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A Registered Investment Advisor

Investment Review & Outlook
2019 Third Quarter Market Report

The latest three month returns in the U.S. and international stock markets can be viewed with two very different attitudes. The first is that many indices (though not all) produced a loss for the quarter, and where there were gains, they tended to be very small. On the other hand, the losses, where they occurred, were too small to wipe out the gains of the previous two quarters, meaning that most investors have still made money so far this year.

Whether that will continue is anyone’s guess, but in today’s uncertain political and economic environment, it’s easy to feel like we all managed to dodge a bullet and are holding onto our gains with gratitude.

The third quarter saw small gains in the broadest market indices. The widely-quoted S&P 500 Index of large company stocks was up 1.19% in the third quarter, and is up 18.74% for the year.

The Russell 2000 Small-Cap Index lost ground, and is now up 14.18% the year's first nine months. The technology-heavy Nasdaq Composite Index lost 0.83% in the prior quarter, but is still up 19.66% for the year.

International investors are still hanging onto gains after a difficult quarter. The broad-based EAFE Index of companies in developed foreign economies lost 1.71% in the third quarter, but remains up 9.85% so far this year. In aggregate, European stocks are up 10.66% in 2019, while EAFE’s Far East Index has so far gained 7.53%. Emerging market stocks of less developed countries, as represented by the EAFE EM Index, lost 5.11% in dollar terms in the third quarter, but the index is still up 3.65% for the year.

Many people thought bond rates had reached rock bottom last quarter, and that the inversion of yields could not continue, but they were wrong on both counts. Coupon rates on 10-year Treasury bonds have fallen to 1.69%, while 6-month bonds are now yielding a higher (but still meager) 1.78%. Five-year municipal bonds are yielding, on average, 1.28%, down from 1.34% last quarter, while 30-year muni yields have fallen to 2.11% on average.

Where will the markets go from here? Of course, nobody knows with any certainty, but that doesn’t stop us from reading the tea leaves. There appears to be great uncertainty among investors about the Trump impeachment hearings, China trade tensions, drone strikes in Saudi Arabia and a messy “Brexit” across the pond. U.S. economic growth has cooled to a 2% annualized rate, and we are experiencing the first contraction in manufacturing in three and a half years. Exports have also been weak—a casualty of the China trade war.

At the same time, we are also experiencing the strongest labor market in several decades, with the pace of layoffs and the unemployment rate near a 50-year low. And consumer spending has been extremely strong, rising an estimated 4.6% year over year. Adjusted pretax corporate profits were up 3.8% in the second quarter (the most recent period for which we have statistics). Economists are hardly in consensus, but many predict that the economy will continue growing to the end of the year at least.

There must have been many times when the soothsayers in China looked at the tea leaves and didn’t see a clear pattern—though it is uncertain whether they then made up a plausible story for the Emperor. We aren’t inclined to try to make up a story here; the future of the markets is uncertain at the moment, with no reason to panic, and no reason to be surprised if a bear market were to start tomorrow. History has shown that bull markets tend to be longer and steeper than bear markets, which means that holding on tight in choppy times tends to be the winning strategy.

The FAM Team