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Third Quarter 2019 Market Summary

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Third Quarter 2019 Market Summary

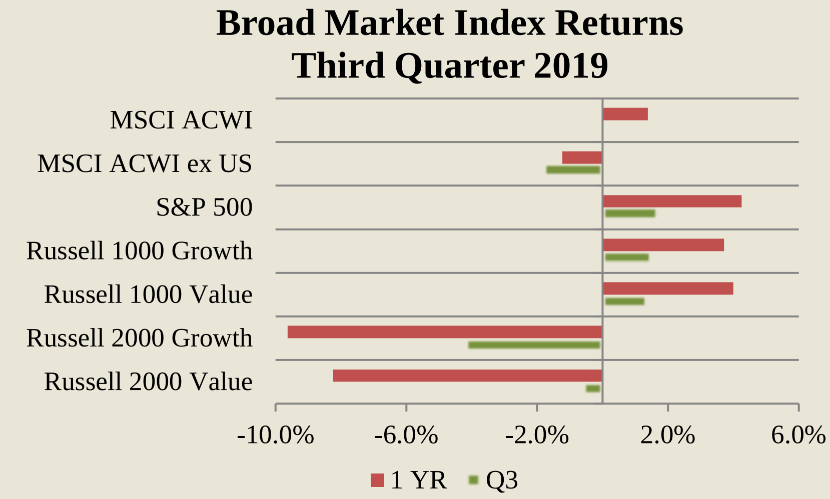
When investors create their long-term investment plan, ideally they should rely on hard data and a time-tested financial philosophy to help them make decisions. The day-to-day seesaw of the stock market should be set aside in favor of a measured, rational plan designed to weather any obstacle ahead. On paper, the map is easy to understand, and seems even easier to follow. But in reality, any personal financial odyssey will be beset with sirens on the road calling to lead the investor astray.

The highly-eventful third quarter was no exception. You may have seen the talking heads or heard the squawk box blaring about global trade, recession probabilities, or the impact of fiscal deficits and negative interest rates. It may feel like volatility has picked up. For entertainment, the media highlights the equity market's gyrations in part because it elicits jubilation and anguish. A simple long-term disciplined plan does not sell a lot of papers.

When bombarded with this cacophony of information, you may be wondering how these items affect you, either in the short-term or over the long-term. In times like this, it is essential to maintain perspective and not get pulled down the rabbit hole. Short-term events are bumps in the road when compared to the overall scope of an investor's financial journey. The 24-hour news cycle may have you believe that recent economic and political events have led to more volatile markets, whereas long-term data tells a less salacious, less marketable story. Market volatility for much of 2016-2017 was historically low, so an uptick, as we have seen recently, feels mountainous, even though volatility has simply returned to long-term averages.

The market narrative and returns experienced in the third quarter were a continuation of what has occurred over the past few years, oscillating between risk appetites. Despite declining manufacturing data, U.S. large company stocks, represented by the S&P 500 Index, are near all-time highs and were up 1.7% during the third quarter of 2019. Other areas of the equity market have not performed as well. U.S. small company stocks, represented by the Russell 2000 Index, had negative returns of 2.4% during the quarter and are down 8.9% over the past year. Deteriorating global trade has been a bigger drag on international stocks, represented by the MSCI ACWI ex US Index, which were down 1.8% during the quarter.

For the quarter, the Bloomberg Barclays U.S. Aggregate Bond Index, which represents a broad basket of bonds, was up 2.3%. Bond returns over the past year have been very strong as interest rates have continued to decline. The Fed lowered the federal funds rate in July and September, which were the first interest rate cuts since 2008. As geopolitical uncertainty continues to negatively impact global economies, many investors feel the Fed will continue to lower rates in concert with other central banks and provide a backstop for risk assets. However, the Fed has been reluctant to firmly outline future monetary easing.



Every plan seems perfect until it is challenged, and it can be hard to keep steady footing when the news of the day seems to demand immediate action. To stay grounded, it is important to remember that prudent investment strategies typically include portfolios with some combination of both bonds and stocks (i.e. a balanced portfolio). As such, these portfolios will not experience the full drama of the stock market due to the "ballast" provided by bonds. A balanced portfolio, though effective in meeting investors' goals, comes with its own trials – mainly behavioral. Due to its "slow and steady" approach, a balanced portfolio may leave investors wanting more in a bullish market. In the table below, however, you will see that investor mindsets change as quickly as the markets do, and over time, a blend of both stocks and bonds has provided favorable investment returns.

Third Quarter 2019 Market Summary (continued)

Years	Global Stocks	Global Bonds	Global Balanced (60% stocks/ 40% bonds)	Investor Mindset
2000-2002	-41.1%	22.1%	-20.1%	“Why do I own stocks?”
2003-2007	136.4%	37.1%	91.6%	“Why do I own bonds?”
2008	-42.3%	4.8%	-24.7%	“Why do I own stocks?”
2009-2017	181.8%	29.4%	110.5%	“Why do I own bonds?”
2018-2019	4.2%	5.1%	4.8%	“Why do I own stocks?”
Cumulative Returns	135.9%	138.4%	154.0%	
Growth of $100k	$235,846	$238,435	$254,003	

*Global Stock: MSCI ACWI IMI NR, Global Bonds: BBgBarc Global Agg TR, Global Balanced is rebalanced semi-annually from 2000-2019

Maintaining perspective on the short-term environment vs. a long-term plan can be difficult. Oftentimes people feel compelled to veer off the path in search of greener pastures or out of the perceived need for action. Discontentment with current investments can lead to forsaking the long-term quest in favor of chasing past performance, the next hot trend or seeking fallacious safety. Often times the new path is not appropriate for meeting the investor’s goals, and doing nothing at all would have yielded better results. At SilverOak, we are always assessing the broader opportunities available to investors. While there are many ways to construct a portfolio that could meet an investor’s goals, we focus on a core set of values that we require in investment strategies – low fees, low taxes, and transparency.

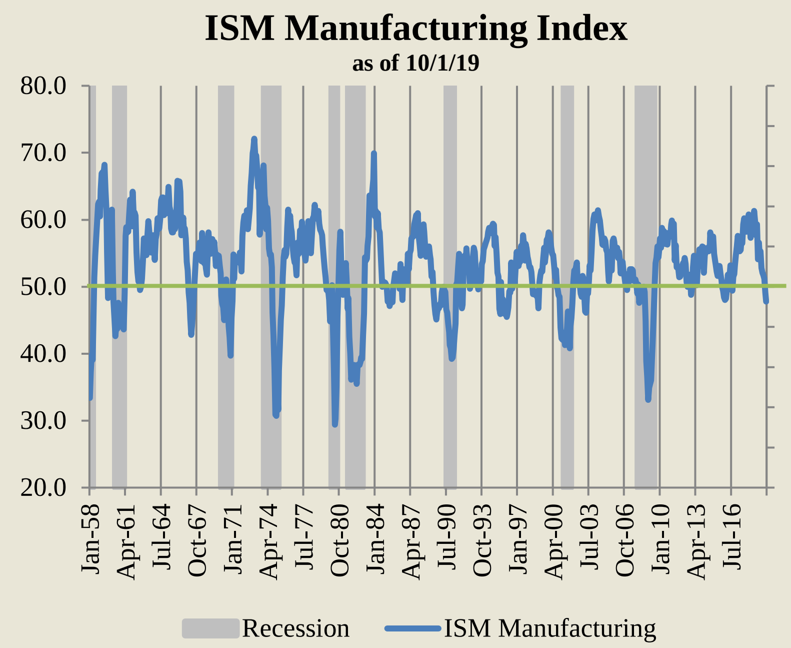
Periods of volatility are inevitable over the course of an investment journey; however, they tend to be short-lived. Over the next year, we expect to hear more recession talk, political noise and monetary policy that ventures into parts unknown. Nonetheless, if the path becomes lost or uncertain, SilverOak can help guide you through it. Investing is often uncomfortable, thus it is important to maintain perspective and balance emotional impulses with a sound investment plan to meet long-term goals.

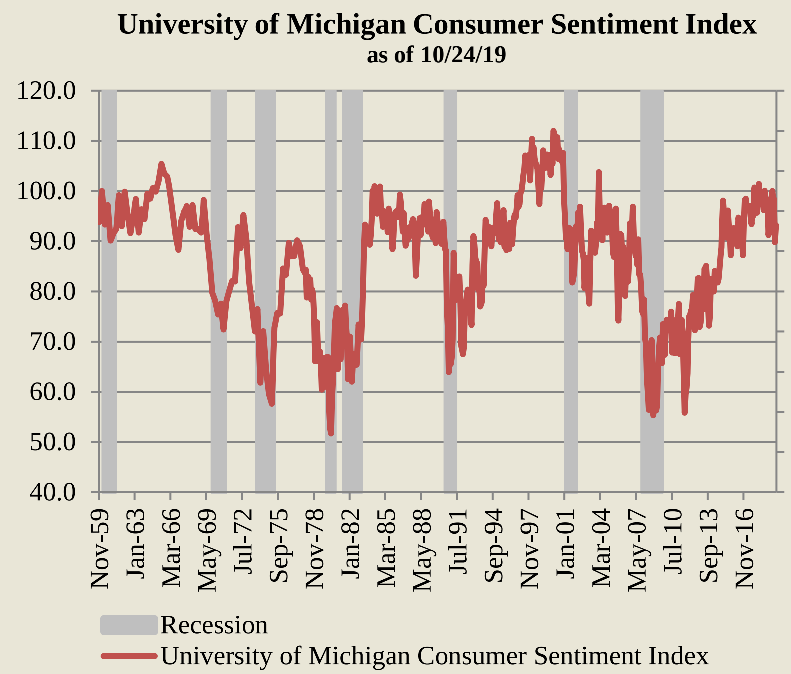
MACROECONOMICS

- The Bureau of Economic Analysis released the advanced estimate of third quarter 2019 real GDP, an annual rate increase of 1.9% from the preceding quarter. There was noted weakness in business spending; however, the U.S. consumer showed strong growth.
- The ISM Manufacturing Index continued its trend lower during the quarter, finishing at 47.8 in September down from 51.7 in June. Manufacturing has weakened as U.S. trade negotiations continue to cause uncertainty. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- The ISM Non-Manufacturing Index also declined during the quarter, finishing at 52.6 in September which is the lowest reading since 2016.
- In September, the Conference Board Leading Economic Index decreased 0.1% month-over-month to 111.9. The index, which is a composite of leading employment, housing, manufacturing, and market indicators, has remained relatively flat since September 2018. Historically, the index has declined prior to recessions.
- The price of WTI Crude Oil was $54.09 at the end of September, which is 7.1% lower than $58.20 at the end of June. The price of Brent Crude Oil ended the quarter at $60.99, which is 9.7% lower than at the end of June. There was a major distribution in Saudi Arabia's oil production in September; however, it did not have a long-term effect on prices.
- Inflation has remained stable. In September, headline CPI increased 1.7% year-over-year. Core CPI, which does not include food and energy, had a 2.4% increase.

CONFIDENCE METRICS

- The University of Michigan Consumer Sentiment Index final reading for September was 93.2. For the quarter, sentiment was a bit lower than the second quarter; however, it remains at very strong levels.
- The Conference Board's Consumer Confidence Index September reading was 126.3, down from 134.2 in August. Despite the decline, the index level indicates that consumers are optimistic about business and labor market conditions.



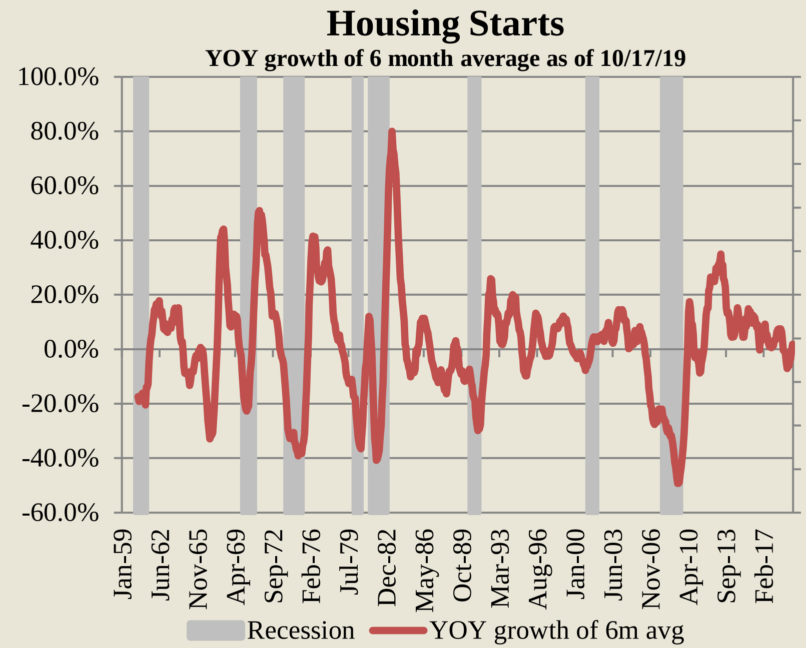


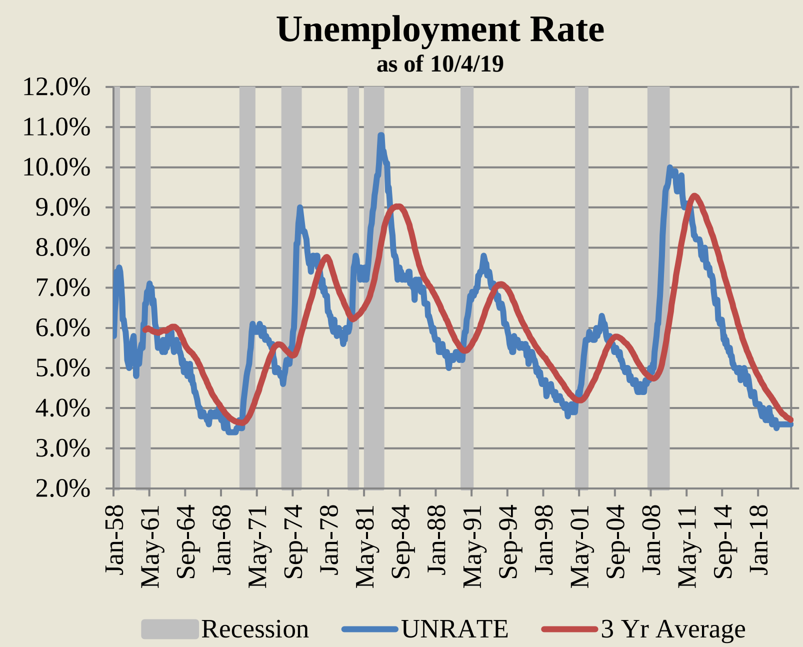
HOUSING

- The housing sector continues to soften but is generally positive. Home sales have stalled but home prices continue to rise.
- Preliminary existing home sales increased in the quarter with a monthly average annualized rate of 5.43 million units from 5.29 million units in the second quarter. Unsold home supply remains at low levels.
- The preliminary existing home sale prices for September were 5.9% higher than the levels of one year ago. Prices have been trending up since the beginning of 2012 and reached an all-time high in June.
- New home sales were generally positive during the quarter; however, they have plateaued at these levels since late 2017. It remains to be seen if housing demand gets a pick up from mortgage rates that have fallen over the past few quarters.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose over 2.1% year-over-year in August. Of the locations in the Index, home prices in San Francisco, Seattle, Phoenix, Las Vegas, and Denver have risen the most since 2011.
- Housing starts were slightly up during the quarter but have generally been flat over the past few years.

EMPLOYMENT

- The labor market has generally been healthy. The job growth rate has slowed, as employers are having difficulty finding workers with the required skills. Wage growth is the strongest it has been in a decade, which could lead to solid consumer spending. Despite a positive labor market, the trend in employment and earnings has shown signs of rolling over given the challenging manufacturing and global trade environment. Employment will be a key area to watch over the next few quarters.
- During the quarter, nonfarm payrolls averaged 157,000 jobs added per month.
- The unemployment rate reduced slightly to 3.5% during the quarter.
- Initial Jobless Claims had been decreasing since 2009 and dipped to lows last seen in 1969; however, claims have flattened over the past year. The low level of initial claims reflects a tight labor market.



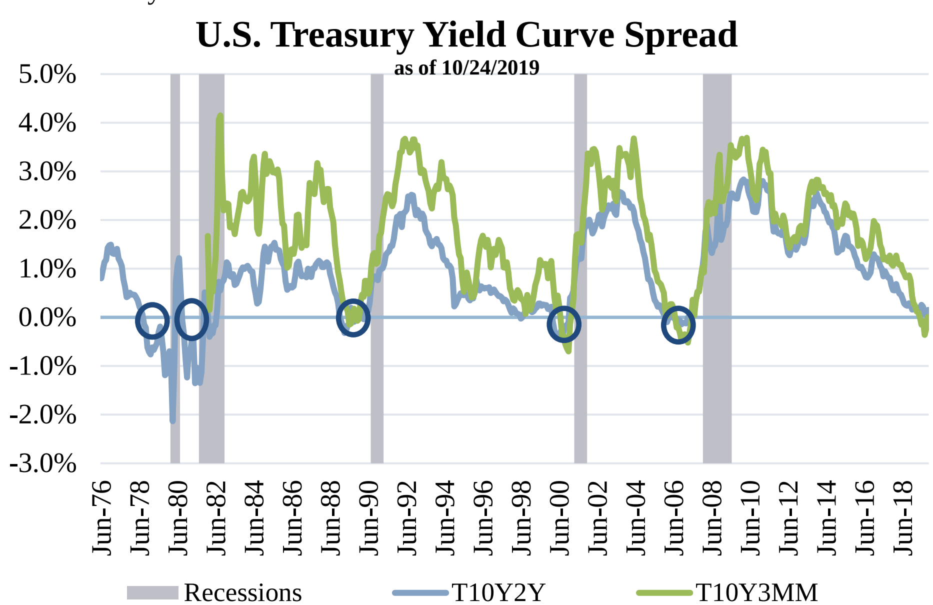


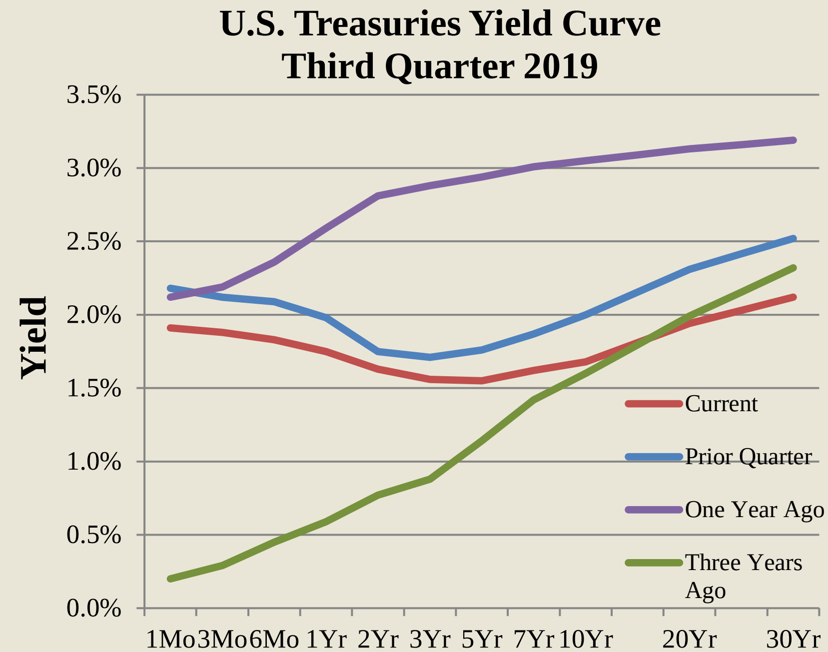
FED POLICY

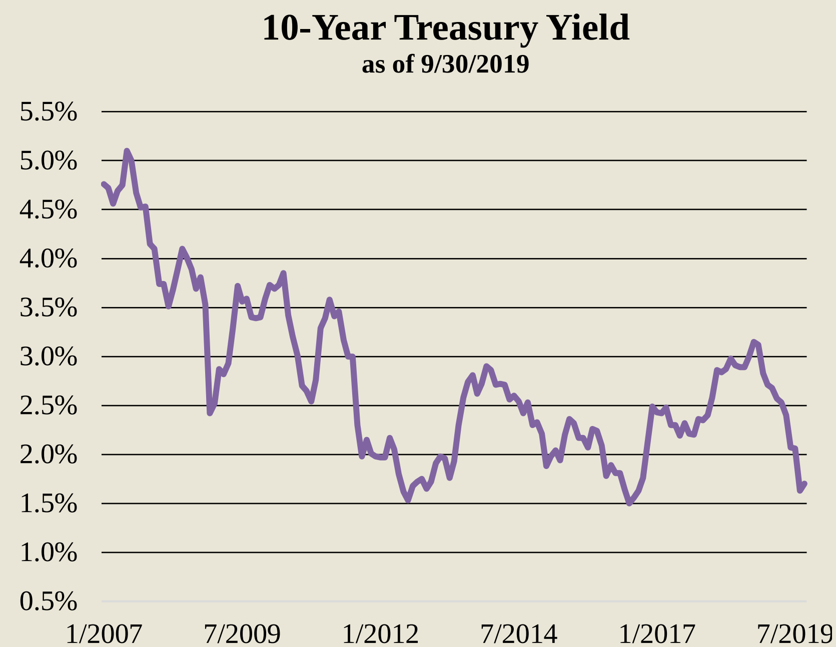
- The Federal Open Market Committee (FOMC) decided to lower the federal funds rate at a target range of 1.75% - 2.00% in their September meeting. The two rate cuts by the Fed in the third quarter were the first since 2008.
- The Fed cited growing global risks, a slowing U.S. economy and subdued inflation as reasons for their increased willingness to support the markets.
- In September, the Fed had to intervene and provide liquidity to the repurchase market, as overnight funding rates temporarily spiked.

FIXED INCOME

- During the third quarter, U.S. Treasury yields declined across the curve. The short to intermediate-term part of the curve remains inverted. The inversion is highlighting the market's view that the Fed will continue to cut rates over the next year.
- Short-term interest rates are controlled or heavily influenced by central banks, whereas long term interest rates are controlled by market forces and economic growth.
- U.S. interest rates will likely remain range bound for the foreseeable future as low economic growth, weak demographics and central banks will likely keep yields down. Despite limited expected returns, bonds still act as the ballast of a portfolio during times of volatility.



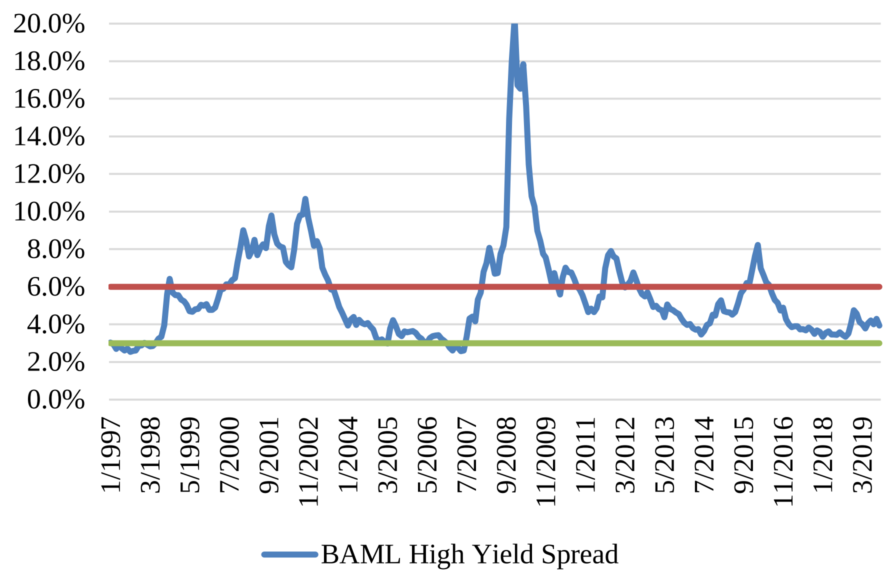




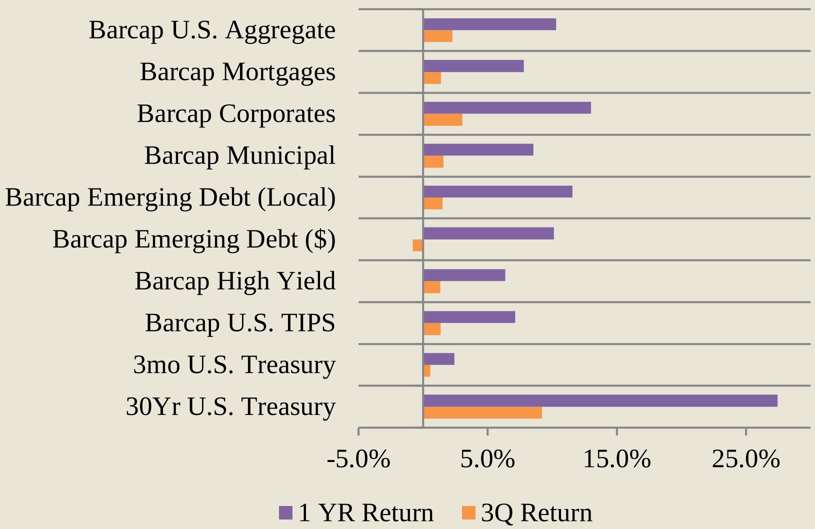
FIXED INCOME (continued)

- Fixed income returns have been impressive year-to-date. During the quarter, the Bloomberg Barclays U.S. Aggregate was up 2.3% as interest rates fell. Over the past year, the Bloomberg Barclays U.S. Aggregate is up 10.3%, which is "equity-like" returns.
- Credit spreads were generally flat during the quarter and remain low as investors continue to seek yield.
- Yields fell globally as well. Ten year German and Japanese bonds are trading at negative rates. Bonds trading with negative interest rates reached $17T during the quarter.
- Municipals continue to see above average demand while supply remains low; thus, technicals remain supportive.
- Despite investors' willingness to accept greater credit risk, fundamentals in the investment-grade corporate and high-yield sectors remain mixed. There is a high amount of leverage in the system and weakening underwriting; however, defaults remain low and corporate earnings remain strong.

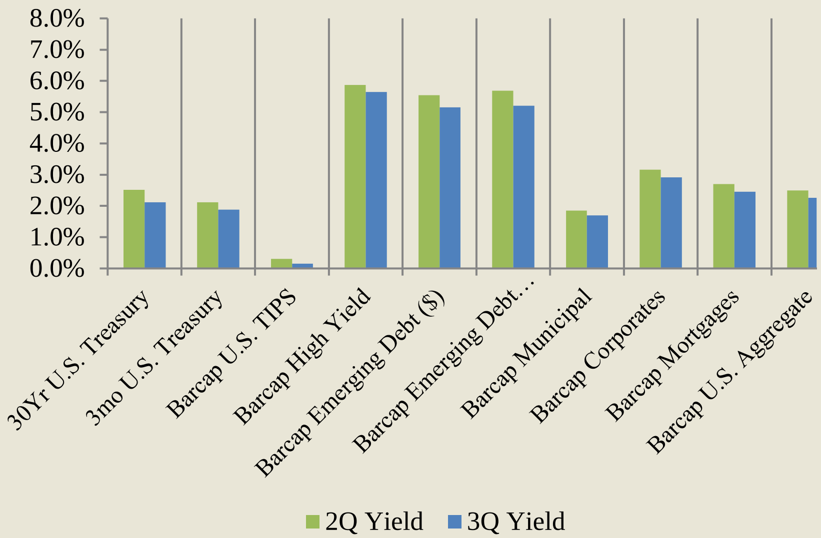
Credit Spreads - High Yield
as of 9/30/2019



Fixed Income Returns
Third Quarter 2019

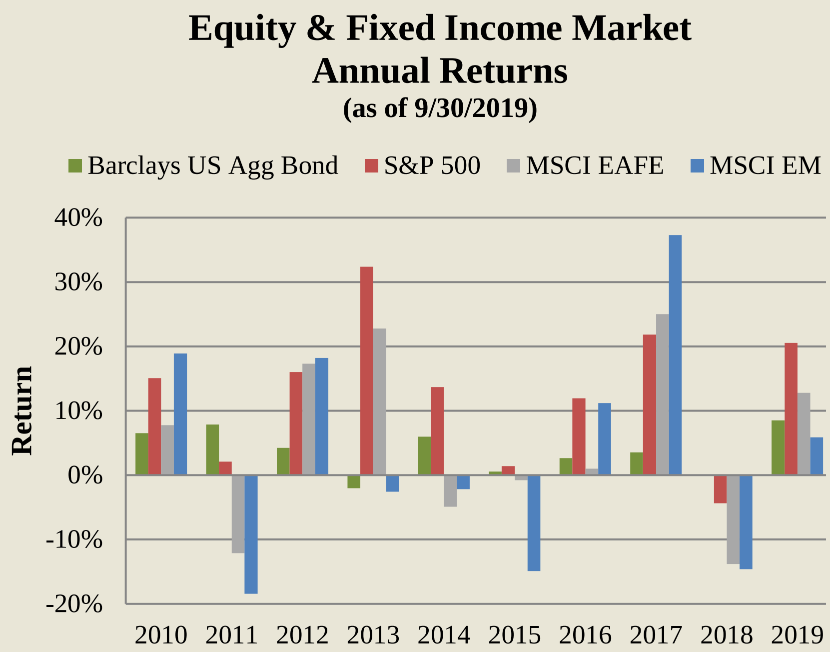


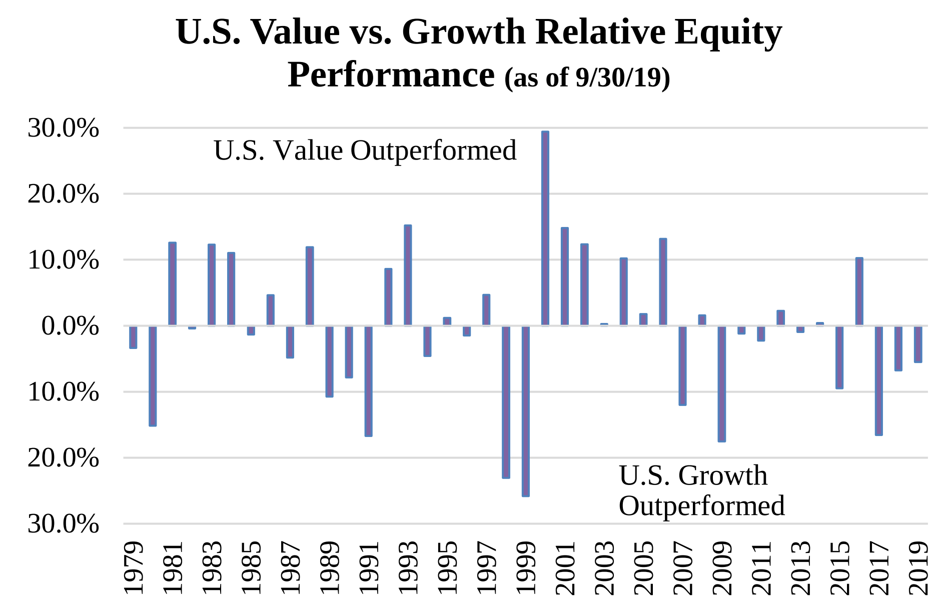
Fixed Income Yields
Third Quarter 2019



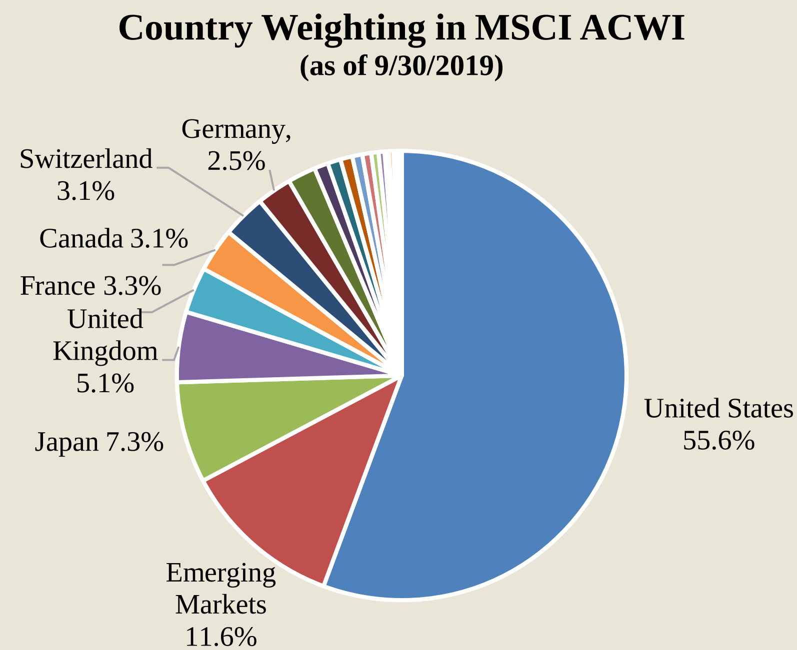
EQUITIES

- There appears to be diverging signals amongst the equity markets and fixed income markets. Equity markets, particularly in the U.S., seem to be more optimistic as evidenced by the S&P 500 ending the quarter near all-time highs while the fixed income markets saw interest rates fall amongst growth concerns.
- Trade was a dominant theme again in the quarter. Volatility picked up and interest rates fell, which caused less cyclically-oriented sectors to perform better.
- Dividend yields among global equity markets are currently higher than intermediate government bonds.
- Internationally, there was no shortage of geopolitical events such as Hong Kong protests, Brexit uncertainty, and increased Middle East tensions.
- A strong U.S. dollar continues to challenge international returns.





Russell 1000 Growth TR vs. Russell 1000 Value TR



DOMESTIC EQUITIES

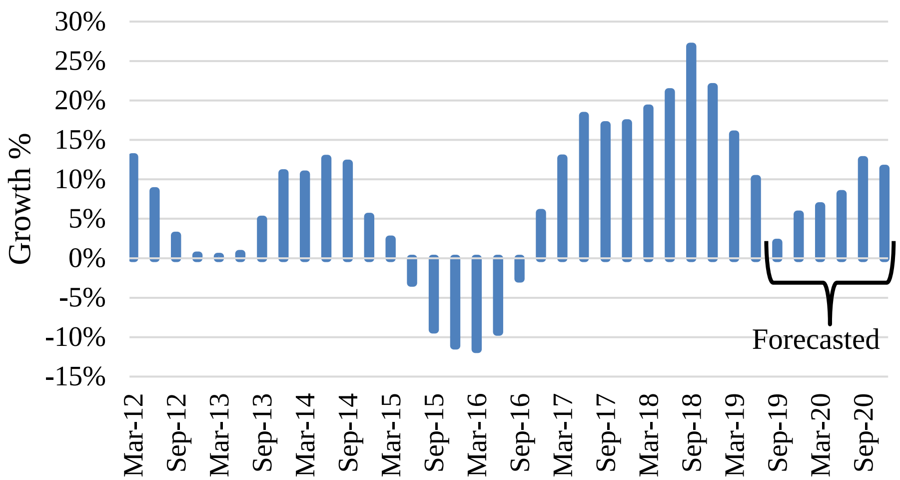
- The Russell 1000 Index, comprised of large and mid-capitalization stocks, posted a total return of 1.4% during the third quarter. On a year-over-year basis, the Russell 1000 Index has increased 3.9%.
- Small capitalization stocks, as represented by the Russell 2000 Index, declined 2.4% during the third quarter. On a year-over-year basis, the index has decreased 8.9%.
- Corporate operating earnings in the second quarter 2019 were higher than the previous year. Estimates for 2020 show double-digit EPS growth; however, forecasts continue to be lowered. Operating profit margins remain strong, though margins could be challenged by higher wages or the potential for higher corporate tax rates.
- U.S. equity forward P/E multiples and trailing P/E multiples are above historical averages.

Third Quarter 2019 Returns			
	Value	**Core**	**Growth**
Mega Cap		1.7%	
Large Cap	1.4%	1.4%	1.5%
Mid Cap	1.2%	0.5%	-0.7%
Small Cap	-0.6%	-2.4%	-4.2%
Micro Cap	-2.0%	-5.5%	-10.1%

S&P 500 Earnings Growth

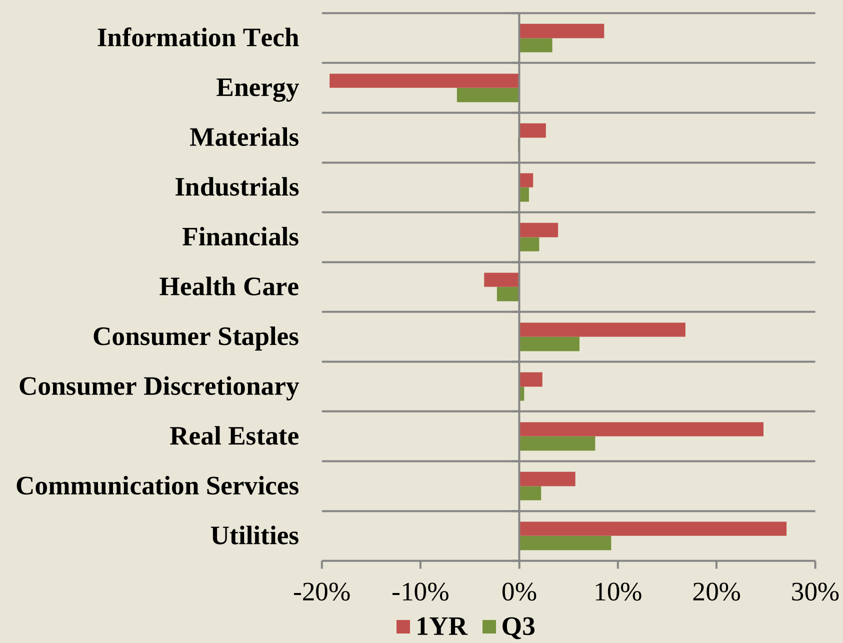
Trailing 12-Month Operating Earnings Growth YOY

(as of 10/17/2019)



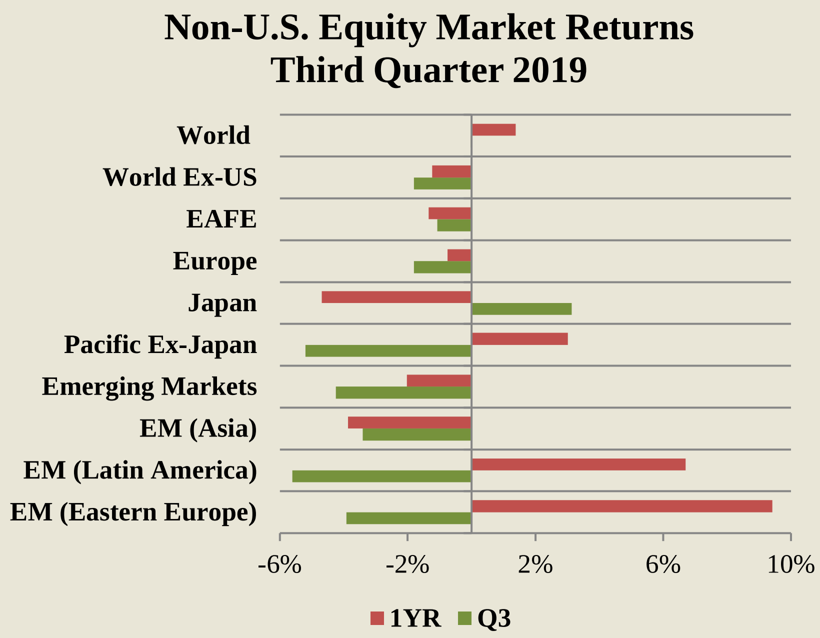
U.S. Equity Market Returns by Major Sector

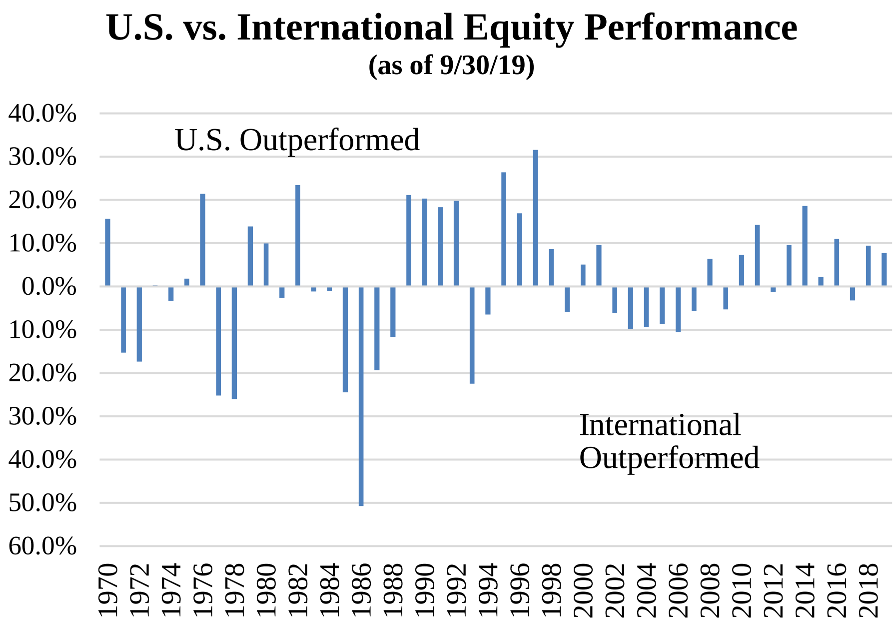
(Securities in S&P 500, Third Quarter 2019)



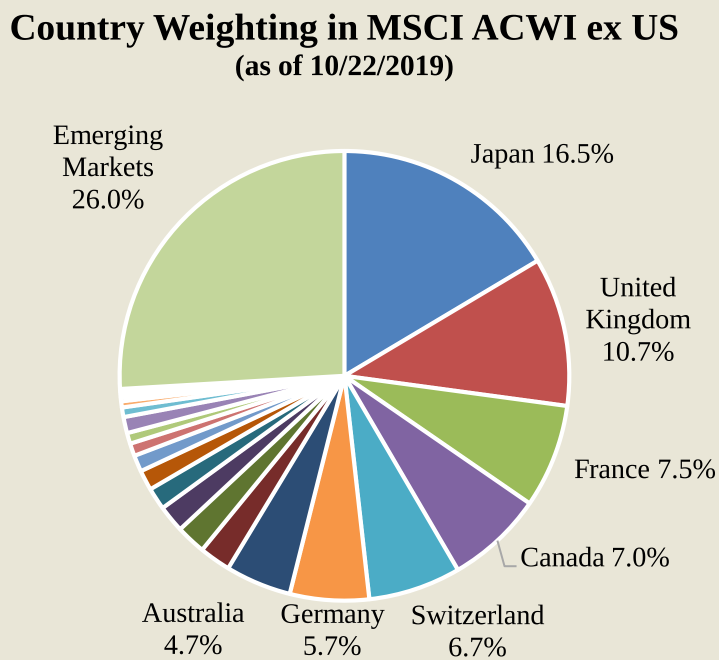
INTERNATIONAL EQUITIES

- Developed international stocks, as represented by the MSCI EAFE, were down 1.1% during the quarter. On a year-over-year basis, the EAFE is down 1.3%, performing worse than U.S. domestic equities.
- Emerging market stocks underperformed developed markets during the third quarter as the MSCI Emerging Markets Index decreased 4.3%.
- Global growth continues to weaken, especially in the manufacturing sectors as trade issues continue. This has disproportionately affected exporting countries like Germany, Japan and Korea. The European Central Bank restarted quantitative easing and changed certain policies in an effort to be more accommodative and to try and stimulate their economy.
- Emerging market corporate earnings estimates have come down considerably since the beginning of the year, thus creating a more manageable hurdle to overcome.





S&P 500 TR vs. MSCI EAFE NR



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Investment decisions should be made based on an investor's specific circumstances taking into account items such as, risk tolerance, time horizon and goals and objectives. All investments have some level of risk associated with them and past performance is no guarantee of future success.