**HAYES**

**ASSET MANAGEMENT LLC**



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| **Commodity Indexes** | **Q2 Return** | **YTD Return** |
| S&P GSCI (Broad-Based Commodities) | -1.42% | 13.34% |
| S&P GSCI Crude Oil | -2.85% | 26.95% |
| LBMA Gold Price | 7.09% | 9.66% |

Quarterly Insights – July 2019

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| **US Equity Indexes** | **Q2 Return** | **YTD Return** |
| S&P 500 | 4.30% | 18.54% |
| DJ Industrial Average | 3.21% | 15.40% |
| NASDAQ Composite | 4.25% | 21.85% |
| S&P MidCap 400 | 3.05% | 17.97% |
| Russell 2000 | 2.10% | 16.98% |

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| **US Bond Indexes** | **Q2 Return** | **YTD Return** |
| BBgBarc US Agg Bond | 3.08% | 6.11% |
| BBgBarc US T-Bill 1-3 Mon | 0.62% | 1.22% |
| ICE US T-Bond 7-10 Year | 3.53% | 6.84% |
| BBgBarc US MBS (Mortgage-backed) | 1.96% | 4.17% |
| BBgBarc Municipal | 2.27% | 5.11% |
| BBgBarc US Corporate Invest Grade | 5.37% | 11.94% |
| BBgBarc US Corporate High Yield | 2.55% | 10.84% |

Historically typical volatility returned in the second quarter as uncertainty regarding U.S.-China trade relations, future Federal Reserve interest rate policy, and the state of the U.S. and global economies caused a more-than-6% pullback in the S&P 500 during May, before stocks broadly recovered in June and finished the quarter near fresh all-time highs.

In sharp contrast to the quiet, steady gains of the first quarter, stock market performance in the second quarter was one marked by extremes. The S&P 500 logged a 4% gain in April thanks to solid first quarter corporate earnings reports, which further reduced concerns that earnings growth peaked in 2018. Additionally, due in part to statistics that showed inflation well below the Fed’s target, investors’ expectations for a 2019 Fed interest rate cut rose in April, which added fuel to the bullish fire. The S&P 500 ended April near new all-time highs.

Volatility returned in the first week of May, however, as President Trump announced via Twitter that he would be raising tariffs on $200 billion in Chinese goods from 10% to 25% following the collapse of U.S.-China trade negotiations. Furthermore, the president threatened to levy additional tariffs on the remaining $325 billion worth of Chinese products imported into the United States.

The news caught investors by surprise as reports previously implied a U.S.-China trade deal was close to being finalized, and stocks dropped sharply in reaction. Further escalating the U.S.-China trade conflict was the decision by the Commerce Department to add the Chinese telecom company Huawei to its “Entity List,” which would effectively ban U.S. companies from doing business with the telecom giant. That development further pressured stocks. Moreover, Federal Reserve Chairman Jerome Powell sewed doubts about any future interest rate cuts when he described low inflation as “transitory,” and implied the Fed was not as open to an interest rate cut as investors anticipated. That combination of factors weighed on markets throughout May and the S&P 500 fell to its lowest levels since early March.

The stock market was able to find support and rebound strongly in June, however, as there was progress across the two main sources of volatility in the second quarter, U.S.-China trade and future Fed interest rate policy. First, at the June 19th meeting, the Federal Reserve reversed course from May and signaled an interest rate cut is likely in 2019, perhaps as early as July. That shift helped to re-validate market expectations of lower interest rates in the near future, and stocks rebounded strongly on that expectation. Second, President Trump and Chinese President Xi Jinping agreed to meet at the recently held G20 meeting, and the result of the meeting was a trade “truce” of no new tariffs while trade negotiations resume.

In sum, investors had to stomach another bout of volatility in the second quarter and macroeconomic uncertainty has increased compared to the first three months of 2019. However, underlying fundamentals for the economy and the markets remain generally solid, and investors are now anticipating the first Fed rate cut in over a decade as well as an extended “truce” in the U.S.-China trade conflict—both of which should be further supportive of the stock market. So, while we should prepare ourselves for more historically typical volatility, the outlook for markets remains generally positive as we begin thesecond half of the year.

## Second Quarter Performance Review – A Mixed Quarter

Despite the uptick in volatility in the second quarter, U.S. stock market performance still resembled that of the first quarter as rising hopes for Fed rate cuts and a U.S.-China trade truce resulted in broad gains across most market segments and sectors.

By market capitalization, large caps outperformed small caps, which is a reversal from the first quarter. Large cap outperformance was partially due to investors reacting to underwhelming economic data, as large caps are historically less sensitive to a potentially slowing economy. Increased hopes for a U.S.-China trade truce in late June also helped large caps outperform as they have more exposure to global trade. From an investment style standpoint, growth again outperformed value mostly due to another quarter of strong returns by tech and consumer discretionary stocks.

On a sector level, 10 of 11 S&P 500 Index sectors finished the second quarter with positive returns; however, consumer staples and the financial sectors were the notable outperformers. Consumer staples were driven higher by solid earnings and investors’ desire for some insulation from a loss of economic momentum and trade uncertainty, while financials benefitted from rising expectations for a Fed rate cut and the late-quarter steepening of the yield curve.

The energy sector, meanwhile, experienced negative performance in the second quarter mainly because of declines in the price of oil. The healthcare sector also lagged the S&P 500 thanks to rising political risks via increasing calls for the expansion of government healthcare programs, dubbed “Medicare for All.”

Looking internationally, foreign markets also had positive returns for the second quarter, but once again underperformed the United States. Foreign developed markets outgained emerging markets due to several factors, including less sensitivity to volatility in foreign trade relations, a stronger dollar (for most of the quarter) and rising hopes for more stimulus from the European Central Bank. Emerging markets, meanwhile, were restrained by concerns about global economic growth and pressures from a mostly stronger U.S. dollar. However, a late-quarter decline in the dollar coupled with rising U.S.-China trade optimism helped emerging markets register a slightly positive gain for the quarter.

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| **International Equity Indexes** | **Q2 Return** | **YTD Return** |
| MSCI EAFE NR USD (Foreign Developed) | 3.68% | 14.03% |
| MSCI EM NR USD (Emerging Markets) | 0.61% | 10.58% |
| MSCI ACWI Ex USA NR USD (Foreign Dev & EM) | 2.98% | 13.60% |

*Source: Morningstar*

Commodities saw mixed returns for the quarter, as gold surged to a multi-year high while oil declined. Gold rallied in the second quarter due to multiple factors including rising expectations for Fed rate cuts, an increase in geopolitical tensions (especially with respect to the U.S. and Iran) and the late-quarter declines in the U.S. dollar. Oil, meanwhile, was volatile last quarter as short, sharp geopolitically driven rallies were offset by rising concerns about declining demand and potential oversupply as U.S. oil production hit another record high in the second quarter.

Switching to the fixed income markets, performance largely reflected investors’ expectations for future Fed rate cuts, and that was positive for the broad bond markets. The leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized more positive returns in the second quarter as rising anticipation of future rate cuts, combined with worries about economic growth and increased geopolitical concerns sent bond indices decidedly higher in the second quarter.

Looking deeper into the fixed income markets, longer-duration bonds outperformed those with shorter durations during the second quarter, which is a continuation of what we observed in the first quarter and reflective of a market that is forecasting future rate cuts and slower economic growth.

Corporate bonds, both investment grade and high yield, again handily outperformed government bonds in the second quarter thanks to a better-than-expected earnings season, and the rising expectations for a future Fed rate cut. Both investment grade and high yield bond funds again posted very strong returns.

## Third Quarter Market Outlook

Markets were impressively resilient in the second quarter and registered gains despite deterioration in global economic activity and renewed uncertainty with U.S.-China trade. But, our years of experience have taught us not to become complacent just because markets have been resilient, and we think that’s again appropriate as we start the second half of the year.

Reductions in interest rates by the Federal Reserve, while welcome, are not a panacea for the U.S. and global economies. And as we start the third quarter, we face macroeconomic uncertainty on multiple fronts.

First, the U.S.-China trade situation remains delicate and very uncertain, and until there is a final agreement on a new U.S.-China trade pact, that lack of clarity will act as a headwind on economic growth and likely create temporary periods of volatility like we experienced in the second quarter.

Looking at the global economy, growth metrics underwhelmed in the second quarter, although the impact on global stocks was muted by rising market expectations of more stimulus from global central banks, including the Fed. But, if we see further deterioration in global and U.S economic indicators, that will also likely be a source of elevated volatility across markets.

Additionally, there are several unsettled geopolitical situations that must be monitored, including Brexit (the deadline is October 31st), North Korea (relations are still unsettled despite the recent Trump/Kim meeting) and Iran (the chances of a U.S.-Iran military conflict are as high as they’ve been in years).

Finally, while the Federal Reserve has signaled it will begin to reduce interest rates in the coming months, the situation remains very fluid, and if the Fed does not meet market expectations by cutting rates, that will cause short-term volatility.

It remains unclear how, or when, these events will be resolved, and what those implications will be for markets. Yet as 2019 has shown us so far, uncertainty is not, by itself, enough to offset the still-strong fundamentals in the U.S. economy and corporate America.

Instead, these and other market uncertainties require an intent focus on financial markets, economic data and political news. Put more generally, markets always face uncertainties at the start of a new quarter, but over the long term, it is core economic and corporate fundamentals that drive market returns—not the latest sensational headlines.

At *Hayes Asset Management LLC*, we understand that volatility, whether it’s related to trade disputes or concerns about Federal Reserve policy, can be unnerving, even if it is historically typical. That’s why we remain committed to helping you navigate this ever-changing market environment, with a focused eye on ensuring we continue to make progress on achieving your long-term investment goals.

Our years of experience in all types of markets (calm and volatile) have taught us that successful investing remains a marathon, not a sprint.

Therefore, it remains critical to stay invested, remain patient, and stick to a plan. That’s why we’ve worked diligently with you to establish a personal allocation target based on your financial position, risk tolerance, and investment time horizon.

The strong first half returns notwithstanding, we understand that volatility can be both unsettling and stressful, and we thank you for your ongoing confidence and trust. Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.