After soaring to as high as 25 in August, and averaging 19 for the month, the VIX dropped back to moderate levels in September. There were even four separate days in August with S&P 500 loses worse than -1%. But in September the VIX average fell back to 15.5 and there were no daily loses for the S&P that exceeded -1%. Volatility in other asset classes such as U.S. Treasuries and oil also spiked in the third quarter before falling well off those highs. The first two days of October is seeing markets spooked again but the volatility levels for stocks, bonds and oil are still under the third quarter high marks. Will the volatility settle or will it revert to it's long-term, pre-GFC tendency? A handful of issues are likely to influence the outcome this quarter: U.S. and Chinese officials are scheduled to meet in Washington for high-level trade talks (U.S.-China trade has been *the* dominate headline risk all year); the Fed's interest rate path will be closely watched for the October and December meetings; the upcoming earnings season is expected to show a third consecutive quarter of slowing profits; the U.K. faces an Oct. 31 deadline to pull itself out of the European Union; and now there is impeachment process risk to add to the mix.



Source: Bespoke Investment Group

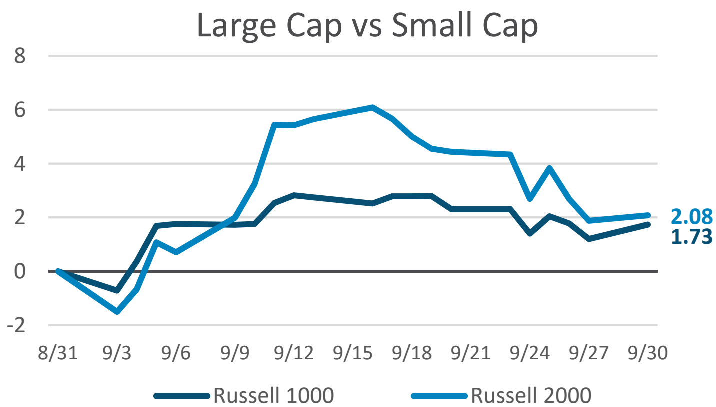


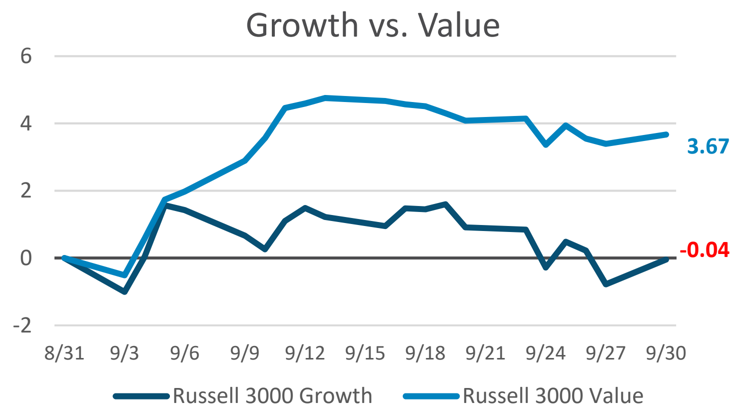
Source: FactSet, WSJ

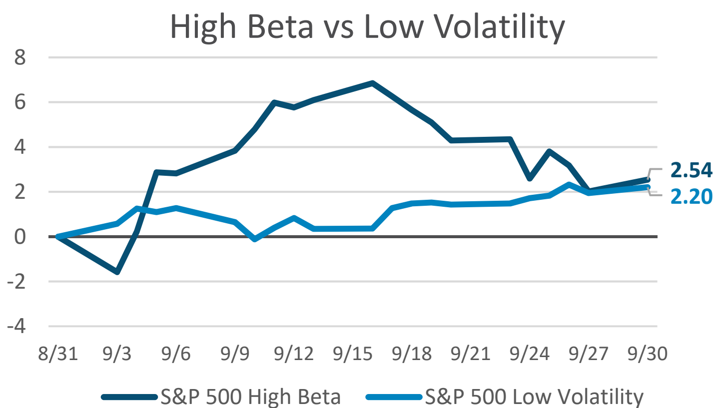
<u>Bottom Line</u>: U.S. stocks and bonds are coming off one of the best starts of the year for the first three quarters in more than two decades. Seasonal trends have been favorable for the final quarter, but there are several volatility catalysts that could prevent seasonal tailwinds. Chief among those are US-China trade, the Fed's monetary policy, and the upcoming earnings season. A major upgrade or downgrade on any of these matters could make or break the quarter.

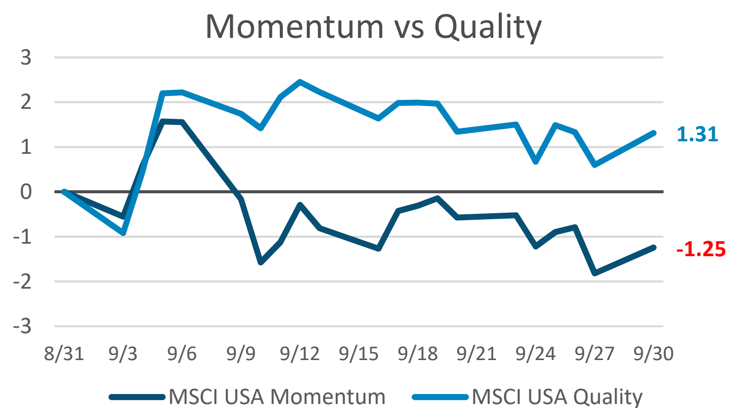
What Worked, What Didn't

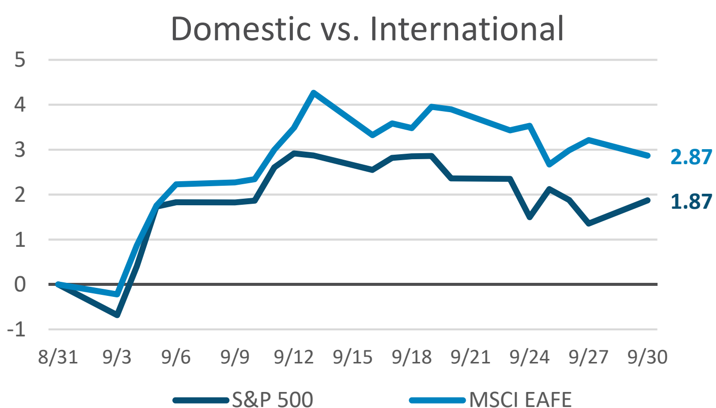
- **Role Reversal.** September brought a rather abrupt reversal of several of the most dominant investing trends in 2019. Small cap stocks, value stocks, and international stocks all outperformed on a relative basis, contra to 2019 themes.
- **Value has its day in the sun.** Until September Growth had beat Value in every month of 2019 except for June. Growth's outperformance wasn't trivial either, it had outperformed Value by more than +8%. But Value put a big dent in that deficit by outperforming Growth in September by almost +4%, its best relative month since October 2018.
- **No mo' momo.** The MSCI USA Momentum index had six days in September in which it lost more the -1%. September was only the second month of negative performance for the style in 2019. As with the Value/Growth reversal, September was the biggest outperformance of Quality over Momentum since October 2018.

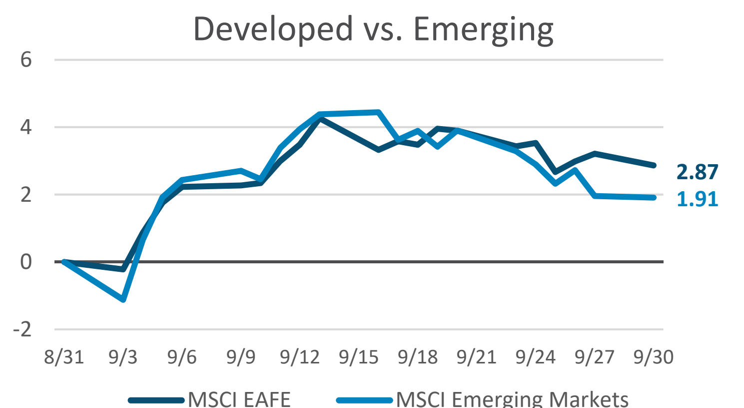












Source: Bloomberg.

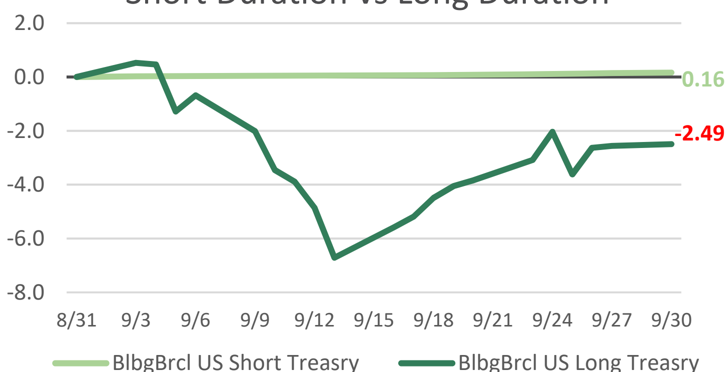
September 2019

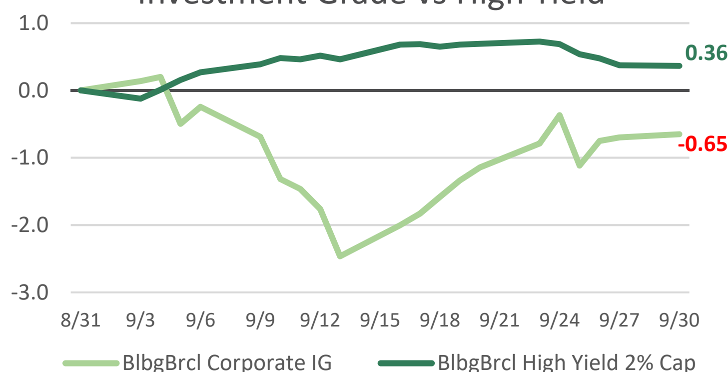
Bond Themes

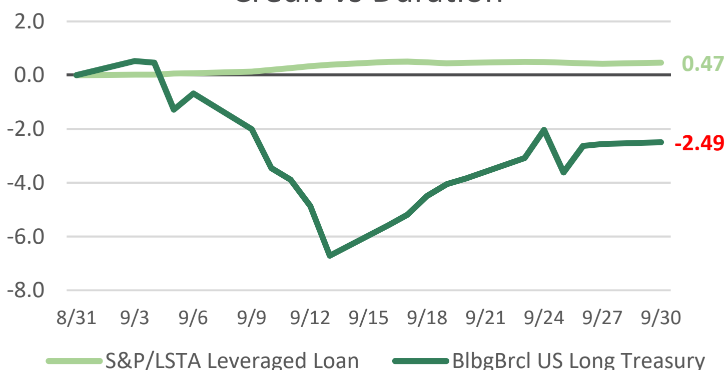
MONTH IN REVIEW

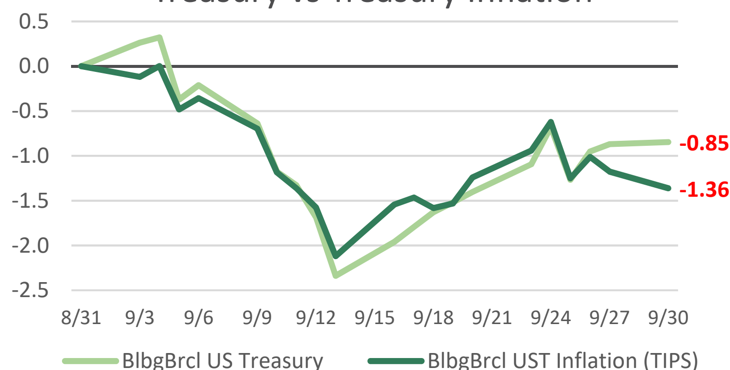
What Worked, What Didn't

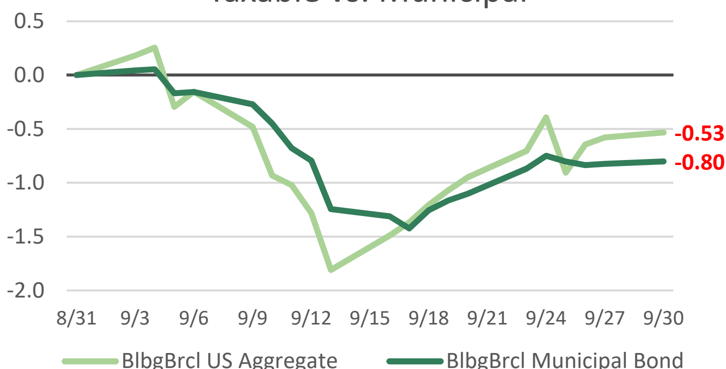
- **Flip flop.** Like the equity trends reversal, fixed income sectors had their own flip flop from 2019 trends. Short duration, High Yield, and Bank Loan sectors all bucked August and 2019 trends to outperform in September.
- **Yields rise.** After dipping to its lowest levels of 2019 in the intimal days of the month, the yield on the benchmark 10-year U.S. Treasury bond rose nearly 17 basis points in September, although at mid-month it was as high as 40 basis points higher than the beginning of the month. As a result longer duration bond sectors underperformed.
- **Credit sectors lead bond performance.** After underperforming Investment Grade by more than -6% over the prior six months, High Yield bonds outperformed Investment Grade in September by +1%. The S&P/LSTA Leveraged Loan index was the top performing bond sector in September, gaining +0.68%.

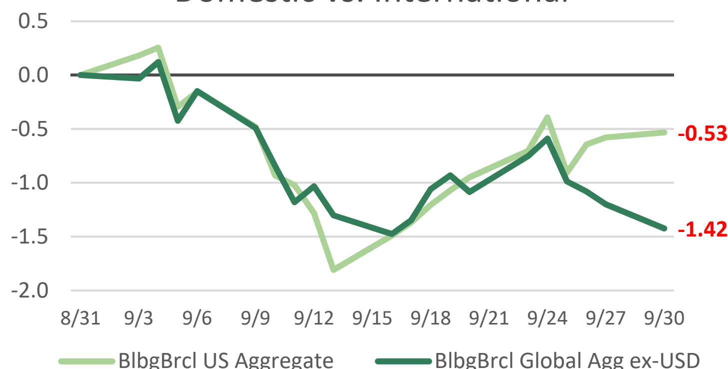












Source: Bloomberg.

September 2019

Asset Class Performance

MONTH IN REVIEW

The Importance of Diversification. From period to period there is no certainty what investment will be the best, or worst, performer. Diversification mitigates the risk of relying on any single investment and offers a host of long-term benefits, such as less portfolio volatility, improved risk-adjusted returns, and more effective compounding.

	Sep-03	Sep-04	Sep-05	Sep-06	Sep-09	Sep-10	Sep-11	Sep-12	Sep-13	Sep-16	Sep-17	Sep-18	Sep-19	Sep-20	Sep-23	Sep-24	Sep-25	Sep-26	Sep-27	Sep-30	Sep
High	RE 0.97	EM 1.68	SCV 2.11	IBD 0.50	SCV 2.26	SCV 1.65	SCG 2.03	EM 0.72	EM 0.57	RE 1.03	RE 1.09	USB 0.12	RE 0.48	USB 0.36	SCV 0.35	IBD 0.78	SCV 1.34	RE 0.82	USB 0.12	MCG 0.74	SCV 5.06
	USB -0.02	IEQ 1.41	MCG 1.57	EM 0.44	MCV 1.02	SCG 0.96	SCV 1.94	IEQ 0.58	IEQ 0.56	SCV 0.45	MCG 0.79	LCG 0.04	IEQ 0.34	HYB 0.13	MCG 0.17	USB 0.27	SCG 0.79	IEQ 0.37	IBD 0.02	LCG 0.73	MCV 4.11
	IBD -0.18	MCV 1.08	SCG 1.55	IEQ 0.33	LCV 0.86	MCV 0.69	MCV 1.00	RE 0.49	IBD 0.33	MCV 0.36	LCG 0.55	LCV 0.01	LCG 0.20	EM 0.10	RE 0.15	RE -0.12	LCG 0.72	USB 0.17	HYB -0.11	EM 0.57	LCV 3.62
	IEQ -0.19	LCV 1.06	LCG 1.51	LCV 0.22	SCG 0.32	LCV 0.51	LCV 0.78	LCG 0.41	SCV 0.31	HYB 0.36	IEQ 0.34	IBD -0.06	USB 0.14	RE -0.04	MCV 0.12	HYB -0.14	MCV 0.63	60/40 0.00	LCV -0.12	RE 0.38	IEQ 3.16
	HYB -0.29	LCG 1.05	MCV 1.24	RE 0.19	EM 0.32	IEQ 0.17	LCG 0.70	MCG 0.22	SCG 0.08	USB 0.27	IBD 0.21	HYB -0.06	60/40 0.04	IBD -0.06	EM 0.10	60/40 -0.34	MCG 0.52	EM -0.02	MCV -0.30	SCG 0.37	RE 1.89
	60/40 -0.32	MCG 1.02	EM 1.13	MCV 0.17	IEQ 0.29	EM 0.07	EM 0.70	60/40 0.21	LCV 0.05	SCG 0.24	60/40 0.18	60/40 -0.07	IBD -0.03	60/40 -0.06	LCV 0.09	IEQ -0.38	LCV 0.48	HYB -0.07	60/40 -0.32	IEQ 0.37	EM 1.69
	LCV -0.32	SCV 0.95	LCV 1.12	60/40 0.15	HYB 0.10	HYB 0.06	MCG 0.60	IBD 0.19	MCV 0.01	MCG 0.08	USB 0.15	IEQ -0.12	HYB -0.11	SCG -0.20	USB 0.04	MCV -0.66	RE 0.08	IBD -0.09	IEQ -0.34	MCV 0.34	60/40 1.22
	MCV -0.48	60/40 0.81	IEQ 0.53	USB 0.11	60/40 0.04	60/40 -0.08	IEQ 0.56	LCV 0.19	60/40 -0.08	LCV -0.10	SCG 0.06	MCG -0.16	LCV -0.14	SCV -0.21	60/40 -0.01	LCV -0.69	60/40 -0.02	LCG -0.16	SCV -0.38	60/40 0.25	HYB 0.44
	EM -0.62	RE 0.78	60/40 0.49	HYB 0.09	IBD -0.27	LCG -0.50	60/40 0.46	SCV 0.11	HYB -0.18	60/40 -0.11	HYB 0.06	MCV -0.19	MCG -0.16	IEQ -0.23	LCG -0.03	LCG -1.02	EM -0.07	MCV -0.26	RE -0.61	LCV 0.23	LCG 0.08
	LCG -0.82	SCG 0.75	HYB 0.39	MCG -0.10	USB -0.42	IBD -0.51	RE 0.10	SCG 0.08	MCG -0.26	LCG -0.33	EM 0.00	RE -0.35	MCV -0.26	MCV -0.27	HYB -0.05	EM -1.06	HYB -0.10	MCG -0.30	LCG -1.00	HYB 0.11	USB -0.61
	MCG -1.01	IBD 0.39	IBD -0.32	LCG -0.11	RE -0.65	USB -0.54	USB 0.02	HYB 0.06	LCG -0.28	IBD -0.39	LCV -0.06	EM -0.41	EM -0.41	LCV -0.27	IBD -0.19	MCG -1.10	IEQ -0.29	LCV -0.31	MCG -1.18	USB 0.03	SCG -0.81
	SCV -1.23	HYB 0.21	USB -0.43	SCV -0.25	LCG -0.78	MCG -0.67	HYB -0.01	MCV 0.01	USB -0.60	EM -0.78	MCV -0.19	SCG -0.54	SCG -0.47	MCG -0.57	IEQ -0.26	SCV -1.21	USB -0.41	SCV -0.99	SCG -1.20	IBD -0.16	MCG -1.13
Low	SCG -1.72	USB 0.18	RE -0.63	SCG -0.48	MCG -1.28	RE -1.06	IBD -0.27	USB -0.16	RE -1.17	IEQ -0.89	SCV -0.73	SCV -0.67	SCV -0.53	LCG -0.77	SCG -0.29	SCG -1.82	IBD -1.10	SCG -1.23	EM -1.29	SCV -0.18	IBD -1.22

Legend

- 60/40 Allocation (60/40)
- Large Growth (LCG)
- Large Value (LCV)
- Mid Growth (MCG)
- Mid Value (MCV)
- Small Growth (SCG)
- Small Value (SCV)
- Intl Equity (IEQ)
- Emg Markets (EM)
- U.S. Bonds (USB)
- High Yield Bond (HYB)
- Intl Bonds (IBD)
- Real Estate (RE)

Source: Bloomberg. Asset-class performance is presented by using market returns from an exchange-traded fund (ETF) proxy that best represents its respective broad asset class. Returns shown are net of fund fees for and do not necessarily represent performance of specific mutual funds and/or exchange-traded funds recommended by the Prime Capital Investment Advisors. The performance of those funds may be substantially different than the performance of the broad asset classes and to proxy ETFs represented here. U.S. Bonds (iShares Core U.S. Aggregate Bond ETF); High-Yield Bond (iShares iBoxx $ High Yield Corporate Bond ETF); Intl Bonds (SPDR® Bloomberg Barclays International Corporate Bond ETF); Large Growth (iShares Russell 1000 Growth ETF); Large Value (iShares Russell 1000 Value ETF); Mid Growth (iShares Russell Mid-Cap Growth ETF); Mid Value (iShares Russell Mid-Cap Value ETF); Small Growth (iShares Russell 2000 Growth ETF); Small Value (iShares Russell 2000 Value ETF); Intl Equity (iShares MSCI EAFE ETF); Emg Markets (iShares MSCI Emerging Markets ETF); and Real Estate (iShares U.S. Real Estate ETF). The return displayed as "Allocation" is a weighted average of the ETF proxies shown as represented by: 30% U.S. Bonds, 5% International Bonds, 5% High Yield Bonds, 10% Large Growth, 10% Large Value, 4% Mid Growth, 4% Mid Value, 2% Small Growth, 2% Small Value, 18% International Stock, 7% Emerging Markets, 3% Real Estate.

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