SAGE FINANCIAL GROUP
Investment and Wealth Management

SAGE INSIGHTS
MONTHLY ECONOMIC & MARKET ANALYSIS

November 2019

Global Stocks and Bonds Extend Gains in October

Overview

In October, most major asset classes rose in response to central bank activity and anticipations of a leveling off of geopolitical risks, including U.S./China trade tensions. The monthly return for the S&P 500 was 2.17%, and non-U.S. stocks in the MSCI ACWI ex-USA gained 3.49%. The U.S. Aggregate Bond Index also rose 0.30%. Year to date through October, the main global market indices are solidly positive.

In this issue of *Insights*, we focus on the tension that recently has dominated the global economic and investment landscape: supportive central bank policies intended to bolster sentiment and markets, on the one hand, and, on the other, somewhat stable economic conditions amid prominent geopolitical risks. As we look ahead, not only to the rest of 2019 but also to 2020, we believe that investment assets will likely take their price cues from whichever side in this tug of war seems to be gaining the most ground. There has indeed been a global growth slowdown, which is reflected in various data releases, among them manufacturing and services orders; however, it takes time to see the effect of central bank policies and the stabilization or re-acceleration of growth. Better-than-expected jobs growth in the U.S. in October and some uptick in manufacturing activity in emerging markets may point to pockets of incipient improvement that, given recent accommodative monetary policy moves, could continue in the months and quarters ahead, barring some geopolitical or economic shock.

Performance

All major asset classes advanced in October (see table below).

	Oct.	2019 YTD	5-Year Annlzd	10-Year Annlzd	Category
BarCap Municipal TR USD	0.18	6.94	3.55	4.40	US Muni Bonds
BarCap US Agg Bond TR USD	0.30	8.85	3.24	3.73	US Taxable Bonds
BoAML US High Yield Master II TR USD	0.23	11.76	5.17	7.69	US Corporate HY Bonds
JPM EMBI Global Diversified TR USD	0.28	13.30	5.44	6.90	Int'l/Emerging Bonds (USD)
JPM GBI EM Global Diversified TR USD	2.90	10.98	0.82	2.67	Int'l/Emerging Bonds (Local)
HFRX Equity Hedge USD	0.52	8.43	1.16	1.25	Hybrid/Hedged Equity
DJ Industrial Average TR USD	0.59	18.19	11.93	13.61	US Equity -- Large
S&P 500 TR	2.17	23.16	10.78	13.70	US Equity -- Large
NASDAQ Composite TR USD	3.71	26.06	13.64	16.34	US Equity -- Large
Russell 1000 TR USD	2.12	23.09	10.55	13.72	US Equity -- Large
Russell Mid Cap TR USD	1.05	23.21	8.67	13.70	US Equity -- Mid-sized
Russell 2000 TR USD	2.63	17.18	7.37	12.27	US Equity -- Small
MSCI All Country World Index ex-USA NR USD	3.49	15.45	3.82	4.94	Int'l Equity -- Comprehensive
MSCI EM NR USD	4.22	10.35	2.93	3.78	Int'l Equity -- Emerging
Bloomberg Commodity TR USD	2.02	5.22	-6.65	-4.44	Commodities
HFRX Global Hedge Fund USD	0.31	6.22	0.65	1.11	Multi-Asset Alternative Invm't

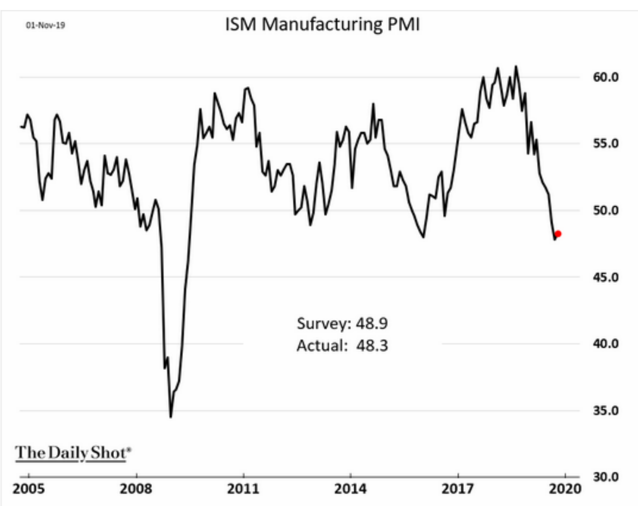
Source: Morningstar Direct. Data through 10/31/2019

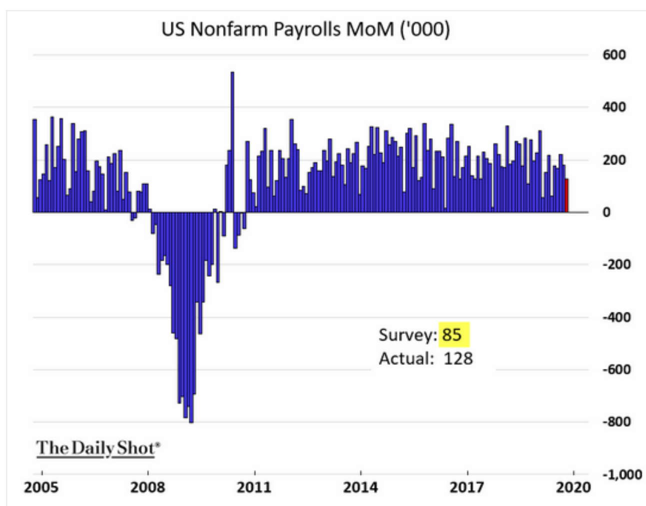
The S&P 500 gained 2.17% on the month, a bit better than the Russell 1000 Index of large companies (+2.12%). The Russell 2000 Index of small companies also rose last month (+2.63%). Large-cap and small-cap Russell indices have advanced 23.09% and 17.18%, respectively, for the year through October. The MSCI ACWI Ex-USA Index, a measure of all stocks outside the U.S., rose again in October by 3.49%, and it has posted a gain of 15.45% YTD through October. The MSCI Emerging Market Index jumped 4.22% higher last month. Despite bouts of volatility, the EM Index is up 10.35% YTD through October.

The Bloomberg Barclays U.S. Aggregate Bond Index gained 0.30% in October. The corresponding Municipal Bond Index inched ahead 0.18%. Emerging market bonds were positive, but the magnitude of gains for the two chief indices differed. U.S. dollar-denominated emerging market bonds in the JPMorgan EMBI Global Diversified Index advanced 0.28% after falling 0.46% in September, and they have now risen 13.30% YTD through October. The local currency EM bond index, the JPMorgan GBI EM Global Diversified Index, leaped ahead 2.90% on the heels of its 0.96% gain in September. A 50/50 blend of the two EM bond indices has a YTD gain through October of 12.14%.

Outlook

We continue to believe that the U.S. economy generally remains sound; in fact, Q3 GDP growth was 1.9%, slower than the 2.0% in Q2 but better than expected. U.S. job gains have trailed off in recent months, but the chart below on the right shows that the October employment report was much better than the consensus survey expected (128,000 new jobs versus 85,000 expected). The figures from previous months were also revised sharply upward. Last month also saw a 0.2% increase in average hourly earnings. On the flip side, as the chart on the left shows, manufacturing sentiment has picked up ever so slightly but remains in contractionary territory below 50, and the survey for October came in below expectations.



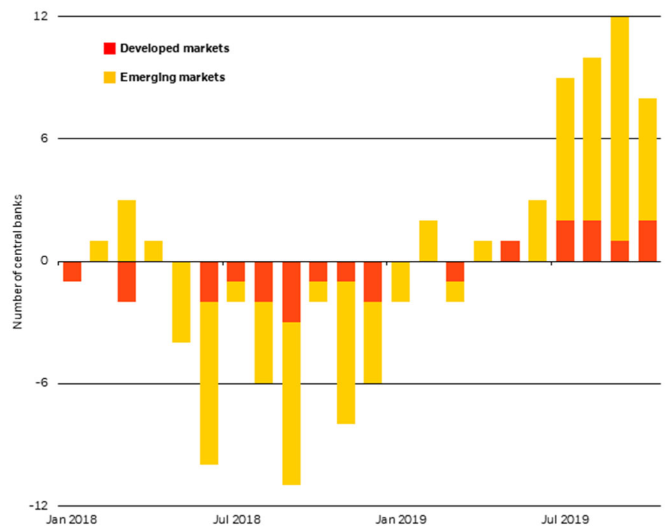


It remains unclear exactly which way the economic data may turn. Will it turn toward continued deceleration of growth and contractionary readings in various industry reports, or to better-than-expected readings? We will be keenly watching in coming weeks and months the U.S. jobs report, consumer sentiment, and consumer spending. Consumer spending has been a particularly bright spot, but if spending and sentiment drop, both lagging indicators, it would reveal something about the depth of the slowdown in the U.S. and perhaps signal how long it may persist. On the other hand, if employment continues to remain solid and wage growth stays well above inflation, this could lead to elevated consumer sentiment and spending. Such a development may indicate that the Fed's "insurance" cuts to protect against further weakening are starting to realize some results.

Central banks globally, both in developed and emerging markets, have become net interest rate-reducers in 2019, as you can see from the nearby graphic. This has come, depending on the locale, either in response to deteriorating economic and financial conditions or in a preemptive move to provide insurance against future erosion of fundamentals.

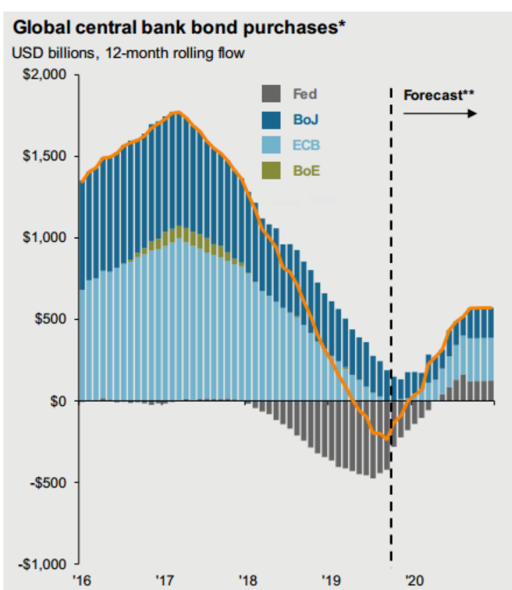
Despite slowing growth and ongoing risks from geopolitics, most critically trade policy disputes, most major stock and bond indices have risen this year. Recently a perceived lull in geopolitical frictions has boosted risk assets such as stocks, and the accommodative pivot by central banks has lifted not only risk assets like equities but also bonds across the globe and across the credit spectrum.

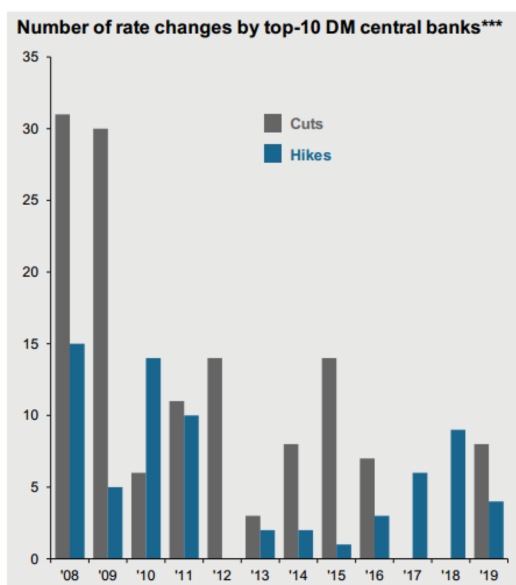
Net number of rate-cutting central banks, 2018-2019



Sources: BlackRock Investment Institute, with data from Bloomberg and MSCI, November 2019. Notes: The stacked bars show the net number of central banks that cut interest rates in each calendar month. Our selection is based on **MSCI's categorizations** of developed markets (DM) and emerging markets (EM), with some modifications. We used a total of 13 DMs and 25 EMs for this analysis. On the DMs list, we grouped together the 10 DMs in the euro area as one as the European Central Bank (ECB) sets their monetary policy and removed Singapore as it manages its monetary policy through currency exchange rates settings and not interest rates. On the EMs list, we omitted Greece as the ECB sets its policy.

The two graphs below reveal the extent to which global central bank activity has helped to buoy asset prices across markets so far in 2019. The main takeaway from the chart on the left is how the tide of rolling 12-month central bank purchases has shifted globally (and not just with the Fed) to a marked increase in asset purchases,





Source: J.P. Morgan Asset Management; (Left) Bank of England, Bank of Japan, European Central Bank, FactSet, Federal Reserve System, J.P. Morgan Global Economic Research; (Right) Bloomberg. *Includes the Bank of Japan (BoJ), Bank of England (BoE), European Central Bank (ECB) and Federal Reserve. **Bond purchase forecast assumes no further purchases from BoE; continued BoJ QE of $20trn JPY ann. for 2019 and 2020; restarting of purchases from the ECB at a pace of $20bn EUR per month beginning in November 2019; and conclusion of Fed balance sheet reduction per the July 2019 FOMC statement, in which beginning August 2019, maturing MBS holdings will be reinvested in Treasuries up to $20bn per month, anything in excess of that is reinvested back into MBS. The Fed balance sheet begins to rise again due to rising liabilities. ***Including: Australia, Canada, Denmark, eurozone, Japan, Norway, Sweden, Switzerland, UK and U.S.
Guide to the Markets – U.S. Data are as of November 4, 2019.

which has increased liquidity and lowered interest rates. The shift in the tide from decreasing liquidity to increasing liquidity tends to have a positive effect on credit and financial markets. As you can see in the righthand chart above, in 2017 and 2018, the top 10 developed market central banks hiked rates and did not reduce them. In 2019, however, these same countries have cut rates more than they have increased them.

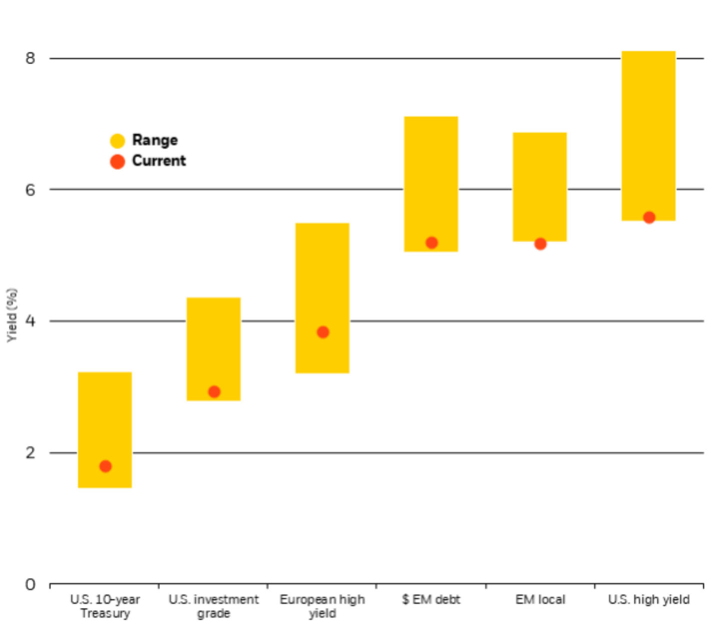
In the U.S., one effect of the three interest rate cuts by the Fed this year has been that the yield curve is no longer inverted, as measured by the 3mo-10yr US Treasury curve. As of November 1, for instance, the spread between the 10-year Treasury note and the 3-month bill was +21 basis points (1.73% vs. 1.52%).

We view this change as encouraging, but the positive spread is not necessarily a positive "all-clear" indicator. Typically, the yield curve inversion reverses before a more persistent slowdown. The Fed has lowered rates to adjust to a slowing economic environment, and avoiding a recession is still largely a function of the Fed's effectiveness and progress in the ongoing trade war, along with avoiding negative geopolitical events such as U.S./China escalation, hard-Brexit, etc. In the absence of notable inflation or outside shock, the Fed's accommodation may succeed in stabilizing the economy in the coming months.

The current forward price-to-earnings ratio (P/E) for the S&P 500 is a full 17.4x (v. the 25-year average of 16.24x), having risen due to FOMC cuts, better-than-feared 3Q earnings, and optimism regarding the "Phase One" trade deal between the U.S. and China. On the latter front, it does seem that Presidents Trump and Xi will agree in the near future to some partial deal that involves still unspecified relief of currently imposed tariffs on Chinese goods, an agreement by the U.S. not to increase existing tariffs further, and a commitment by the U.S. not to impose the tariffs scheduled to go into effect on December 15 on about $156 billion worth of Chinese goods, including cell phones, laptop computers, and toys. In return, China might agree to certain U.S. agricultural purchases and perhaps some matters of intellectual property pertaining to copyrights and trademarks. Negotiations are ongoing, and nothing is certain until a deal is signed—and perhaps not even then since compliance and enforcement remain questionable.

Even a successful "Phase One" deal would imply that additional phases are still necessary, and those would involve the most difficult issues on which to agree. We are of the opinion that tariffs on imported goods from China have likely peaked and that tariffs will remain at current levels or slightly lower through 2020. Meanwhile, we are closely examining the data to discern if the global economy is feeling effects from the various pockets of protectionism beyond the manufacturing sector. We are also monitoring signs of increasing inflationary pressures from trade tensions, although inflation related to tariffs seems to be limited. On the whole, we anticipate that looser financial conditions will contribute to an increase global growth in the next 6 to 12 months.

Selected fixed income yields, 2018-2019



Past performance is not a reliable indicator of current or future results.
Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, Bloomberg Barclays and J.P. Morgan, October 2019. Notes: The bars show the range in yields for each index from the start of January 2018. Indices used: Refinitiv 10-year benchmark U.S. Treasury, Bloomberg Barclays U.S. Corporate Investment Grade, Bloomberg Barclays Pan-European Corporate High Yield, J.P. Morgan Government Bond Index-Emerging Markets Index, J.P. Morgan EMBI Global Diversified Index and Bloomberg Barclays U.S. Corporate High Yield Index. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.

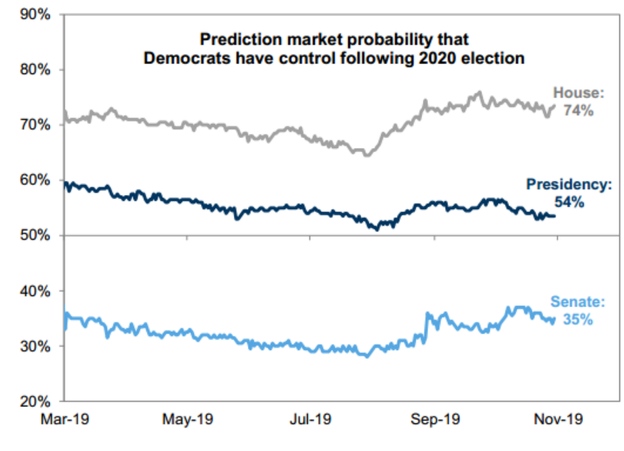
Active and more dovish central banks have helped to push interest rates to very low levels across the globe, as you can see from the nearby graph. U.S., European, and emerging market debt trades are at yield levels at the low end of their nearly 2-year range.

We believe that government and high-quality bonds, in particular, continue to play a central role as portfolio stabilizers that can offset equity volatility despite relatively low yields. We also think that it could be prudent to seek additional diversifying assets to help balance a portfolio against the wide range of potential fundamental and geopolitical risks that prevail.

Although geopolitical frictions have become a factor in the direction and health of the global economy and asset markets, at present, we do not see that factor by itself as sufficient to tip the U.S. economy into a recession, especially in the absence of major or systemic financial imbalances.

One geopolitical risk, however, that is beginning to capture increasing attention is the 2020 U.S. presidential election. The resurgence of protectionism in many countries over the last couple of years has raised the level of uncertainty associated with business investment decisions and has weakened economic activity. Some investors are beginning to voice a worry that protectionism may intensify depending on who secures the White House in 2020. For instance, if President Trump is re-elected, there is concern that he might feel emboldened to seek additional trade measures that dovetail with his larger agenda to boost U.S. manufacturing jobs and decrease the trade deficit. Of the leading Democratic candidates, two of the three top-polling candidates (Senators Warren and Sanders) have stated trade policy positions that are in their own ways as hawkish on global trade terms with certain countries, although for reasons different from those that President Trump has cited in his negotiations with major partners such as China, Europe, and Mexico/Canada. Warren, for instance, most readily cites human rights abuses as reasons for restricting or terminating trade terms with a partner country, whereas Trump tends to cite the harm done to U.S. industries or producers. Voters and investors are just beginning to sort through the economic implications of the candidates' stated policy preferences and proposals.

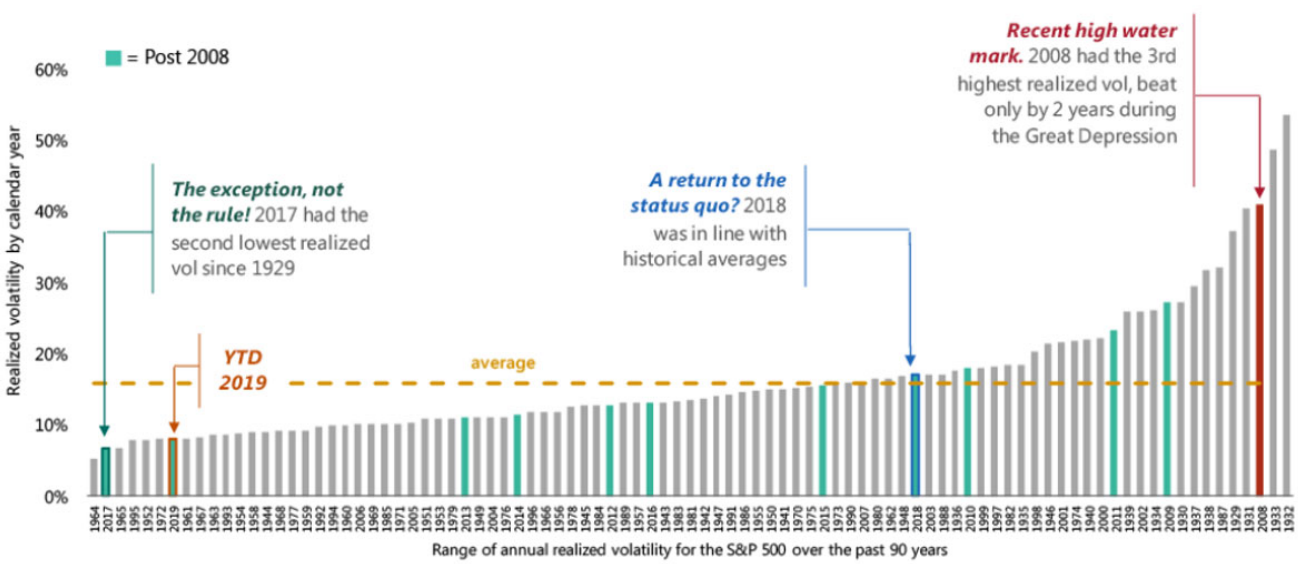
These questions are understandable, but at this point, voters and investors may do well not to worry overly about stump speeches becoming enacted legislative realities. According to a recent analysis by Goldman Sachs, for instance, "Taken together, prediction markets currently suggest a roughly 70% likelihood that the 2020 election results in a divided government. Prediction markets assign a 20% probability of a Democratic sweep and a 10% probability of a Republican sweep. *A divided Congress would likely constrain the prospect of sweeping legislation or reforms, which require passage from both chambers of Congress*" (our emphasis).



Source: PredictIt, Goldman Sachs Global Investment Research

The nearby graph shows various federal election outcome probabilities mapped over time. Although Democratic candidates currently enjoy a high probability of controlling the House of Representatives and a better than average probability of taking the White House, there is only (as of 11/1/2019) a 35% probability that the Democratic party will win back the Senate.

However, even in a Democratic sweep scenario, many establishment Democrats still oppose some of Senator Warren's more radical proposals such as Medicare-for-All which bans private insurance, imposes a significant wealth tax, and other policies. For example, House Speaker Pelosi recently came out against Medicare-for-All and affirmed that she prefers building on the Affordable Care Act. Nevertheless, we believe that there could be a pick-up in equity market volatility heading into the U.S. presidential election season despite the potential stabilizing actions of the Federal Reserve. In many ways, 2019 has been a banner year for both stocks and bonds. In particular, the higher valuations have led to below-average realized volatility for equities, as you can see from the graphic below. Last year, during which the S&P 500 lost 4.78%, volatility was at what is considered an average level.



Source: PIMCO, Bloomberg

One reason that there may be some pick-up in volatility is that there remains some disparity in the outlooks reflected in the rates and core bond markets (which have priced in a more adverse outlook) and the credit and equities markets (which have priced in healthier outcomes). The challenge for investment positioning, as we have pointed out previously, is that uncertainty is still high, especially around trade policy and now presidential election drama. Deterioration in the strength of the U.S. consumer or in trade negotiations between the U.S. and other nations could skew economic and investment outcomes negatively; however, a more substantive breakthrough in trade policy and marked success by central banks (monetary policy) or legislatures (fiscal policy) to support global growth could result in higher prices in riskier assets such as stocks and high yield bonds.

Conclusion

The future investment landscape is likely to be shaped by this tug of war between accommodative global central bank policies acting to bolster sentiment and markets, on the one hand, and decelerating economic growth and uncertain or shaky fundamentals amid various geopolitical risks, on the other hand.

The U.S. economy, in particular, has remained solid, although GDP growth has been decelerating, a trend that may well continue for the next few quarters. At the same time, we think there are reasons to believe that the Fed's proactive interest rate policy reductions up to this point and its resumption of balance sheet expansion through various asset purchases may produce economic fruit. The movement toward a "Phase One" trade deal between the U.S. and China, has helped to reduce market tensions about a further escalation in the trade dispute between the two economic giants. European economies may continue to struggle for a time; however, EM countries are showing some signs of stabilizing within manufacturing, which may portend additional improvements to come.

Although we see more warrant for anticipating economic improvement over the next 12 months, we also realize that the global economy remains fragile and susceptible to tugs in the other direction. For this reason, we continue to be somewhat cautious on the margins. We have made asset class positioning closer to neutral in areas like equities, and we have readied ourselves to take advantage of opportunities that may arise.

As we look ahead to the holiday season as 2019 draws to a close, we also want to take a moment to express thankfulness for the confidence that our clients have placed in us to steward their portfolios and contribute to their overall financial lives. The satisfaction of helping clients in this way is more rewarding than the positive returns we have enjoyed this year.

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