SIERRA RIDGE WEALTH MANAGEMENT

1435 River Park Drive, Suite 504
Sacramento, CA 95815
Office: 916-891-2557
Fax: 916-891-5907
sierraridgewealth.com

# Capital Market Outlook

10/18/2019

## MARKET NEWS

### QUICK VIEW

- September saw the first quantified data hinting at global economic slowdown, but investors still optimistic as key growth rates in retail sales and manufacturing still at record highs
- Trade negotiations have led to partial agreements regarding both Brexit and the US:China war, respectively. News added to investor confidence across all sectors, but concrete outcomes will certainly come with steeper reactions
- Q3 Earnings season began last week - look for increased trading volume and volatility as investors look to capitalize on earnings surprises
- SRWM now offers model portfolios for clients seeking tax-advantaged or income-focused investments

### U.S. RETAIL SALES

Retail sales fell in September for the first time in seven months, but the result on capital markets was not as dire as it could have been. On one hand, the news of declining sales growth briefly but drastically surged volatility across all sectors. On the other hand, investor confidence was quickly restored with news from the auto industry that drove positive expectations for overall sales growth in the coming months. Sure, great news for investors, but why has optimism on consumer spending continued to buoy the U.S. economy through recent economic uncertainty? Here, we will explore one mechanism that illustrates how the average spender keeps the American economic machine moving forward when other fundamental drivers of production are operating below their full capacity.

While there are many constraints that contribute to the health of our economy, we can simplify our understanding of these relationships by looking at *the Income Method* of assessing Gross Domestic Product (GDP). The equality reads:

$$Agg.Output = Consumption + Savings + Taxes$$

Here, *consumption* measures business income generated by consumer spending, *savings* represents income retained by households after expenses, and *taxes* represents government revenues. The total of these three items assesses the gross income realized by all households and businesses in a nation within a given time period.

To see how this equation applies to investor sentiments in the real-world, we must first examine our interest rate environment to develop expectations for consumerism in the near future. Today, we are seeing historic lows for interest rates in the U.S. as well as continuing pressures for those rates to drop even lower by the end of the year. This will lead to increasingly easier access to borrowed funds for households and, therefore, higher disposable incomes for them to spend at their own discretion. Looking back to our GDP relationship, and holding taxes constant, we see that a decrease in household savings should theoretically be offset by an increase in business revenue (represented by *consumption*), leading to a net neutral effect on the economy's output. Basically, assuming all else is equal, these two factors can be manipulated through the Fed's fiscal policy without directly impacting the growth of the economy.

Why do it then? The idea is that lowered interest rates also mean cheaper borrowing for businesses, so an increase in consumer spending (*consumption*) may encourage businesses to invest in their own growth, eventually leading to more jobs and growth in employee wages (*savings*). If these efforts succeed, overall economic output will rise. Conversely, if businesses do not realize the growth as expected, their demand for workers may decrease and wages may start to wane, which certainly decreases consumption. In this scenario, low interest rates are hurting investors, business and households – all negatives for the overall economy.

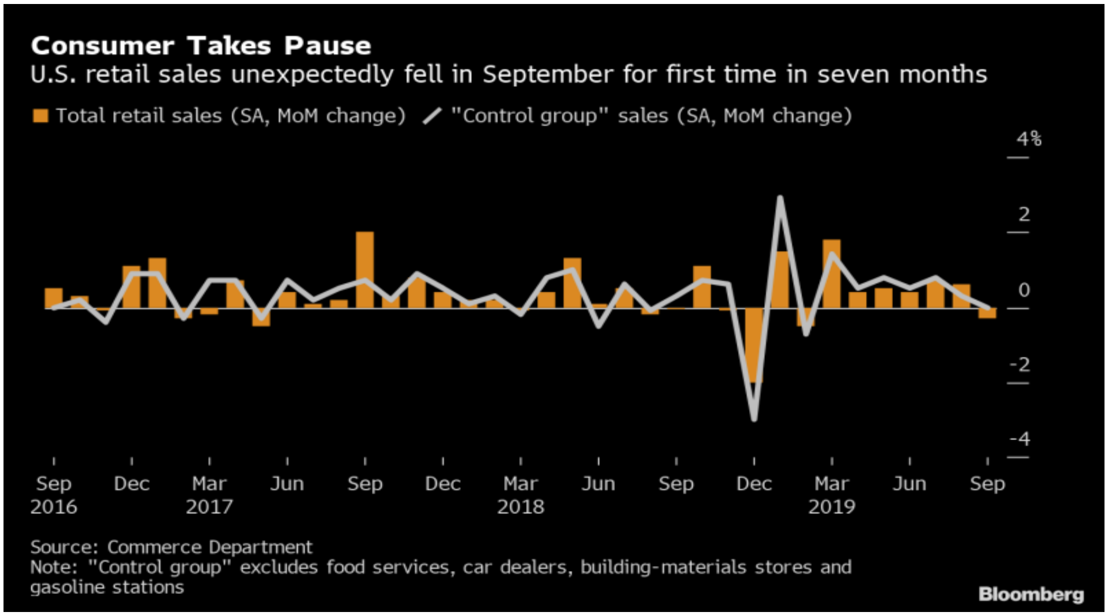


*Exhibit 1 – September Drop in U.S. retail sales*

Essentially, businesses need consumers just as consumers need businesses. Proper tradeoffs in economic resources between the two can lead to overall economic prosperity, but economic reports showing shortcomings on either side of this relationship can lead to doubt in future economic forecasts. For now, the outlook is positive, but knowing this method for gauging the strength of the economy will surely be invaluable as we encounter further action by the Fed through the end of the year.

## MARKET INDEX PERFORMANCE

As of 10/15/2019

| | Total Return % | | |
|---|---|---|---|
| INDEX | WTD | MTD | YTD |
| Dow Jones Industrial Average | 0.9 | -0.3 | 17.1 |
| S&P 500 Index | 0.7 | -0.1 | 20.4 |
| NASDAQ | 0.9 | 0.7 | 22.5 |
| MSCI EAFE | 2.3 | 0.4 | 13.3 |
| MSCI Emerging Markets | 1.5 | 1.1 | 7.1 |

## 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.

## GLOSSARY

**Benchmark Rates** are globally-accepted reference rates used to determine the values of various classes of financial instruments traded worldwide. A famous example is LIBOR (the London InterBank Offered Rate) which is the agreed cost at which major global banks can borrow funds from one another.

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

**Fiscal Policy** is the means by which a government adjusts its spending levels and tax rates to regulate a nation's economy.

**Money Market** is the market for securities with short-term maturities. Times to maturity range from overnight to a maximum of one year. Anything with a longer time to maturity is considered part of the capital markets.