**OCTOBER 2019**

# Third Quarter Commentary

***The second quarter of the year saw the return of volatility to global security markets, caused by an escalating trade war between the world's two largest economies and simmering geopolitical concerns, offset by a pivot in global central bank policy to a more accommodative stance in order to stabilize the global economy. As U.S. interest rates rallied on global growth concerns, risk assets thrived, driven by explicit support from global central banks. While the S&P 500 recorded an all-time high at the end of the quarter, 10-year interest rates reached lows not seen since before the 2016 election.***

***Many of the influences that drove volatility in the second quarter remained unresolved not only as we entered July, but as we progressed through the third quarter of this year. However, the magnitude of the reaction in global markets, which seemed hypersensitive to every Presidential tweet related to trade with China and how its effect would potentially drive the Fed toward increasingly dovish policy and further rate cuts, grew. This increased volatility was evident in global securities markets as the S&P 500 again recorded an all-time high in the quarter while ten-year U.S. Treasury rates declined thirty-four basis points to end the quarter at 1.67%. Given the further decline in interest rates, the Bloomberg Barclays U.S. Aggregate Bond Index returned 2.27% for the quarter, bringing year to date total return to 8.52%.***

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## Volatility – increasing velocity

Investors began the quarter aware of the continued deceleration in global growth driven by ongoing uncertainty surrounding global trade and heightened geopolitical risks but found comfort in assertive actions and commentary from global central banks. The appointment of former IMF head Christine Lagarde to lead the European Central Bank - as well as Chris Waller and Judy Shelton to the Fed Board - signaled an increasingly dovish posture from global central banks. Strong payroll and employment numbers coupled with better than expected corporate earnings signaled economic strength and seemed to overwhelm worrisome geopolitical factors, including the seizing of a foreign oil tanker by Iran and further turmoil surrounding BREXIT in the U.K. This relative stability resulted in the 10-year U.S. Treasury yield staying range-bound between 1.95% - 2.13% and finishing the month one basis point higher than where it started.

The tranquility was short-lived as markets were negatively impacted by a flare-up in trade war rhetoric, geopolitical tensions, and the first sign of the trade war flowing into the U.S. economy. On August 1st, President Trump announced a 10% tariff on $300 billion worth of Chinese goods that, at the time, were not subject to U.S. tariffs. Mid-month, the prospect of military intervention in the form of the mainland Chinese Army pushing into Hong Kong to quell protests further pressured securities markets. Lastly, to end the month, ISM Manufacturing came in at 49.1, the first recessionary reading (< 50) since August 2016. The metric signaled that the impact of the trade war – both the financial impact of tariffs on goods and services flowing into/out of the country and the slowdown in business investment given the uncertain operating environment – was now flowing through to the U.S. economy. Volatility increased precipitously during the month, with rates moving in excess of five basis points on ten of twenty-two days and more than ten basis points four times (out of five in the quarter) while equity markets moved more than 1.0% on eleven days. Overall, equity markets registered a 1.8% loss in the month while the 10-year U.S. Treasury yield fell 52 basis points to 1.50%. This reflects a 25.6% monthly decline in yield, the second largest rate decline in the last forty years, trailing only November 2008 (start of Great Financial Crisis), and is in distinct contrast with the S&P 500 which is off to its best nine-month year-to-date performance since 1995.

Volatility further accelerated in September with the 10-year falling to 1.46% on September 3rd, its lowest mark since July 2016, before rising as high as 1.90% and closing the quarter at 1.67%. Rates rose ahead of the mid-month Fed rate decision before falling off after the announcement of an official impeachment investigation centered on President Trump's call with the Ukrainian President.

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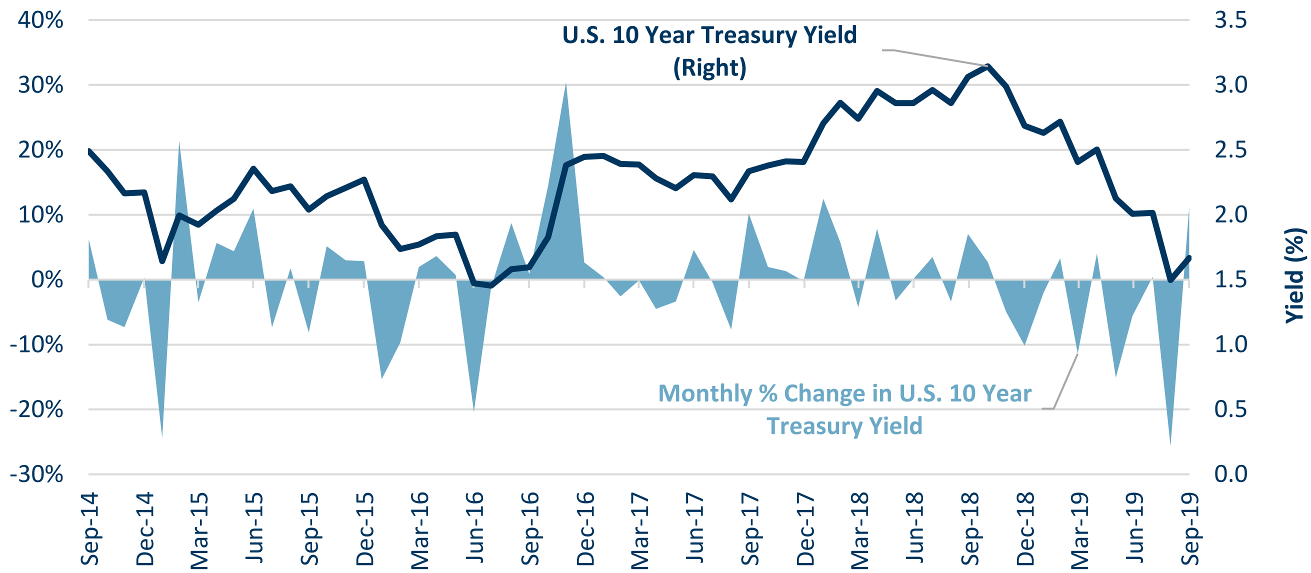
**Exhibit 1**: Volatility returned to interest rates during 2019, with the 10 year U.S. Treasury falling to levels not seen since the since the summer of 2016.




Source: Bloomberg

**U.S. growth remains on trend**

Apart from ISM Manufacturing, economic metrics remain in expansionary territory, albeit at a slower pace. U.S. GDP undershot expectations in the second quarter, coming in at 2.0% after expanding 3.1% in the first quarter. Consensus estimates have U.S. GDP moderating to 2.3% for full year 2019. Continued economic growth is supported by strong labor markets, with unemployment well below 4%, and inflation running slightly below long-term objectives. Lastly, corporate fundamentals remain supportive of the current expansion, with earnings again surprising to the upside in Q2 and lower-rated BBB issuers focused on continued balance sheet strengthening.

***The risk of a recession is always present, it is the timing that is less certain and difficult to predict. As global central banks reverse course and shift to more accommodative policies, the economic backdrop should benefit, resulting in stabilized growth rates and sustained investor confidence. However, with valuations across the capital markets close to all-time highs and potential risks mounting, investing in this environment continues to warrant caution. When allocating and investing in our portfolios, we are keeping this backdrop in mind in an effort to minimize the volatility within the portfolios while maintaining a focus on fundamental financial strength, capital preservation and liquidity. This stance also creates the ability to capitalize on opportunities if they present themselves.***

## IMPORTANT INFORMATION