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Investment Review & Outlook
2019 Second Quarter Market Report

If we could simply stop the year at this point, the gains would be unusually high for a typical *12-month* period; for six months, they are extraordinary. Perhaps we should celebrate cautiously.

How to make sense out of the recent market behavior? We experienced a painful decline in the last month of 2018 before the markets took a sharp (and unexpected) about-face and delivered the biggest one-quarter gain since the third quarter of 2009. The surprise upward trend has continued through the second quarter, albeit with more modest gains, despite what would normally be considered warning signs in the economy, the global trade markets and corporate earnings.

The S&P 500 Index of large company stocks was up 3.79% in the second three months of the year, and is up 17.35% in the first half of 2019.

The Russell 2000 Small-Cap Index gained 16.98% in the year's first six months.

International investors are also sitting on gains. The broad-based EAFE Index of companies in developed foreign economies gained 2.50% in the second quarter, and is up 11.77% so far this year. Emerging market stocks of less developed countries, as represented by the EAFE EM Index, lost 0.31% in dollar terms in the second quarter, but the index is still up 9.22% for the year.

The bond markets continue the long stretch of low-yield environment, coupled with either a flat or inverted yield curve, depending on where you look. Coupon rates on 10-year Treasury bonds have dropped to 2.01%, while 6-month bonds are now yielding a higher 2.09%. Five-year municipal bonds are yielding, on average, 1.34%, down from 1.89% last quarter, while 30-year muni yields have fallen to 2.40% on average.

What's going on? It's tempting to think that the bull market is running out of steam, in part due to the fact that it's not easy to see how valuations can go much higher. The price-to-earnings ratio of the S&P 500 Index--a popular way of valuing stocks--is 21.83 on a trailing basis, compared with a 10-year average of 17.87, and a long-term historical mean of 15.75. At the same time, a popular haven for retreat from the markets--gold--is also above its historical value; the precious metal is not far from its highest level in six years, at $1,413 an ounce.

Bonds are not attractive investments at the 2% range for Treasuries, especially when your yield on six-month issues is higher than if you take the risk of investing over ten years.

Moreover, there is growing uneasiness about a global slowdown in economic activity, and trade wars and the threat of trade wars are not likely to boost the global economy, even if the recently-announced detente between the U.S. and China holds. Sluggish profit and economic growth are not normally a recipe for higher stock prices.

You might imagine that a strong first half of the year would normally be followed by an easing back or even a drop in value over the second half, but that hasn't necessarily been the case historically. In years in which the U.S. market rose in the first half of the year, the odds of a positive second half, based on the historical record, are 72%. That certainly doesn't guarantee anything, but it does suggest that market movements tend to be much harder to predict than one might imagine.

All of us were surprised at the roaring start to 2019 considering the downturns at the end of 2018. We can expect to be surprised again, either on the upside or the downside, in the second half of this year.

The FAM Team