

## Equities in Review

Markets were mixed and mostly flat during the quarter as investors attempted to digest risks and opportunities. The Federal Reserve Board ("the Fed") cut rates twice during the quarter; lower yields in the fixed income marketplace made higher yielding common stocks and REIT's more attractive.

Emerging markets and foreign stocks struggled on continued trade tensions and the strengthening US dollar.

Despite a short-term spike in oil following an attack on Saudi oil facilities, the price of oil fell during the quarter due to a weaker economic outlook and slowing demand.

Following are the quarterly, year-to-date and 5-year average returns for the six equity indexes that we track:

INDEX	DESCRIPTION	<u>Quarter</u>	<u>Year-to-Date</u>	<u>5-Year Avg.</u>
DJ Industrial Average	Large cap stocks	+1.83%	+17.51%	+12.28%
MSCI EAFE	Foreign stocks of developed nations	-1.07%	+12.80%	+ 3.27%
MSCI Emerging Markets	Foreign stocks of emerging nations	-1.29%	+7.67%	+ 3.52%
NASDAQ Composite	Growth-oriented large cap stocks	+0.18%	+21.54%	+13.51%
Russell 2000	Small cap stocks	-2.40%	+14.18%	+ 8.19%
S&P 500	Large cap stocks	+1.70%	+20.55%	+10.84%
Weighted Index Benchmark*	Diversified Equities	+0.03%	+16.81%	+ 9.64%

*\*The Index weighting is 20% each: DJ Industrial Average, NASDAQ Composite, S&P 500, and Russell 2000; and 10% each: MSCI EAFE and MSCI Emerging Markets.*

## Other Important Data

For the twelve months ending September 30, 2019, inflation as measured by the CPI increased 1.7%.

We believe the spread on the yield curve is a reliable leading indicator of the likelihood of recession. During the third quarter, the spread narrowed again after showing signs of stabilizing earlier in the year. While the current spread implies recession is not imminent, we do note the spread remains narrow. We continue to monitor the yield curve very closely.

- September 30, 2019 0.37%
- June 30, 2019 0.60%
- March 31, 2019 0.41%
- December 31, 2018 0.39%
- September 30, 2018 0.60%

## Equities Looking Forward

We avoid making short-term equity predictions because short-term market moves are often driven by factors other than fundamentals. Our longer-term outlook is mixed for the following reasons.

- **Bullish:** The US economy continues to grow at a decent pace.
- **Bullish:** Unemployment is the lowest it has been in 50 years.
- **Bullish:** Inflation is relatively tame and interest rates remain low and seem more likely to fall than rise in the near future.
- **Bearish:** Economic growth is slowing in other key parts of the world (e.g. Europe, Japan, and China). Slowing worldwide growth negatively impacts sales and profits of US multinational corporations.
- **Bearish:** The rate at which corporations are buying back their own stock is slowing significantly.
- **Bearish:** Stock market fundamentals are elevated (average P/E ratios are in the upper teens), meaning companies must continue growing earnings to justify current stock prices.
- **Bearish:** As noted above, the spread on the yield curve implies that the likelihood of a recession is higher.

## Hybrid and Hedging Assets

We believe that the Morningstar Moderate Risk Target Index offers the best benchmarks for hybrid and hedging assets. Returns are as follows:

INDEX	DESCRIPTION	<u>Quarter</u>	<u>Year-to-Date</u>	<u>5-Year Avg.</u>
Morningstar Moderate Risk	Hybrid (bonds and stocks)	+0.92%	+13.11%	+5.91%

Since the hybrid assets we own in our portfolios invest in a combination of securities including, but not limited to, bonds and stocks, the hybrid assets typically produce returns close to the average of the bond and stock index returns. This is the case for the quarter and for the annualized returns of the past five years.

Hedging assets like commodities or alternative strategies generally move with little, zero, or negative correlation to the bond and stock markets. We believe hedging assets should play a role in diversified portfolios because over the long-term, their limited or inverse correlation to bonds and stocks should reduce the volatility of overall portfolio returns.

## Bonds

Bond prices rose for the third consecutive quarter. The combination of recession fears and stock market investor anxiety made fixed income the asset category of choice over the past three months. Since bond prices and bond yields move in opposite directions, the activity led to bond yields falling in all but the issues with the shortest times to maturity. The quarterly and historical results for the bond indexes that we track are as follows:

INDEX	DESCRIPTION	<u>Quarter</u>	<u>Year-to-Date</u>	<u>5-Year Avg.</u>
Barclays Municipal Bond	I-T US Municipality Issues	+1.74%	+7.37%	+4.00%
Barclays US Aggregate Bond	I-T US Gov't and Corporate Issues	+2.27%	+8.52%	+3.38%
Morningstar TIPS	Inflation Protected Gov't Issues	+0.67%	+6.05%	+2.14%
Average of the Indexes	Diversified Fixed Income	+1.56%	+7.31%	+3.17%

On September 30, the yield on the 2-year US treasury was 1.63%, the yield on the 10-year US treasury was 1.68% and the yield on the German Bund—Germany's equivalent of the 10-year treasury—was **-0.572%**. Yes, if you invested in the German Bund on September 30 and planned to hold the issue until maturity in 10 years, you did so with the expectation you would **lose** 0.572% annually over the 10 years.

Per the yields above, when assessing the US bond market, intermediate-term and longer-term bonds seem relatively overvalued and shorter-term issues look undervalued. However, when viewing US bonds in the realm of the worldwide bond market, intermediate-term and longer-term US treasuries represent good opportunities, especially for fixed income investors in the world's established markets outside of the US.

Throughout most of 2018, the Fed was indicating rates would continue to increase in 2019. Last December, they changed course and stated that the slowing worldwide economy led them to a neutral position for 2019. During the recently completed quarter, the Fed cut rates in July for the first time in over ten years and cut rates again in September. After the September cut, they have taken more of a wait-and-see approach to their next moves, while they monitor inflation and other factors.

Even when we think bonds are overvalued, we believe they have a place in diversified portfolios to reduce volatility, preserve principal, and provide income.

## Our Asset Allocation Philosophy

It is our philosophy that investors with long-term time horizons are best served by using a disciplined, diversified asset allocation approach (investing in bonds, hybrid and other hedging assets and stocks) rather than trying to time the markets. It is important to periodically review your asset allocation and your target allocation and to rebalance your assets among the classes to keep the allocation close to the target. We will address the issues specific to you when we review your situation in the coming months. In the interim, if you would like to discuss these issues, please contact us at [howard@kadescheifetz.com](mailto:howard@kadescheifetz.com) or [steve@kadescheifetz.com](mailto:steve@kadescheifetz.com).

## Reminders

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Kades & Cheifetz LLC has provided this overview for internal use and for use by our clients. We have prepared it using sources believed to be reliable. We do not guarantee the accuracy of the sources. We reserve the right to change our opinions (expressed above) without notice.

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