IdahoTrustBank

November 2019

WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust Bank

Despite the looming geopolitical and trade-related threats, as well as a marked slowdown in global economic growth, domestic stock and bond markets have posted very strong gains so far this year. Global economic activity should experience modest growth going forward with limited inflation levels. Moreover, global monetary policy is likely to become slightly more accommodative; although, these actions may not be enough to offset the political uncertainties.

Federal Reserve Bank

At the end of the October meeting, the Federal Reserve Bank (Fed) lowered interest rates for the third time since 2008. The target range of the Fed funds is now 1.50% – 1.75%. The domestic economy has experienced a slowdown over the past six months and many forward looking indicators remain weak. The Fed has faced growing pressure to have a more accommodative monetary policy as many believe that the economy will continue to slow down. Although the consumer has remained strong other areas of the economy have weakened, especially manufacturing.

In its previous statement, the Fed had said it “will act as appropriate” to keep the economy moving ahead. This time, however, those words were removed. Instead, the Fed said it will “monitor the implications of incoming information for the

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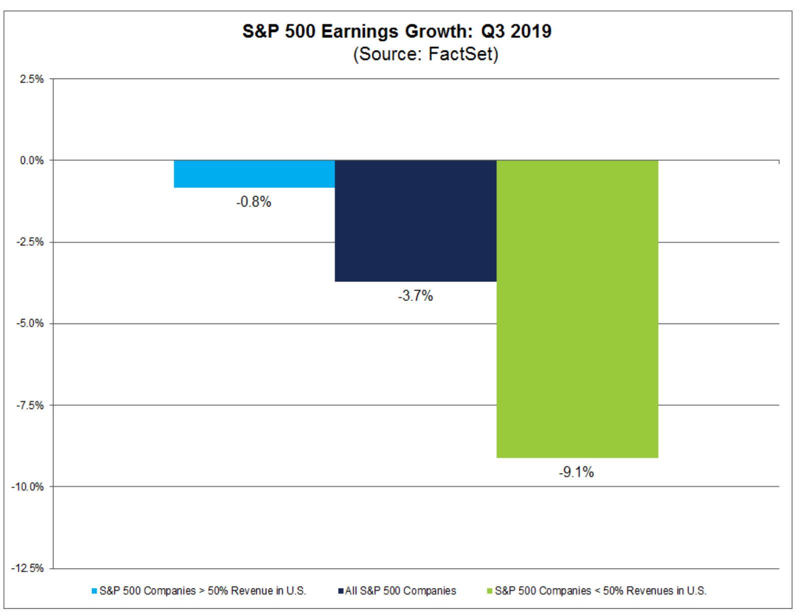
economic outlook as it assesses the appropriate path."

The central bank has boldly lowered rates this year. In response, mortgage rates have fallen, which should boost housing and construction activity. In his post-meeting press conference, Fed Chair Jay Powell said, "We believe that monetary policy is in a good place." This statement seems to suggest that there will be a pause to changes in monetary policy going forward, commonly referred to as a 'wait and see' mode.

Economic Activity

Recent updates to global economic forecasts show a slowdown in global growth due to rising trade tensions and increasing economic uncertainty. The International Monetary Fund (IMF) expects world GDP growth to slow from 3.6% in 2018 to 3.0% in 2019. A 3.0% growth rate would be the slowest global growth since the 2008-2009 financial crisis. According to the IMF, risks to the global growth outlook skew to the downside as trade barriers and heightened geopolitical tensions disrupt global supply chains and hurt confidence, investment, and growth.

In the U.S, the economic backdrop in 2019 has been characterized by weakness in manufacturing that has thus far been offset by the resilience of services and the health of the consumer. However, recent economic figures, have seen a deceleration in the pace of employment growth and a notable softening across the non-manufacturing sector. The idea that this expansion will continue has been predicated on manufacturing weakness remaining contained, but this dynamic is increasingly being called into question. Currently, the domestic data suggests that U.S. economic growth is slowing, but not stalling.

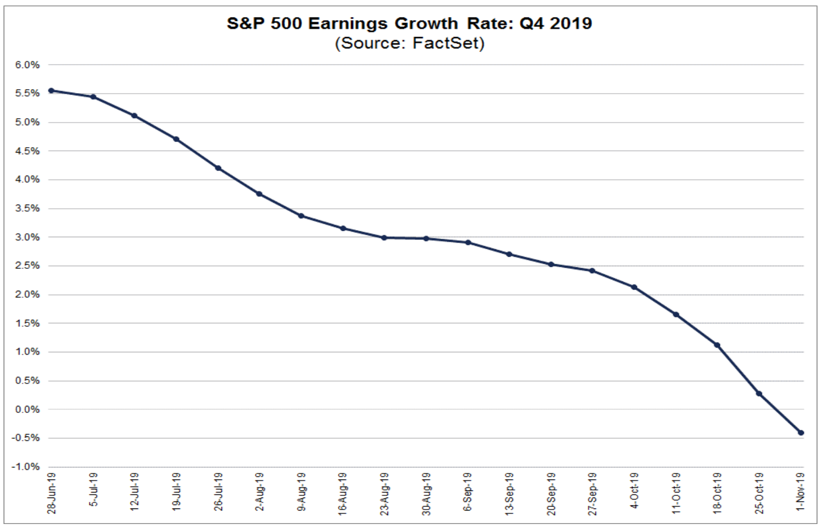


However, this is not necessarily true for the rest of the world, which is far more exposed to manufacturing and trade than the United States. Forecasts suggest that the Eurozone and Japan saw minimal growth in 3Q, while emerging markets experienced mixed results. The risk of recession outside of the U.S. has been rising.

The S&P 500 is far more exposed to global manufacturing activity than it is to services, and weaker manufacturing data has a more meaningful impact on corporate profits. For this reason, equity markets tend to exhibit a strong positive correlation to manufacturing survey data. Given that uncertainty continues to permeate the air, the more cautious tone in markets seems warranted.

Corporate Earnings

Although not all companies have reported, third-quarter earnings are likely to post a decline of about 3.7%. If forecasts prove accurate, this will mark the first time the index has reported three straight quarters of year-over-year profit declines since 2015. Moreover, expectations for earnings growth for 4Q19 have been falling over the past few months. (see chart below) On June 30, the estimated earnings growth rate for 4Q was 5.6%. By September 30, the estimated earnings growth rate had fallen to 2.4%. As of the most recent reading, profits are forecasted to decline by 0.4% in the final quarter of the year.



Conclusion

So far this year, generally positive employment numbers in the U.S. have driven personal consumption which in turn has supported the economic expansion that begun eleven years ago. Still, the global economy faces a myriad of challenges. Capital spending is weak, the manufacturing sector is posting recession-like numbers and political divisiveness both within and among countries is a growing threat. The specter of impeachment proceedings in the US as well as the bitter tone of the presidential campaign is exacerbating the sense of disunity in America. The same can be said for the ongoing heated debates in the UK around Brexit as well as the protests playing out on the streets of Hong Kong.

While the trade war could very well trigger a recession, negative GDP growth in the next year is not forecasted at this point. Unlike previous recessions, the banking system is sound, inventories are not overextended, inflation is modest, consumers are not overly indebted and the job outlook remains moderately positive. Additionally, while one can argue the efficacy of monetary policy at this point, central bankers here and abroad are clearly in a state of vigilance and ready to intervene if and when necessary. Passage of some kind of fiscal stimulus such as a one-time tax rebate, is also a possibility in the year ahead. The combination of the aforementioned multifaceted challenges suggest an increase in volatility going into next year.

S&P 500 Index

3 Month	2.43%
Year-to-Date	23.16%
1 Year	14.32%
3 Year	14.90%
5 Year	10.76%

MSCI EAFE Net Index

3 Month	3.80%
Year-to-Date	16.86%
1 Year	11.04%
3 Year	8.48%
5 Year	4.30%

Barclays Aggregate Bond Index

3 Month	2.35%
Year-to-Date	8.85%
1 Year	11.51%
3 Year	3.29%
5 Year	3.24%

As of 10.31.2019

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