Beacon Trust
INNOVATING WEALTH STRATEGY

Third Quarter Summary

U.S. stocks had their best third quarter since 2013, with the S&P 500 Index rising 7.7%. The two 10% corrections from the first quarter seem but a distant memory, with the S&P 500 up 10.6% on a year-to-date basis through the end of September. Strong earnings and a lessening of global trade tensions were among the catalysts for the gains. The successor to NAFTA, the US-Mexico-Canada Agreement (USMCA) was officially announced on October 1st, although rumors of an agreement surfaced before the third quarter came to a close. Small-cap stocks continued moving upward, with the Russell 2000 increasing 3.6% over the third quarter and 11.5% on a year-to-date basis. International stocks remained laggards, partially due to the effects of a strong U.S. Dollar, with the MSCI World Index (ex-U.S.) up a modest 1.3% over the quarter and down 1.5% on a year-to-date basis.

The Federal Reserve continued to hike short-term interest rates, with the Fed Funds rate increasing 0.25% on the heels of the Fed's September Open Market Committee meeting. This marks the third 0.25% increase in interest rates this year and the Fed seems poised to raise rates another 25 basis points after its December meeting. The benchmark 10 Year U.S. Treasury Note continued to edge upward, ending the quarter at a 3.06% yield. The Barclay's Aggregate Index, the most widely cited bond index, increased a miniscule 0.02% over the quarter, trimming its year-to-date loss to a disappointing, but manageable 1.6%. The traditional indicators of domestic economic strength remain strong. U.S. GDP officially grew at a robust 4.2% rate in Q2 and is projected to grow at 4.4% once the official numbers are tallied for Q3. The unemployment rate remained at 3.7%, a 49-year low.

Market Outlook

The current bull market, which began in March of 2009, is now officially the longest bull market on record since at least the 1900s. To borrow an expression, "Bull markets don't die because of old age." Accordingly, we remain moderately optimistic on stocks due to the strong economy and solid expected earnings growth. In our view, stocks will increase in proportion to earnings growth in the year ahead, or roughly 8% - 10%. With the S&P 500 trading at roughly 16.5x forward earnings, we don't believe further multiple expansion is likely. The increase in interest rates across the maturity spectrum from the near zero level that existed for many years subsequent to the Great Recession has created some competition for stocks, especially among skittish investors. We now think it is likely that the Fed will raise interest rates four times this year, up from our prior view of three or more increases of 0.25%. As long as the unemployment numbers remain low, we feel that the Fed prefers to continue its gradual interest rate hike path, so it has some ammunition when the next downturn inevitably occurs. According to the Fed's "dot plot" another three increases of 0.25% are likely in the cards for 2019. We don't want to get ahead of ourselves, but we continue to see a gradually rising path for interest rates looking out over the next twelve months. Accordingly, we continue to favor high quality municipal bonds, floating rate bonds, and shorter duration investment grade bonds. Portfolio diversification has been detrimental to returns this year due to the S&P 500 outperforming virtually all other asset classes, but we believe this time tested strategy will ultimately prove its worth. Putting all of your investment eggs in one proverbial basket has rarely been a sound long-term investment strategy, despite the temptation to do so during very strong equity markets.

With North American trade tensions largely behind us, the elephant(s) in the international trade room remains U.S. and China. There seems to be some fundamental disagreements on trade between the two global titans and there are some indications that the U.S. may first look to settle its trade disputes with the members of the European Union. This dynamic raises the possibility of the U.S. and Europe "ganging up" on China in order to have a stronger bargaining position. In any event, the threat of a global trade war remains our most important risk to the global financial markets. Rising interest rates and a related increasing federal budget deficit remain another risk to derailing the current expansion. Threat of war with North Korea has been moved to the back burner, for now, in light of the "love letter" relationship between President Trump and Kim Jong-un. However, a simmering international risk is underway in Italy. The new populist government appears poised to run a budget deficit in excess of European Commission standards. Since the Italian economy is much larger than Greece's, a fiscal standoff between Rome and EC economic leadership in Brussels would likely increase contagion risk and be viewed unfavorably by the financial markets.

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