ICR® 3rd Quarter Newsletter – October 2019

Global equity markets were mixed in the third quarter as investors tried to make sense of easing monetary policy against a backdrop of slowing global growth and trade tensions. The S&P 500 finished up 1.2% while small cap U.S. stocks fell by 2.8%. Foreign equities struggled in light of concerns over economic growth and decreased corporate profits. The MSCI EAFE index for developed foreign markets posted a loss of 1.7% in the third quarter while emerging markets lost 5.1%. The Federal Reserve cut its key interest rate twice in the quarter which supported risk assets and bonds. Bond proxies (sectors that benefit from lower interest rates) fared best, with utilities up 9.3% and real estate up 7.7%. Energy, meanwhile, was the biggest laggard among sectors, losing 6.3%. U.S. Core Bonds returned 2.3% for the quarter and have gained 8.5% year to date.

Interest rates continued to drop during the third quarter, with the 10-year Treasury yield going from 2.01% to 1.67% and briefly falling as low as 1.46%. After reaching a seven-year high of 3.25% in October of 2018, the ten-year yield has been in a free-fall ever since as growth prospects and inflation expectations have weakened. The European Central Bank (ECB) also cut rates further and will restart quantitative easing which had ended last year. Globally, about $15 trillion worth of debt – about a quarter of the total debt issued by governments and companies – now trades with a negative yield. So, on a relative basis, U.S. debt is actually high-yielding compared to other developed markets. For example, as of September 30, you could buy a German bond and lock in a negative 0.56% yield for the next ten years.

What We're Watching

In early September, we witnessed a pronounced reversal in equity market leadership from momentum to value. September 9 and 10 saw an unusual scenario where value stocks (+1.5%) and momentum stocks (-3.1%) headed in completely opposite directions. The prolonged outperformance of growth over value coupled with last month's dramatic reversal has market participants wondering if this is the beginning of the long-awaited shift from growth to value. This brief rotation may have been largely technical in nature, given the low exposure to risk assets of most investors at the time. However, style reversals similar to the one witnessed in September – from a starting point with similarly wide valuation spreads – have tended to persist. Perhaps this, along with the WeWork IPO failure, is a sign that investors are finally tired of purchasing companies with high sales growth but weak underlying earnings or cash flow.

Markets face a barrage of potentially negative catalysts: US/China trade war, the recent inversion of the yield curve, the ongoing Brexit debacle, and continued tensions with Iran. Also, House Speaker Nancy Pelosi announced a formal impeachment inquiry, based on President Trump's dealings with Ukraine.

Thus far, these geopolitical challenges have eroded confidence, stifled business investment, reduced trade, and caused what some are calling a global manufacturing recession. Looking at a wide range of leading economic indicators, it appears that the global economy continues to slow. (Chinese economic growth slowed to 6% in the third quarter – its lowest rate in almost 30 years.) However, consumers continue to support the services and housing sectors due to record lows in both

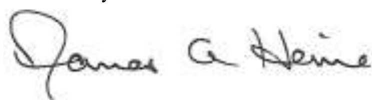
unemployment and interest rates. We are concerned that consumers may not continue to be immune to the synchronized slowdown that is occurring around them. We think central banks will continue providing monetary support, but with interest rates already low, policy makers may struggle to satisfy expectations.

Geopolitics are likely to keep volatility levels high in the near term. This is especially important given where we are in the economic cycle. We are now more than 10 years into the longest expansion on record. This does not mean a recession is imminent. It does, however, suggest prudence and thoughtful risk taking.

While we incorporate issues like trade-war uncertainty into our investment outlook, we don't try to predict the effects of every trade-related tweet. We view current trade tensions as part of what will be a long struggle between an enduring power – the U.S. – and a rising power – China. There will be many fits and starts along the way, and markets will continue to overreact in both directions as it comes to grips with the secular nature of this protracted conflict. We try to assess the likely long-term impact on the economy, monetary policy, and valuations.

Weighing all of these inputs, we continue to position our investment portfolios with a defensive tilt and a quality bias. We believe that by combining our prudent investment process with your patience and confidence we can help you achieve your long-term goals. We are grateful for your partnership, and we would enjoy discussing any thoughts or concerns you may have.

Sincerely,



James A. Heine

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Market Report (as of 9/30/19)

Index	**2019 YTD (%)**	**3-Year Annualized (%)**	**5-Year Annualized (%)**
S&P 500	18.75	11.14	8.58
Dow Jones Industrial Average	15.39	13.71	9.57
U.S. Aggregate Bond Index	8.52	2.93	3.38
MSCI EAFE (Foreign Index)	9.85	3.55	0.46

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