NEWSLETTER

THE | Miles Capital • Update | 2019

SECOND QUARTER 2019 | VOLUME 18 | ISSUE 2

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NAVIGATING CROSS CURRENTS

THE ECONOMY CONTINUED TO SHOW STRENGTH DURING THE SECOND QUARTER OF 2019

However, the markets exhibited more volatility as concerns about trade, growth, and the Federal Reserve (Fed) took center stage.

Gross Domestic Product (GDP) growth for the first quarter of 2019 came in at 3.1 percent, significantly better than the estimate of 2.3 percent and the fourth quarter of 2018 at 2.2 percent. However, this 3.1 percent is temporarily elevated due to higher-than-normal inventory flows tht stemmed from trade concerns. Corporate earnings growth for the first quarter 2019 was fairly flat. While this is a significant decline from the double digit positive growth in 2018, those higher rates were harder to maintain after the initial benefit of the fiscal tax stimulus. The consumer remains strong and unemployment remains low around 3.7 percent. Some business forecasting surveys, including the Institute of Supply Management (ISM) surveys, have started to decline, but overall business activity is moderate. We believe it likely the overall slower-but-moderate pace of economic growth continues throughout 2019 and into 2020.

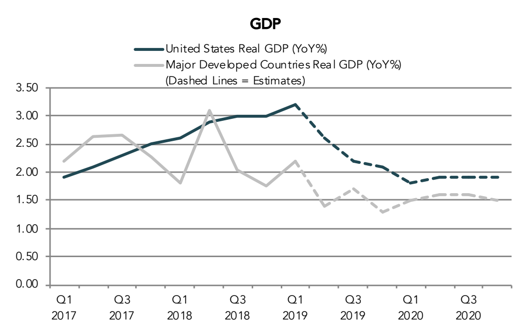
The Fed raised rates four times during 2018. They initially indicated they would raise interest rates twice in 2019, but then put the increases on "pause" due to mixed economic signals. In June they shifted position again and indicated they would do whatever it took to support the continued economic expansion. They stated there are uncertainties in the U.S. economic outlook, including some "cross currents" between trade developments and growth. As a result, they are now indicating a more accommodative posture. Both the Fed and the financial markets are digesting the effects of the more conciliatory tone of recent trade talks. The financial markets, as measured by Fed futures, now project a high probability of 2 interest rate cuts in 2019, with one occurring at the July meeting of the Fed Open Market Committee. Interest rate cuts may be premature, but at this point the Fed has limited other options.

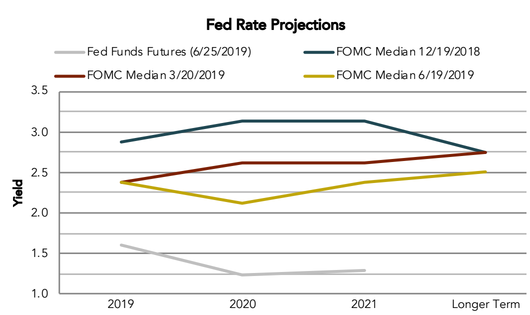
Both the fixed income and equity markets showed strong performance for the 2nd quarter of 2019. Risks include increased trade tensions, slowing global growth, and geopolitical uncertainties.

2ND QUARTER *snap shot*

+3.1%

GROSS DOMESTIC PRODUCT FOR THE FIRST QUARTER





Fixed Income Market Update

VOLATILITY RETURNS

Volatility ruled the day within the fixed income markets during the second quarter. Some volatility was created by external market factors such as trade negotiations and political disruptions (e.g. Brexit). However, a growing source of volatility for investors is the ongoing debate regarding if/when the U.S. Federal Reserve (Fed) and other global central banks will begin to cut interest rates later this year. The timing and magnitude of any cuts could have wide ranging implications for fixed income investors.

OVER THE PAST FEW MONTHS, INTEREST RATES EXPERIENCED THEIR HIGHEST LEVELS OF VOLATILITY IN NEARLY 3 YEARS.

The market factor most impacted by volatility over the past quarter was interest rates which experienced their highest levels of volatility in nearly three years. Interest rates, as measured by the 10 year U.S Treasury Note, declined significantly over the quarter and ended at 2.01 percent, which was 0.40 percent lower than where it ended the previous quarter and over 0.68 percent lower from the beginning of the year. Short term interest rates declined even further as the market begin pricing in more potential future rate cuts by the Fed.

Declining interest rates resulted in strong absolute performance for most fixed income sectors during the quarter. The Bloomberg Barclay's Aggregate index (Agg), a broad measure of the investment grade U.S. bond market, rose by 3.08 percent for the second quarter and is up over 6 percent year-to-date. A return of 6 percent for the Agg has only been exceeded twice in the last ten calendar years.

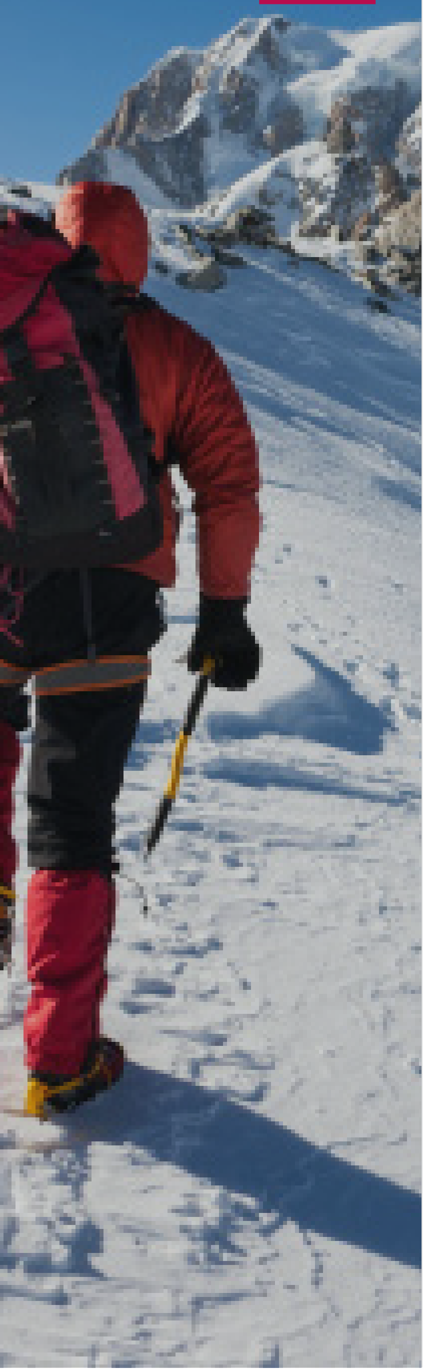
A few major fixed income sectors, such as corporate and municipal bonds, managed to outperform similar duration U.S. Treasuries for the quarter while other sectors such as mortgage-backed securities and agency bonds underperformed due to their heightened sensitivity to interest rate volatility. Within the corporate sector, lower quality and longer duration slightly outperformed higher quality and shorter duration segments of the sector.

In the coming months and quarters the fixed income markets will be heavily influenced by the direction and timing of interest rate moves. Those rate changes will be dictated by the path of economic activity and by the Fed and other global central banks. Miles Capital forecasts slower growth ahead for the U.S. This type of environment could cause the Fed to cut rates 1-2 times over the remainder of 2019. However, barring any major shocks from external market factors, we may see less volatility in the second half of the year.

+2.01%

INTEREST RATES AS MEASURED BY THE 10 YEAR U.S. TREASURY NOTE AT QUARTER END

> “U.S. EQUITIES CONTINUED TO RALLY IN THE SECOND QUARTER AFTER A STELLAR FIRST QUARTER.



EQUITY DESPITE STUMBLES, MARKET KEEPS CLIMBING

U.S. equities continued to rally in the second quarter after a stellar first quarter. The S&P 500 increased 4.30 percent for the quarter. Combined with the first quarter, which was the best quarter in almost a decade, 2019 has had the best start to the year since 1997.

All sectors were positive except for energy, with financials, materials, and information technology leading the way. Other laggards were the defensive sectors (health care, real estate, consumer staples), but even these still posted gains for the quarter.

It may sound like a broken record at this point, but the second quarter saw continued volatility that has accompanied the stock market since October. Most of the market gains came in April when investors optimistically believed that the U.S. and China were close to reaching an accord on trade. That optimism disappeared in May as the U.S. and China ramped up rhetoric and threatened higher tariffs. The S&P 500 then recovered from May upon its best June since 1955 on hopes that the Federal Reserve (Fed) will soon cut interest rates in an effort to maintain economic growth.

> **WITH THE STELLAR FIRST QUARTER PERFORMANCE, THE S&P 500 IS UP 17.9 PERCENT YEAR-TO-DATE, WHICH IS THE BEST START TO THE YEAR SINCE 1997.**

The commentary calling a potential slowdown in the economy has increased due to mixed data reports and the first quarter earnings results, which reported the first year-over-year decline since 2016. However, expectations are for corporate earnings to remain low in the second quarter, then strengthen throughout the remainder of the year. We do not believe a prolonged earnings recession or significant economic deterioration in 2019 is likely.

China trade negotiations and the Fed remained the primary focus for market participants. There were other significant headlines throughout the quarter, such as strife between the U.S. and Iran or the potential for additional tariffs with Mexico, but these were largely shrugged off. We expect these two topics to remain the focus for much of the markets going forward.

+4.3%

THE S&P 500 INCREASED 4.30 PERCENT FOR THE QUARTER

+17.9%

THE S&P 500 INCREASED 17.9 PERCENT YEAR-TO-DATE

ALTERNATIVES

THE TREND IS YOUR FRIEND

The second quarter began with optimism about a trade deal between the U.S. and China, only to see the optimism fade as China reversed course on some previously negotiated items and the U.S. followed through with increased tariffs. Negotiations were resumed late in the quarter after Trump and Xi met at the G20 meetings. This back-and-forth on the trade front did cause market volatility.

The U.S. Federal Reserve (Fed) comments from their June meeting indicated a more accommodative posture as nearly half the voting members indicated interest rate cuts would be necessary. The change in position contributed to a strong rally in the equity markets and a sharp decline in interest rates.

Hedge funds had another positive quarter, albeit not quite as strong as what might be expected given broad market movements. Despite the solid equity returns, long/short equity strategies struggled as health care, a key sector exposure, came under pressure. The political rhetoric from the 2020 presidental candidates regarding "medicare for all" caused the health care sector to underperform, particularly hospitals. It is likely the healthcare sector will recover given the low probability of these events, but we expect more sector-specific volatility throughout the election.

Macro strategies produced the best performance, with systematic (trend following) strategies leading the way. The strong equity market trends that developed in the first quarter resulted in systematic managers re-positioning portfolios to take advantage of higher equity markets, leading to positive returns. The significant decline in interest rates also contributed to returns, as managers have been positioned for lower rates for a while.

Going forward, trade and central bank policy will continue to be key themes driving the markets, and correspondingly, hedge funds. We expect the Fed to cut rates one or two times during the remainder of 2019, and also anticipate the U.S. and China ultimately coming to an agreement on trade. Both would be positive for investment performance, but the path might not be smooth.

2ND QUARTER *snap shot*

+7.4%

FINANCIALS WAS THE BEST PERFORMING SECTOR IN THE SECOND QUARTER

-3.7%

ENERGY WAS THE ONLY SECTOR WITH A NEGATIVE RETURN IN THE SECOND QUARTER

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Contact us at 800.343.7084 if you have additional questions or would like to visit with any of our team members.