IdahoTrustBank

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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 next year with limited inflation levels. Moreover, global monetary policy has become slightly more accommodative; although, the level of political uncertainty remains very high and may contribute to increased volatility in 2020.

Gross Domestic Product

The third quarter (3Q) Gross Domestic Product (GDP) was 2.1%, revised up from the preliminary reading of 1.9%. The 3Q results represent a slight improvement from the 2.0% pace experienced in the previous quarter. The increase in real GDP in the third quarter reflected positive contributions from Personal Consumption Expenditure (PCE), federal government spending, residential investment, private inventory investment, exports, and state and local government spending that were partly offset by a negative contribution from nonresidential fixed investment.

Growth in the U.S. economy benefited from resilient consumer spending that was partially offset by weak manufacturing activity levels. Although personal consumption moderated somewhat from the very strong pace in the second

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quarter, the growth rate was still ahead of consensus expectations for the latest reported period. Consumer spending comprises more than two-thirds of U.S. economic activity. Residential real estate activity grew, marking a positive contribution to GDP for the first time in two years as lower mortgage rates helped drive a broad recovery in the housing market.

Ongoing geopolitical concerns have spurred weak business investment to shore up resources and curb new spending to prepare for a possible future downturn. Nonresidential private investment turned negative for the first time since 2016 in the second quarter and contracted again during the third quarter. Some transitory factors, including fewer shipments of Boeing aircraft and the 40-day United Auto Workers strike on General Motors, negatively contributed to the softer activity levels.

As the tailwinds from fiscal stimulus wane, trade policy uncertainty persists, and sluggish global demand continues, the pace of U.S. GDP growth should moderate over the coming quarters. For 2020, economists are expecting growth to remain around 2 percent in the United States.

Economic Activity

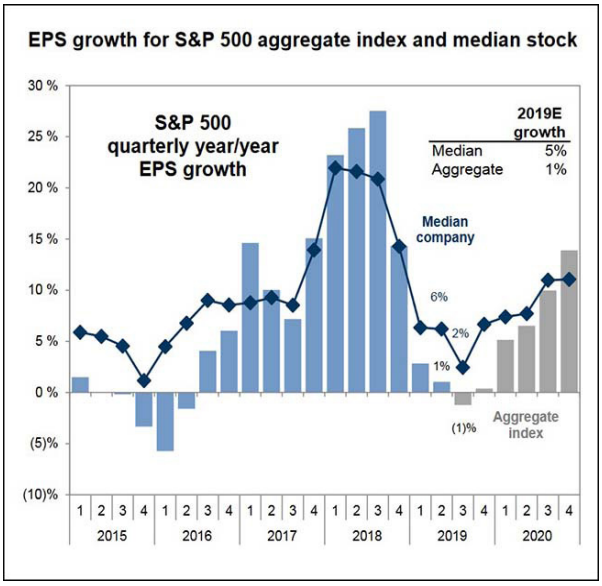
Recent updates to global economic forecasts show a slowdown in global growth due to rising trade tensions and increasing economic uncertainty. The International Monetary Fund (IMF) expects world GDP growth to slow from 3.6% in 2018 to 3.0% in 2019. A 3.0% growth rate would be the slowest global growth 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.



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	7.89%
Year-to-Date	27.63%
1 Year	16.10%
3 Year	14.87%
5 Year	10.96%

MSCI EAFE Net Index

3 Month	7.76%
Year-to-Date	18.17%
1 Year	12.44%
3 Year	9.62%
5 Year	4.26%

Barclays Aggregate Bond Index

3 Month	-0.28%
Year-to-Date	8.79%
1 Year	10.79%
3 Year	4.10%
5 Year	3.08%

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