IdahoTrustBank

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust Bank

The domestic financial markets have experienced very strong performance so far this year. However, a slowdown in global economic activity has begun to impact the investment environment as interest rates have fallen around the globe. The Federal Reserve Bank has shifted its monetary policy position to reflect softer economic conditions.

Interest Rates

At the late-July meeting, the Federal Reserve Bank (Fed) lowered interest rates for the first time since 2008. The target range of the Fed funds is now 2.00% – 2.25%. The domestic economy experienced a slowdown in the second quarter. Moreover, many forward looking indicators remain weak, which suggests there may be some further slowing in the coming months. The Fed is facing growing pressure to have a more accommodative monetary policy as many believe that the economy will slow down dramatically from current levels. The yield on the 10-year Treasury had been declining over the past several months in anticipation of the Fed meeting.

In their policy statement, the Fed Chairman, Jerome Powell, listed three reasons for the recent rate reduction: “to insure against downside risks from weak global growth and trade policy uncertainty; to help offset the effects these factors are currently having on the economy; and to promote a faster return of inflation to our

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LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust Bank's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.

symmetric two percent objective."

Powell also stated that "we're thinking of it as essentially in the nature of a mid-cycle adjustment to policy." In other words, the Fed does not regard this move as the first in a long series of rate cuts going into a recession. Instead, they see a few cuts to help the economy during a slowdown. That statement disappointed many investors who believe a more aggressive interest rate reduction is necessary.

Powell also said, "After simmering early in the year, trade-policy tensions nearly boiled over in May and June, but now appear to have returned to a simmer." However, shortly after the meeting, President Trump tweeted that the U.S. will impose additional tariffs on Chinese goods starting in September, which contributed to an increase in market volatility.

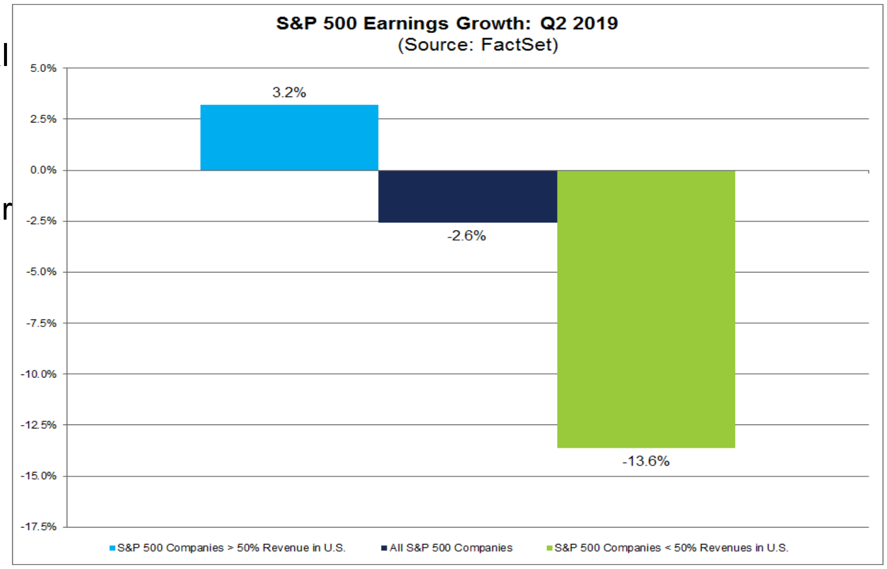
Gross Domestic Product

The second quarter (2Q) Gross Domestic Product (GDP) was 2.1%, a preliminary reading subject to revision. The 2Q results, while slightly better than expected, represent a deceleration from the 3.1% pace experienced in the first quarter. Business investment declined for the first time since 2016, as nonresidential fixed investment fell by 0.6% versus a 4.4% increase in 1Q. Consumer spending rose at an inflation adjusted annualized rate of 4.3%, accelerating from the first quarter rate of 1.1%, marking the strongest pace of growth since late 2017. Consumer spending, which accounts for more than two-thirds of the U.S. economy, was boosted by sales of big-ticket items such as cars. Declining oil prices as well as a healthy labor market were also positive contributing factors.

Corporate Earnings

Although not all the companies have reported 2Q results, earnings for the S&P 500 will likely decline by (2.6%), but revenues should increase by 3.8%. This marks the first time the index has reported two straight quarters of year-over-year declines in earnings since 2016. The profit declines reflect narrower operating margins. It is estimated that the profit margin for the S&P

500 will decline to 11.3% in 2Q from 11.8% for the prior year period. Ten of the 11 sectors may well report year-over-year declines in their net profit margins. One factor contributing to these declines is a difficult year-over-year comparison. The prior year's period benefited from exceptionally high profitability due to several one-time items. Other negative factors appear to be higher costs from labor as well as raw material price pressure. Weakness in overseas economies, the stronger U.S. dollar, as well as trade tensions have negatively impacted profits of companies with higher international revenue exposure. As noted in the chart above, these internationally focused companies experienced an earnings decline of over 13%, compared to domestically oriented companies with a modest profit gain of 3.2%.



Looking ahead, earnings are expected to post a modest decline in the third quarter. Expectations for earnings growth for 3Q19 have been falling over the past few months. Interestingly, two of the eleven sectors are projected to report a year-over-year decrease in 3Q earnings: Energy (-13%) and Information Technology (-9%), sectors with very high international revenue exposure. Consequently, activity levels overseas seem to be the primary source of earnings pressure.

Conclusion

Market volatility has picked up in recent weeks as fears of a protracted and pronounced trade war have intensified. Even before the U.S. tariffs that were levied on China officially went into effect, global trade had shown signs of slowing. The global trade slowdown explains the recent sell-off in emerging-market investments. One issue with imposing tariffs is that it will likely raise the cost of raw materials. Another concern is that the near-term impact on growth could likely be negative as business investments decisions get delayed. While we think the chances of a full blown trade war are low, the possibility is worrisome and recent talks have not produced much progress.

S&P 500 Index

3 Month	1.69%
Year-to-Date	20.24%
1 Year	7.98%
3 Year	13.35%
5 Year	11.32%

MSCI EAFE Net Index

3 Month	-0.44%
Year-to-Date	12.58%
1 Year	-2.60%
3 Year	6.87%
5 Year	2.39%

Barclays Aggregate Bond Index

3 Month	3.28%
Year-to-Date	6.35%
1 Year	8.08%
3 Year	2.17%
5 Year	3.04%

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Boise Branch
888 W. Broad St.
Boise, Idaho
208.373.6500

Coeur d'Alene Branch
622 E. Sherman Ave.
Coeur d'Alene, Idaho
208.664.6448

Las Vegas Trust Office
2850 W. Horizon Ridge PKWY, Ste 200
Henderson, Nevada
702.430.4747

Info@IdahoTrust.com
www.IdahoTrust.com

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