Capital Market Outlook

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QUICK VIEW

- Investor sentiments have shifted broadly from risk-seeking to defensive positions
- Market volatility has increased with fears of economic decline due to increased trade tensions and speculation of improper management of U.S. monetary policy
- Our view is that positive economic fundamentals will outweigh trade concerns in the long run. We will continue monitoring for signs of economic decline
- Current SRWM model portfolio allocations will remain unchanged; volatility will be closely observed to ensure protective strategies are implemented if downward market pressures are sustained

MARKET VOLATILITY

Recent, downward market momentum and high volatility have been comprised of two opposing forces. On one hand, federal rate cuts have improved access to borrowing for corporations and consumers, generally a positive catalyst in a tempered economy. On the other hand, trade tensions with China have stoked fear in global investors of weakening of the U.S. dollar, motivating shifts from the equity markets into the safety of bonds and commodities.

The underpinning of the negative global response to U.S. federal rate cuts indicate the market's disagreement with the suitability of such action. Many believe that rate increases from 2015-2018 overshot the necessary level of government intervention needed to keep with inflation, and recent rate cuts are intended to compensate for those overzealous adjustments during that span. Now, positive economic indicators and record low unemployment rates point to a healthy financial system without real need for a change in monetary policy. This dichotomy, along with critical commentary from the President regarding the work of the Federal Reserve, has increased fears of unnecessary weakening of the dollar and unsustainable economic growth in this historic bull run.

Additionally, the trade pact between the U.S. and China ended abruptly with the August 1 announcement from President Trump that the U.S. was planning a 10% tariff on $300+ billion of Chinese imports beginning September 1. The tariffs, if implemented, will target consumer goods for the first time, and has the possibility to further worsen the U.S.-China trade war. In response, China allowed for the yuan/U.S. dollar translation rate to drop below CNY7.00 first time in over a decade, a move that could escalate currency devaluations and worsen positions in negotiation between the two parties. The Chinese government has also ordered state-owned companies to suspend the import of U.S. agricultural goods.

INVESTOR SENTIMENTS

The short-term effects of the recent jump in trade volatility could potentially include: declining global government yields; lower inflation expectations and commodity prices; weakened business confidence and investment levels; and a general decrease in investors' appetite for risk. Escalating U.S.-China trade tensions have been accompanied by sharp market selloffs in the past, followed by market recoveries due to countercyclical forces (e.g., easy monetary policies) and a de-escalation of trade tensions as the negative effects become more painful to both parties. Investors must stay diligent in monitoring trade-related market volatility but not lose sight of positive fundamentals: strong U.S. GDP growth; low U.S. unemployment rates; global central bank easing; and fairly-priced U.S. equities.

PORTFOLIO IMPLICATIONS

Our portfolio weighting will remain unchanged in the short term, with the possibility of greater allocation in safer asset classes in the long run assuming sustained market volatility. Equity exposure in our growth models will continue to outweigh fixed income, and we will assess the need for protective strategies daily going forward. There is increased interest in emerging markets due to expected, long-term growth opportunities, but exposures will remain low while heightened uncertainty exists in current global market health. Cash positions may also be increased, as needed, to dampen sharp swings in daily market returns. This will create added flexibility for opportunistic equity investment within each of our growth portfolio strategies.

INDEX DEFINITIONS

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

Russell 3000 Index is a market value-weighted index that tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities.

Dow Jones Industrial Average is a price-weighted index that indicates the value of 30 large, publicly owned companies based in the United States.

NASDAQ Composite is a stock market index comprised of the companies listed on the NASDAQ stock exchanged. It is typically used as a proxy for the relative market performance of information technology companies.

GLOSSARY

Monetary policy consists of management of money supply and interest rates, aimed at achieving macroeconomic objectives such as controlling inflation, consumption, growth, and liquidity.