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Quarterly Economic Review
July 2019

Economic Review

- ***The first half of 2019 saw robust gains across most asset classes, but it certainly wasn't a smooth ride.*** Global stock markets got a jump start on the year thanks to progress in US-China trade negotiations and a newly "patient" Fed, but an abrupt breakdown in the trade talks (announced via Presidential tweet) spurred a sharp market sell-off in May. Stock markets subsequently shook off their swoon in June, rebounding on expectations of Fed rate cuts later in the year and (tentative) signs of re-engagement on the US-China trade front.

- ***The S&P 500 hit a new high near the end of June. Large-cap U.S. stocks shot up 7.0% for the month – their best June since 1955.*** They were up 4.3% for the second quarter, and a remarkable 18.5% for the first six months of the year—their best first half since 1997.

- ***Foreign stocks also notched double-digit gains through the first half of the year.*** Developed international stocks gained 5.9% in June, 3.2% for the second quarter, and 14.2% for the year to date. European stocks have done a bit better, gaining 15.6% on the year so far. In April, the "Brexit can" was kicked down the road at least until October 31, but the risk of a disruptive "no-deal" exit remains. Emerging-market stocks also rebounded in June, gaining 5.4%. Although emerging-market stocks were only up 0.8% for the second quarter, their first-half gains stand at 12.6%.

- ***Moving on to the fixed-income markets, the 10-year Treasury yield continued to plunge from its multi-year high of 3.2% last October, dipping below 2% following the Federal Reserve's June meeting. This was a near three-year low, and among its lowest levels ever.*** The 10-year yield ended the month at 2.0%. Bond prices rise as yields fall, driving the core bond index to a 3.0% gain for the quarter and an impressive 6.1% return so far this year. Floating-rate loans gained 1.7% for the quarter and are up 5.7% for the year

It was a bull market for all asset classes in the second quarter of 2019!

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Bond Market ex US
Q2 2019	**STOCKS**				**BONDS**	
	4.10%	**3.79%**	**0.61%**	**1.29%**	**3.08%**	**2.75%**
Since Jan. 2001						
Avg. Quarterly Return	2.0%	1.5%	2.9%	2.6%	1.2%	1.1%
Best Quarter	16.8%	25.9%	34.7%	32.3%	4.6%	4.6%
	2009 Q2	**2009 Q2**	**2009 Q2**	**2009 Q3**	**2001 Q3**	**2008 Q4**
Worst Quarter	-22.8%	-21.2%	-27.6%	-36.1%	-3.0%	-2.7%
	2008 Q4	**2008 Q4**	**2008 Q4**	**2008 Q4**	**2016 Q4**	**2015 Q2**

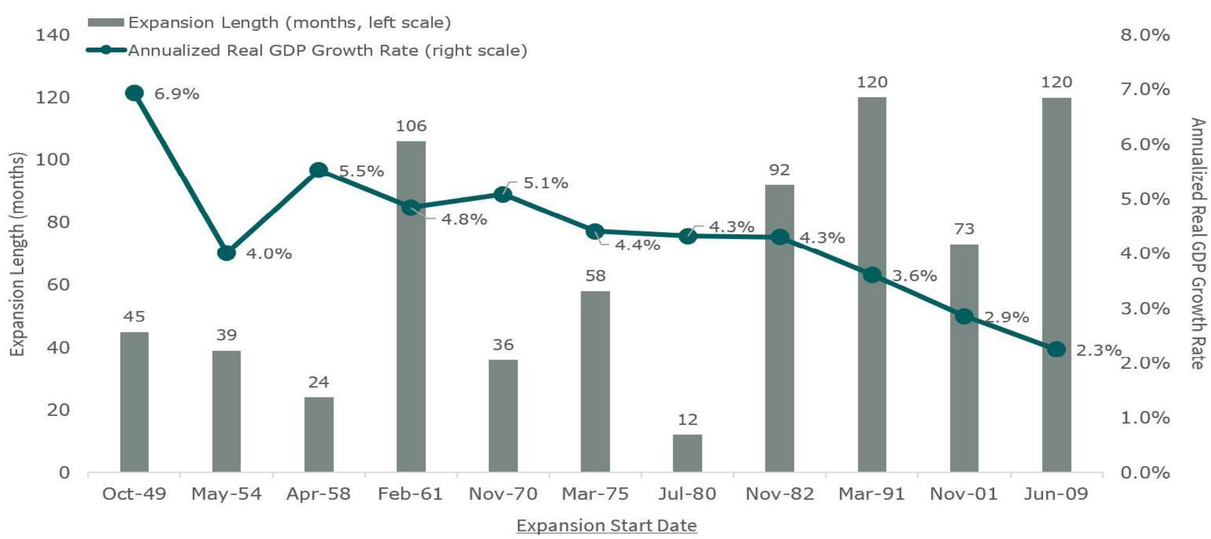
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). Bloomberg Barclays data provided by Bloomberg.

This year's rally earned back fourth quarter 2018 losses.

- The Fed-fueled rally that began in January with comments of being "patient" extended to the second quarter.
- May saw a temporary set-back as U.S./China trade tensions escalated with the announcement of additional tariff increases.
- In June, the Fed signaled a strengthened case for more accommodative policy, spurning the market upwards.

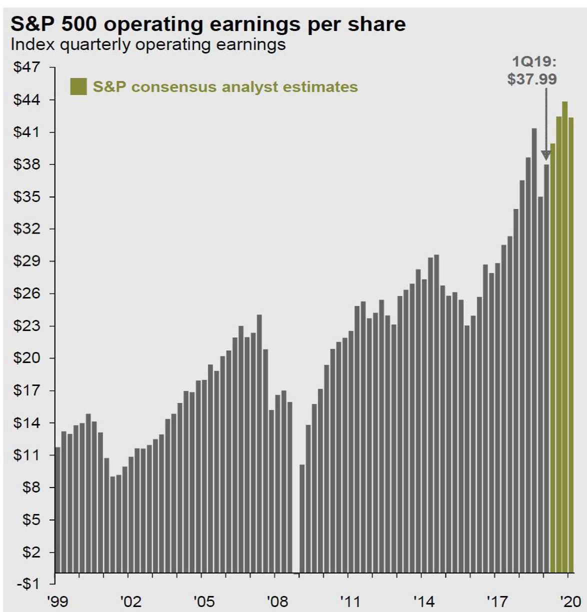
This U.S. economic expansion is the longest but slowest.

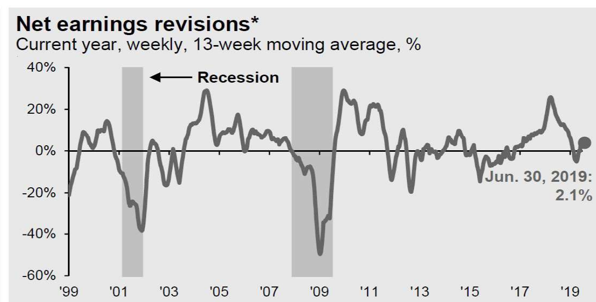
While lengthy, this recovery doesn't yet exhibit the financial market excesses (asset price bubbles) or economic overheating (inflation) typically seen late in the cycle.

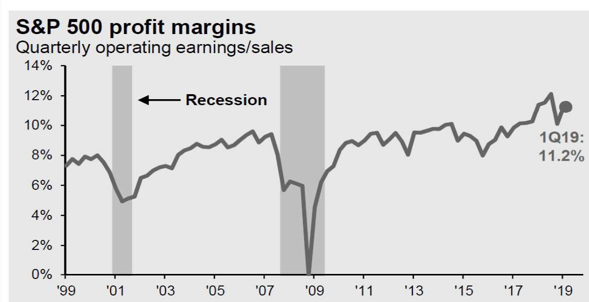


Source: U.S. Bureau of Economic Analysis. Data as of 6/30/2019.

Corporate profits are still at all time highs…







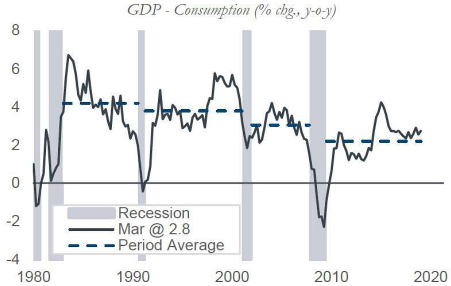
Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.
EPS levels are based on operating earnings per share. Earnings estimates are Standard & Poor's consensus analyst expectations. Past performance is not indicative of future returns. *Net earnings revisions are calculated as the number of upward revisions minus the number of downward revisions as a percentage of total revisions. Total revisions include upward, downward and unchanged revisions.
Guide to the Markets – U.S. Data are as of June 30, 2019.

J.P.Morgan Asset Management

... the U.S. consumer is in good shape...

Household financial conditions are strong and supportive of further spending.

Consumption Remaining Strong, Consumers Enjoying Tax Cuts
GDP - Consumption (% chg., y-o-y)

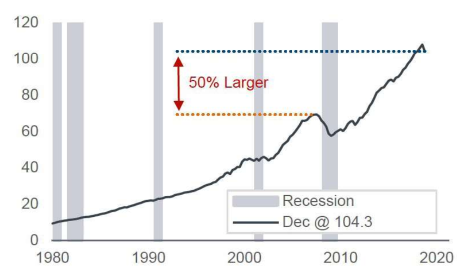


Source: Bureau of Economic Analysis. As of March 2018.

Historically High Savings Sign of Strong Consumer
Personal Savings as a Percentage of Disposable Personal Income (%

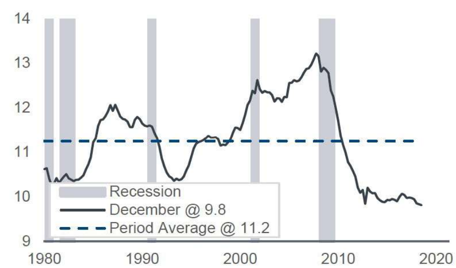
Source: Bureau of Economic Analysis. As of April 2019.

Households Have Record Wealth
Household Net Worth ($, trillions)



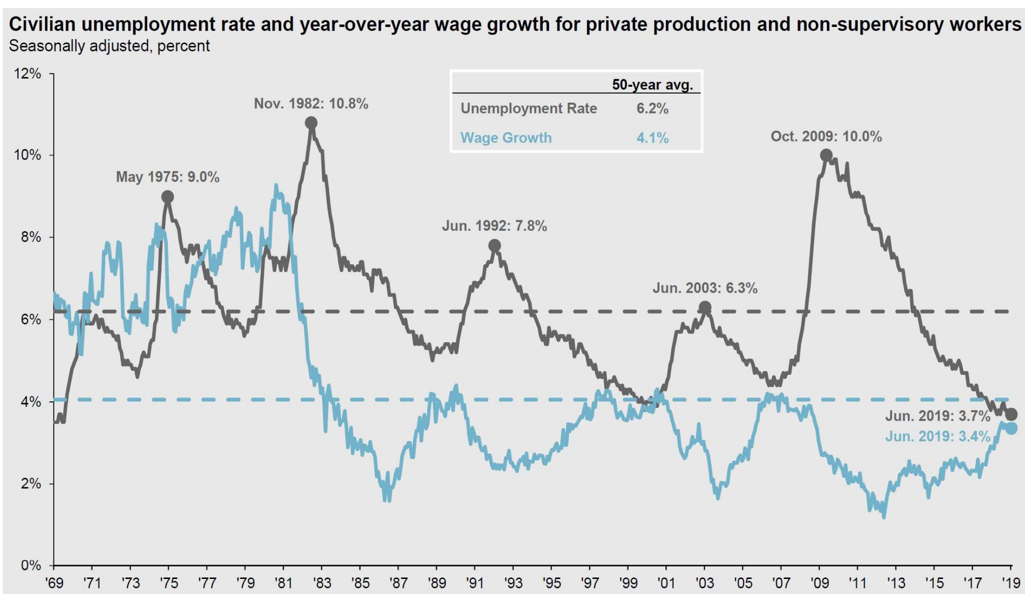
Source: Federal Reserve Bank. As of December 2018.

Household Debt Burden at Very Low Levels
Debt Service Ratio (%)



Sources: Federal Reserve Bank, Bureau of Economic Analysis. As of December 2018.

...unemployment is low and wages are rising.



Source: BLS, FactSet, J.P. Morgan Asset Management.
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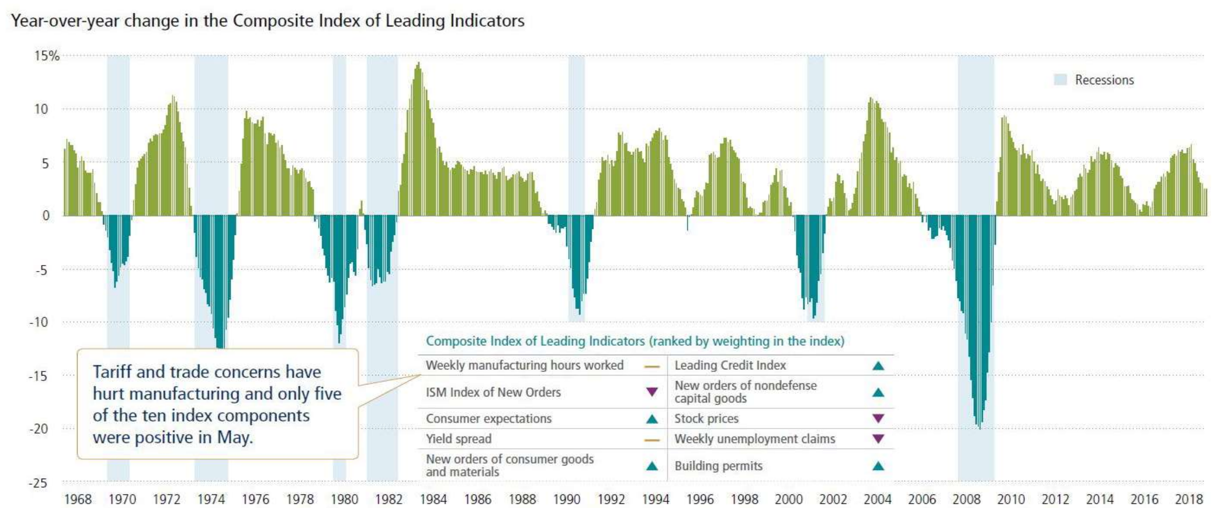
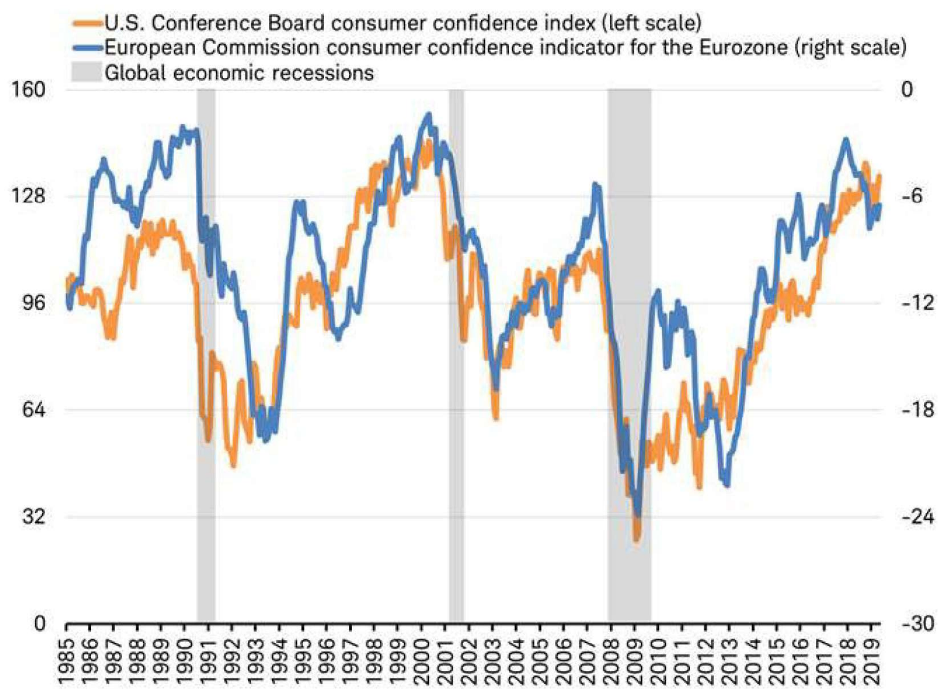
J.P.Morgan Asset Management

Leading economic indicators remain positive for now, but show signs of weakening.

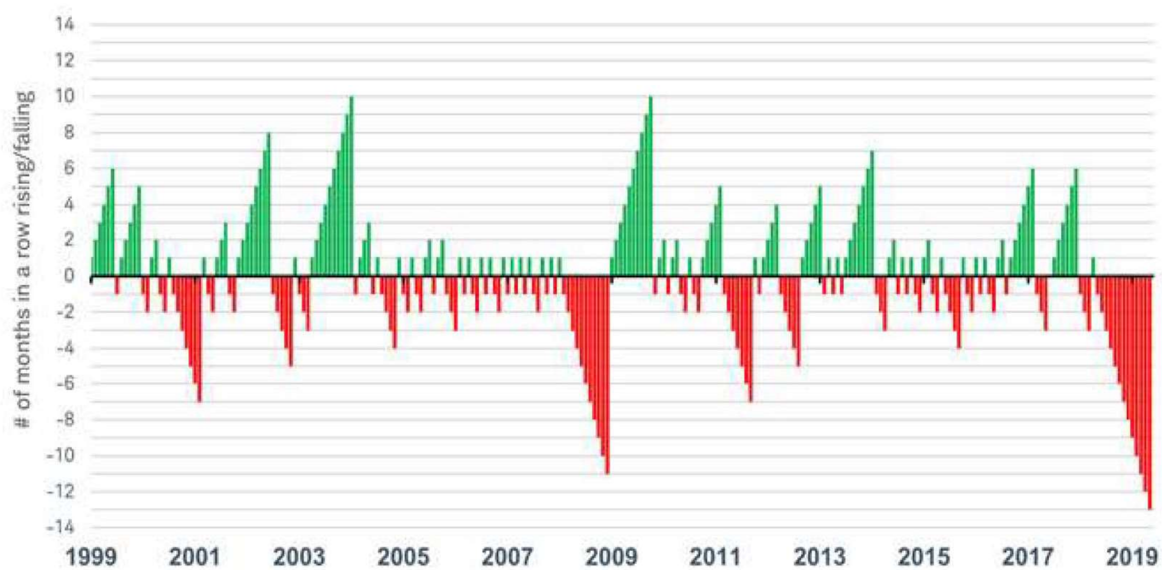


Source: The Conference Board, as of 5/31/19. The Composite Index of Leading Indicators is an index published monthly by The Conference Board, used to predict the direction of the economy's movements in the months to come. The index is made up of 10 economic components whose changes tend to precede changes in the overall economy. It is not possible to invest directly in an index. Past performance does not guarantee future results.

Consumer confidence measurements are at levels that have preceeded past recessions.

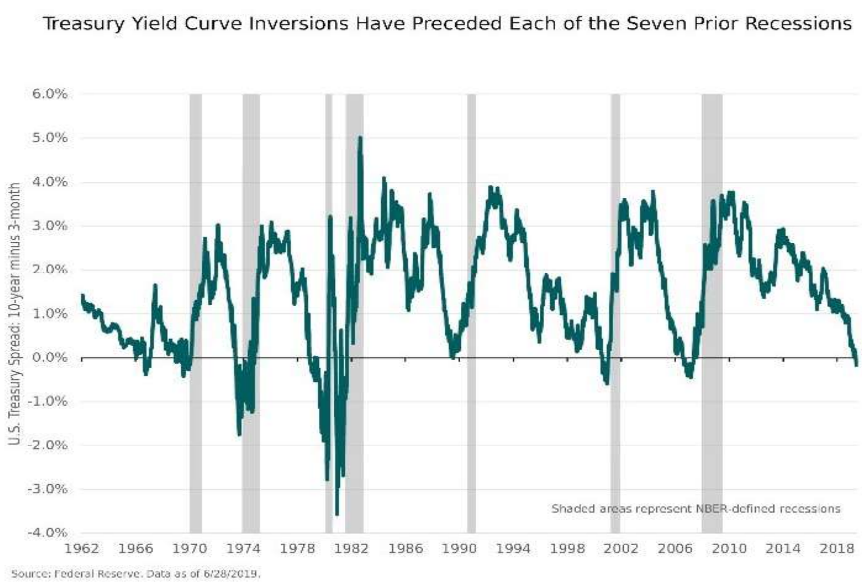


The global purchasing managers' index fell for 13 months in a row.



Source: Charles Schwab, Factset data as of 6/16/2019.

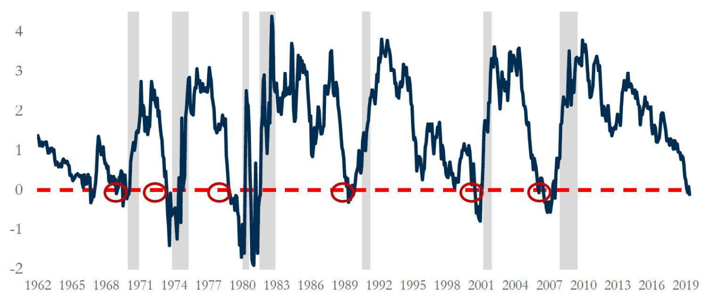
And, the yield curve has remained inverted…



...which isn't a sign of imminent recession...

An Inverted Yield Curve Isn't Immediate Trouble

Since the 1970s, it has taken an average of 22 months before a recession emerged after the yield curve has inverted. Stocks have also performed well for a significant period after inversion.



Inversion Signal	Months to Recession	S&P 500 Return (NTM)
Sep-66	False Alarm	24%
Dec-68	12	-15%
Feb-73	9	-22%
Jul-78	18	8%
Sep-80	11	1%
May-89	14	12%
Sep-98	30	37%
Feb-06	22	13%
Average	**16.6**	**7.3%**
Median	**15.3**	**7.7%**

Source: Bloomberg. As of May 2019.

...but has been a reliable indicator of recession in the past.

HISTORICAL 10-YEAR/3-MONTH U.S. TREASURY YIELD CURVE INVERSIONS			
DATE	DURATION (DAYS)	MAGNITUDE (BASIS POINTS)	OUTCOME
1989	84	-14	Recession
1998	5	-6	False alarm
2000	196	-46	Recession
2007	314	-33	Recession
2019*	23	-14	?

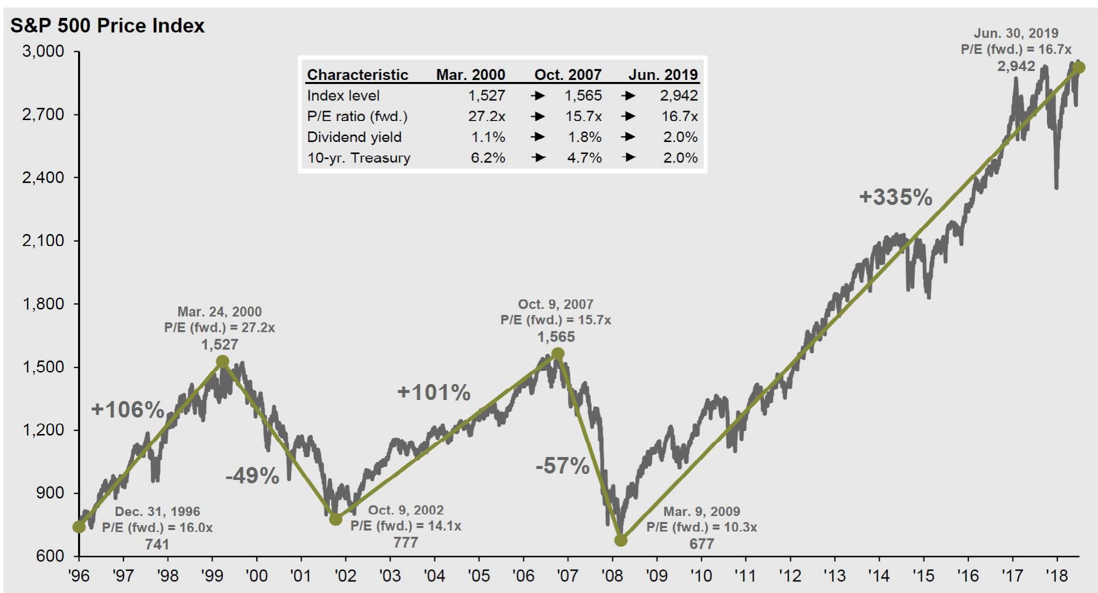
*As of June 14, 2019, for the yield inversion which started on May 23, 2019.

Overall recession probability remains low for now.

	May 2019	April 2019
Yield Curve	✗	✗
Credit Spreads	⬆	⬆
Money Supply	●	●
Wage Growth	●	●
Commodities	✗	●
Housing Permits	⬆	⬆
Jobless Claims	⬆	⬆
Retail Sales	⬆	⬆
Job Sentiment	⬆	⬆
ISM New Orders	⬆	⬆
Profit Margins	⬆	⬆
Truck Shipments	⬆	⬆
Overall Signal	⬆	⬆

Source: ClearBridge Investments.

Despite weakening economic numbers, the U.S. market continues to climb higher…

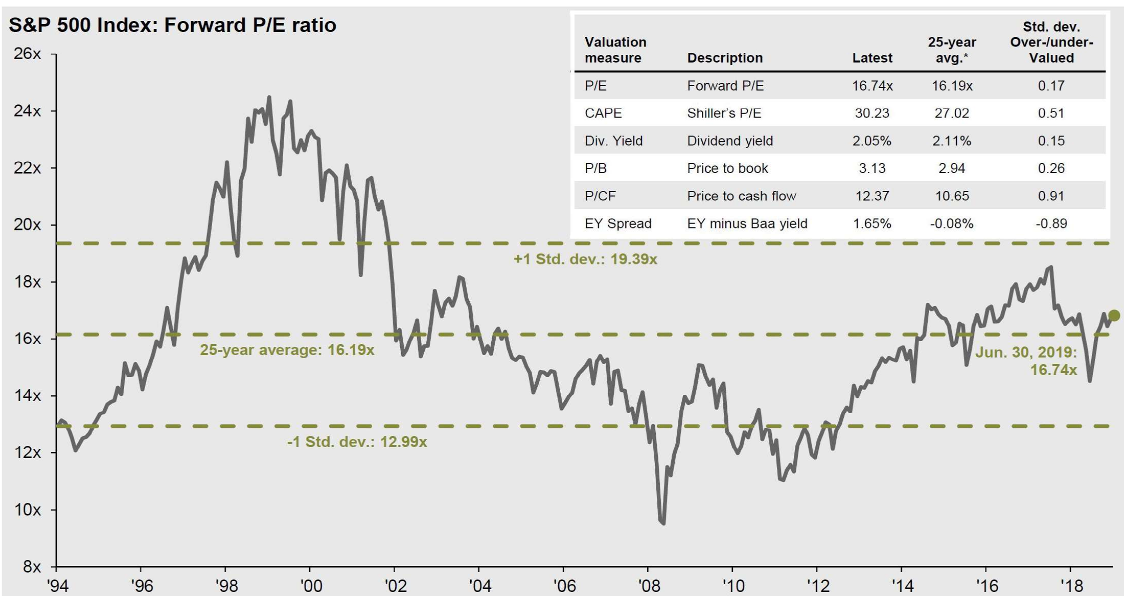


Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of June 30, 2019.

J.P.Morgan
Asset Management

…and is currently trading at slightly elevated valuations.

S&P 500 Index: Forward P/E ratio



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	16.74x	16.19x	0.17
CAPE	Shiller's P/E	30.23	27.02	0.51
Div. Yield	Dividend yield	2.05%	2.11%	0.15
P/B	Price to book	3.13	2.94	0.26
P/CF	Price to cash flow	12.37	10.65	0.91
EY Spread	EY minus Baa yield	1.65%	-0.08%	-0.89

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since July 1994, and FactSet for June 30, 2019. Average P/E and standard deviations are calculated using 25 years of IBES history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Price to book ratio is the price divided by book value per share. Price to cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure. *P/CF is a 20-year average due to cash flow data availability.
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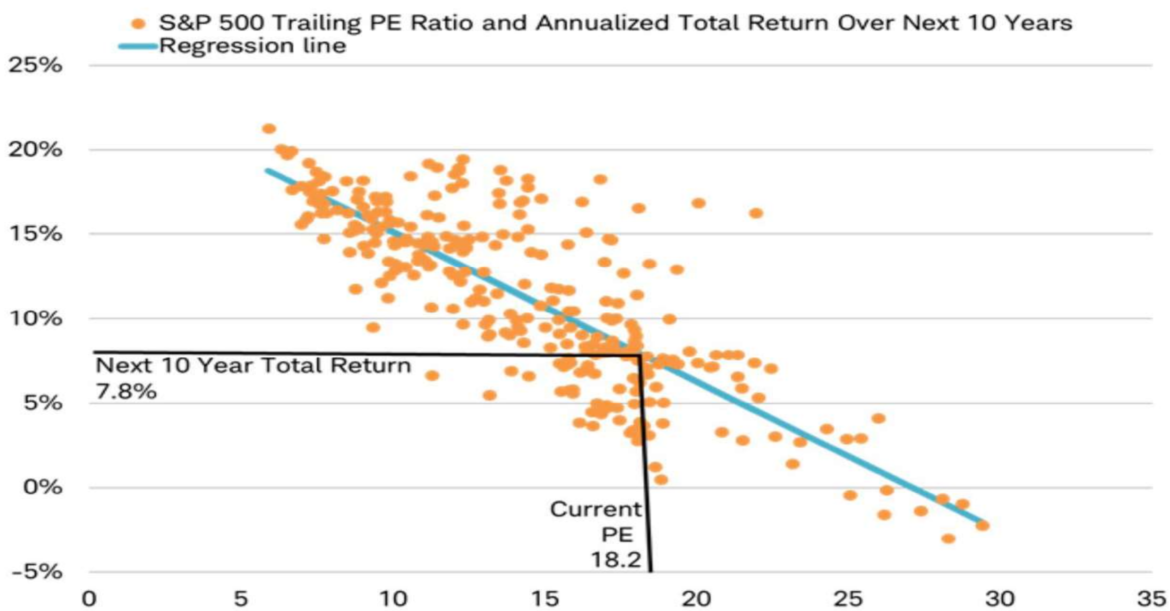
Historically, when starting at current valuation levels, the next decade return for the U.S. market has been positive.



Source: Charles Schwab, Factset data as of 7/7/2019.

Currently, the U.S. markets appear to have priced in a fair bit of good news...

- ✓ Insurance rate cuts by the Fed
- ✓ 2 cuts by September 2019 and 2 cuts in 2020
- ✓ A U.S.-China trade deal over the summer
- ✓ Earnings acceleration in the second half of 2019
- ✓ GDP of approx. 2%
- ✓ No recession
- ✓ Inflation never again
- ✓ Absorbable impact from tariffs on the fundamental and earnings side
- ✓ No European auto tariffs
- ✓ Ratification of United States-Mexico-Canada Agreement
- ✓ More China stimulus

- ✗ No Fed cuts or one cut
- ✗ No U.S.-China trade deal until year-end if at all
- ✗ Earnings deterioration
- ✗ U.S. GDP less than 2%
- ✗ An inflation spike
- ✗ Ineffective China stimulus
- ✗ Hard Brexit
- ✗ European auto tariffs
- ✗ No ratification of United States-Mexico-Canada Agreement in the next few months
- ✗ A tariff induced fundamentals slowdown
- ✗ Certain presidential election outcomes

Source: BNY Mellon Global Investment Strategy (June 2019), based on internal team research and market observations. Actual market sentiment and activity may differ materially from views expressed here.

...and the rest of the year is full of potentially disrupting events...

2019: "Let's Make a Deal"

Jan. | Feb. | Mar. | Apr. | May | Jun. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec.

- U.S.-Japan Formal Trade Negotiations Begin

- Commerce Department National Security Report on Auto Imports
- Deadline to Avoid Second U.S. Government Shutdown

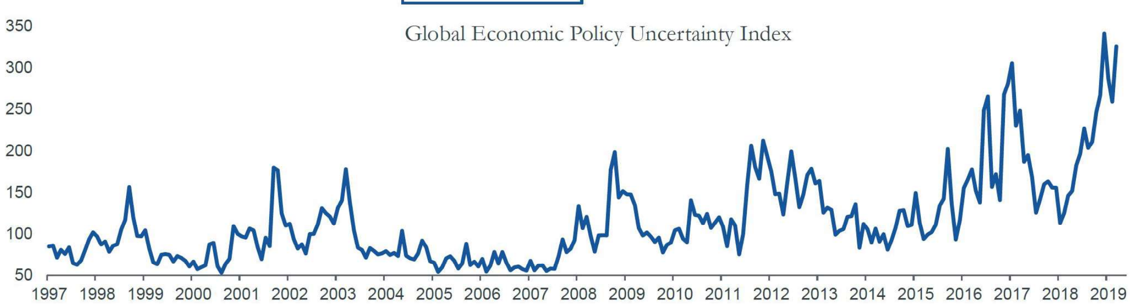
- China Passes Revised Foreign Investment Law

- U.S. Raises Tariffs on $200B of Chinese Goods/Begins Plans on Additional $300B
- U.S. Postpones Decision on Auto Tariffs for 6 Months
- EU Parliament Elections
- Temporary Waivers on Iranian Oil Expire

- G20 Summit
- China Expected to Impose Tariffs on $60B in U.S. Goods

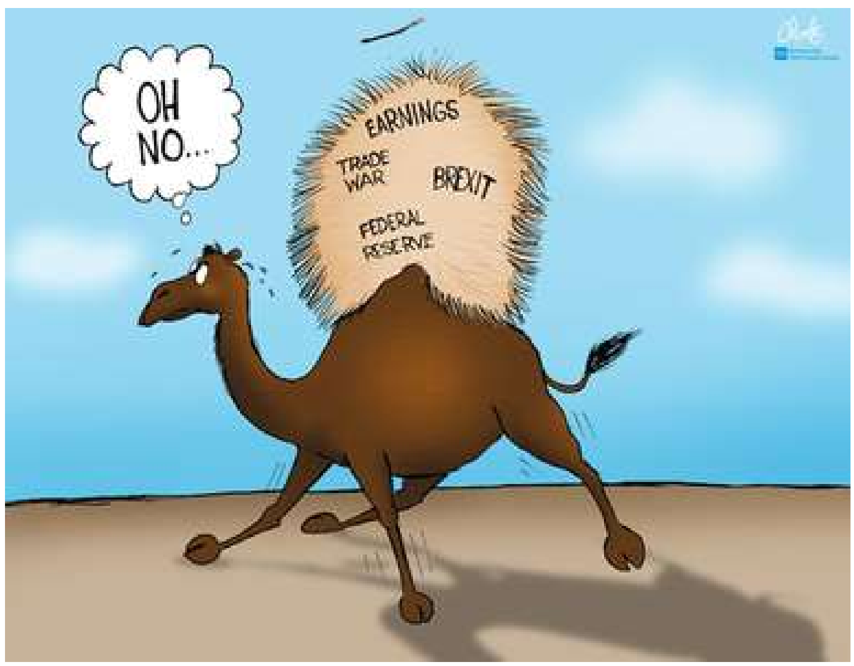
- Potential USMCA (NAFTA 2.0) Ratification

- U.S. Budget Caps/Debt Ceiling
- New ECB President
- New Brexit Deadline October 31



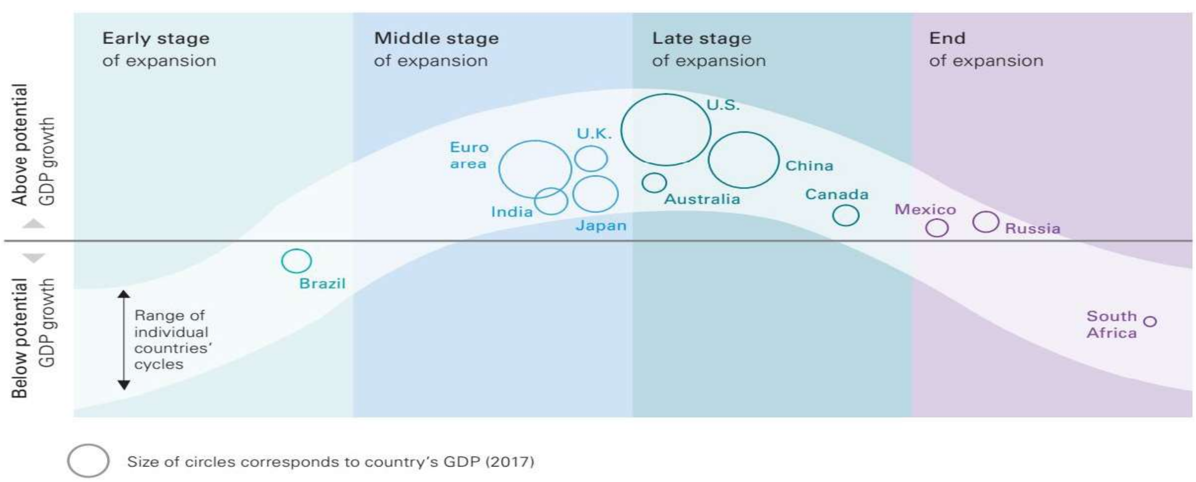
Source: www.policyuncertainty.com, May 2019.

...so it is difficult to predict which straw may be the last!



While the U.S. economy seems to be entering the late expansion cycle, several international markets appear to be still mid-cycle.

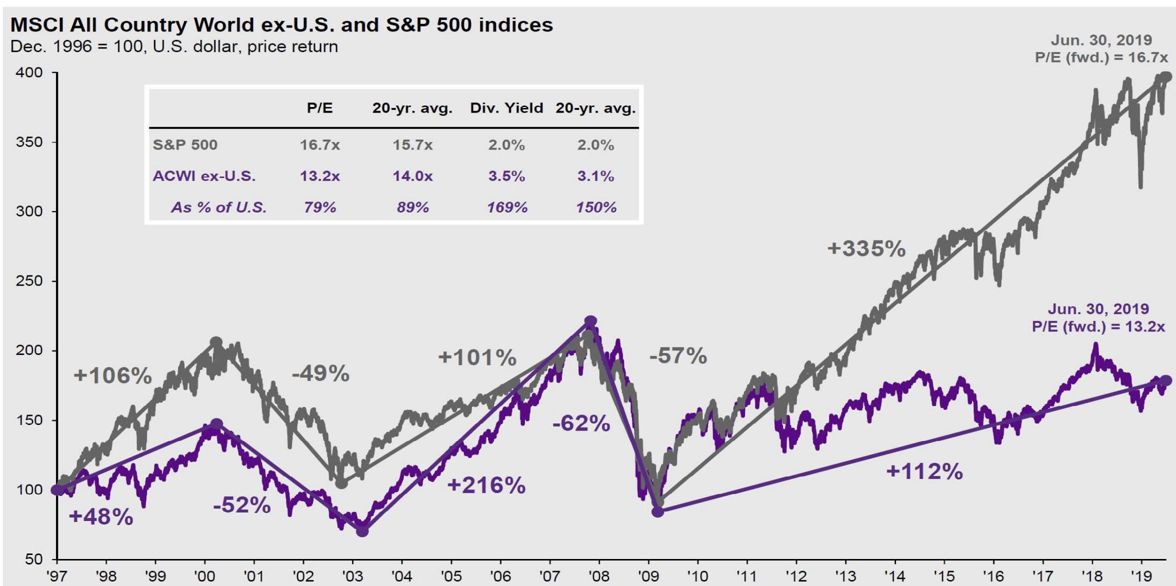
Where are countries in their economic cycles?



Notes: The vertical axis represents GDP growth rate relative to each country's potential growth rate, represented by the horizontal line. There is no inherent time limit on the length of each stage; different economies progress through the stages at varying speeds. The end of an expansion represents below-trend growth, which may or may not match the common definition of recession of two consecutive quarters of negative real GDP growth.

Sources: Vanguard and the International Monetary Fund (IMF).

Global equity markets have not expanded as quickly as the US, and are trading at more attractive valuations with higher dividend yields.



	P/E	20-yr. avg.	Div. Yield	20-yr. avg.
S&P 500	16.7x	15.7x	2.0%	2.0%
ACWI ex-U.S.	13.2x	14.0x	3.5%	3.1%
As % of U.S.	*79%*	*89%*	*169%*	*150%*

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Forward price to earnings ratio is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on price movement only, and do not include the reinvestment of dividends. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by FactSet Market Aggregates. Past performance is not a reliable indicator of current and future results.
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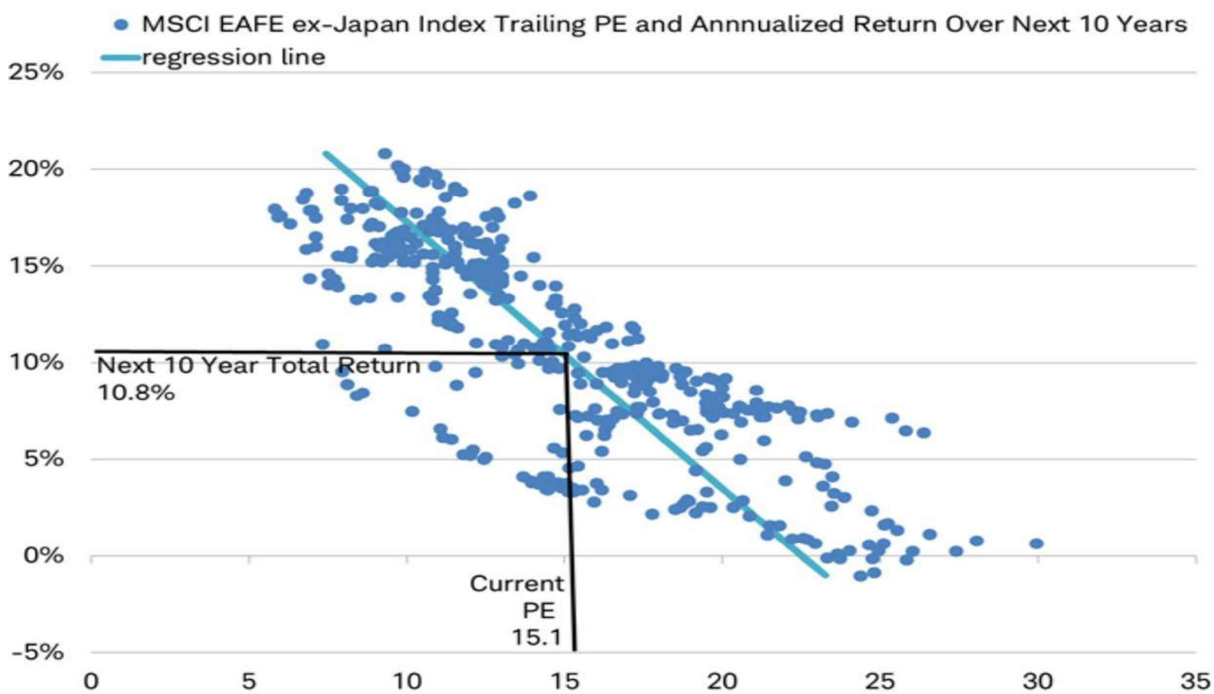
J.P.Morgan
Asset Management

Historically, global stock market returns from current valuation levels have been healthy.



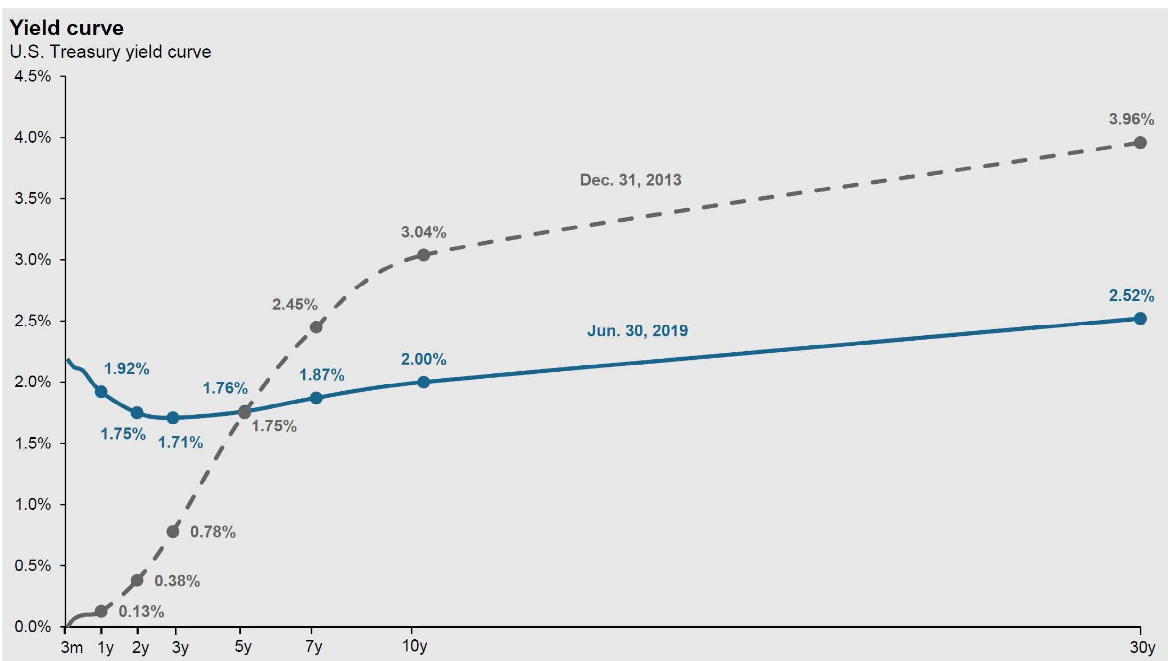
Source: Charles Schwab, Factset data as of 7/7/2019.

While the stock market presses forward on anticipation of continued positive economic news, the bond market continues to price in economic slowdown.

Exhibit 1: Equities and Bonds Are Sending Different Messages

As of 28 June 2019
Source: Haver Analytics, Standard & Poor's, Tullett Prebon Information

The yield curve has inverted further, meaning long term growth rates are anticipated to be lower in the future.



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
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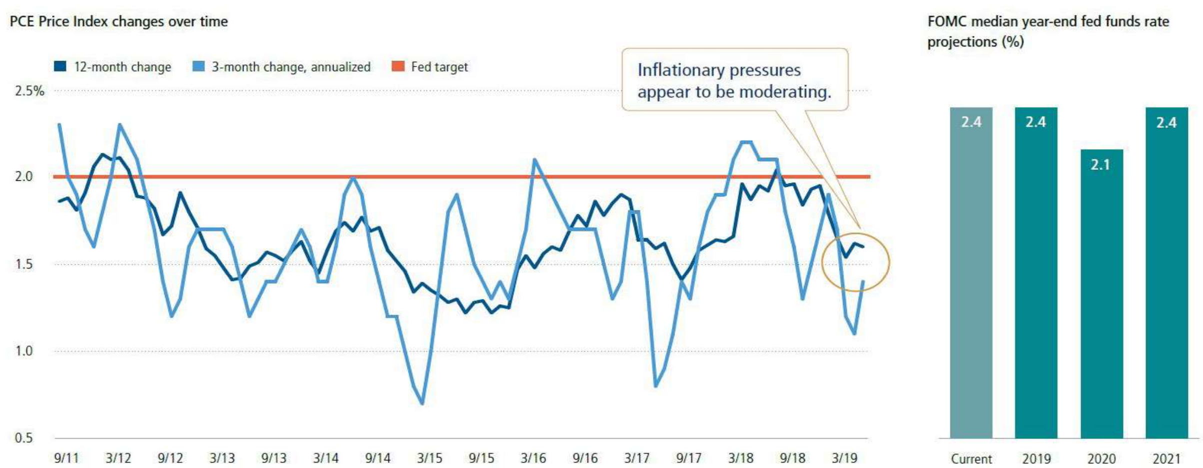
As inflation has moderated, the Fed has indicated they may ease and begin rate cuts.

Inflation briefly climbed to the Fed's target before retreating more recently



Source: U.S. Federal Reserve (Fed), Chicago Fed, as of 5/31/19. Interest-rate projections are based on the median for the federal funds rate projections of the Federal Open Market Committee (FOMC), the body responsible for setting the federal funds rate, which meets eight times a year. FOMC members anonymously report interest-rate projections four times a year, in March, June, September, and December. The Core Personal Consumption Expenditure (PCE) Price Index measures the prices paid by consumers for goods and services, excluding more volatile food and energy prices. It is not possible to invest directly in an index. Past performance does not guarantee future results.

But the benefits from additional rate cuts will likely be limited.

After nine rate *hikes*, the fed funds rate is barely above levels where it has ended most other *easing* cycles. Moreover, the Fed has historically cut rates by 5-7% during a recessionary easing cycle, and there will be little room to cut rates before hitting the "zero lower bound"

Shaded regions represent NBER-defined recessions. Source: Federal Reserve. Data as of 6/19/2019.

In summary, while there are a lot of positives, the potential magnitude of the cautionary items are rather large...

The investment landscape, while still positive, is growing more challenging as investors adjust to more typical late-stage expansion conditions.

Positives	Cautionary Signs/Areas to Watch
Global economic expansion	Trade policy missteps
Fed dovish pivot	Higher volatility
Positive corporate profit growth	Fading fiscal stimulus
Healthy consumer and business fundamentals	Acceleration in wages and other business costs
Rising confidence	Geopolitical shocks
Favorable financial conditions	Higher federal debt levels
Moderate inflation	Aging business cycle
Very few signs of imbalances — massive debt growth, overinvestment, capacity constraints	

…leading to caution when constructing portfolios.

Business Cycle

U.S. firmly in late-cycle phase

China's economy has stabilized, but its slowdown is still weighing on the global economy

Risks

Monetary and trade policy uncertainty

China's uncertain outlook and policy response

Asset allocation implications

Current environment warrants smaller asset allocation tilts and a diversified strategy

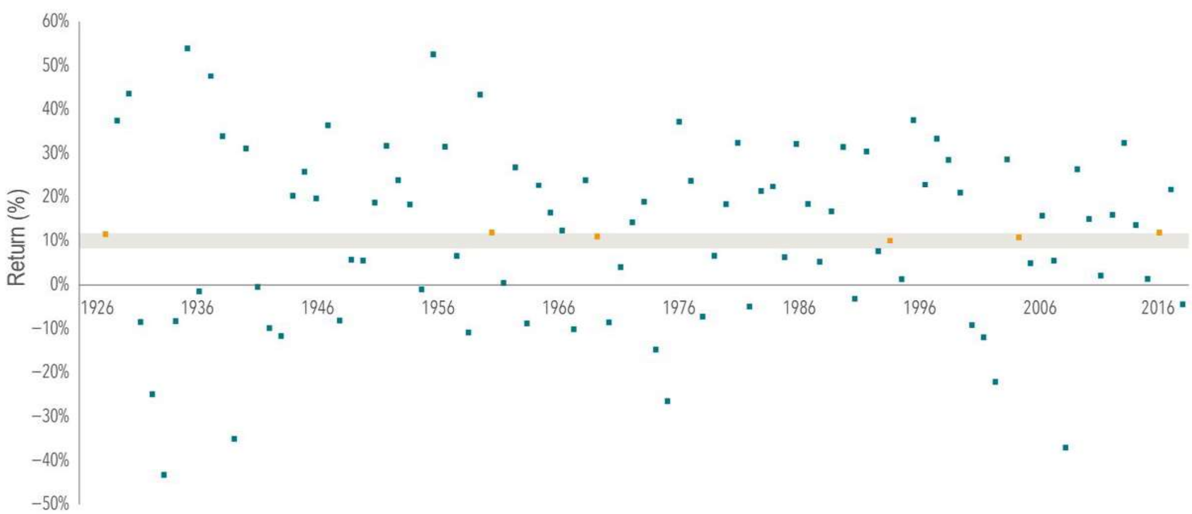
Policymakers' shift to more accommodative stance may support global asset markets

Inflation-linked asset valuations appear attractive relative to other asset classes

For illustrative purposes only. Source: Fidelity Investments (AART) as of 6/30/19.

While the stock market may average positive returns over the next cycle, the actual annual returns will most likely be scattered.

Exhibit 1. S&P 500 Index Annual Returns
1926–2018



In US dollars. S&P data © S&P Dow Jones Indices LLC, a division of S&P Global. Indices are not available for direct investment. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Past performance is no guarantee of future results. Actual returns may be lower.

So, time in the market - not timing the market - will be what matters.

Exhibit 2. Frequency of Positive Returns in the S&P 500 Index
Overlapping Periods: 1926–2018

In US dollars. From January 1926–December 2018, there are 997 overlapping 10-year periods, 1,057 overlapping 5-year periods, and 1,105 overlapping 1-year periods. The first period starts in January 1926, the second period starts in February 1926, the third in March 1926, and so on. S&P data © S&P Dow Jones Indices LLC, a division of S&P Global. Indices are not available for direct investment. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Past performance is no guarantee of future results. Actual returns may be lower.

Portfolio Implications

- ***Looking ahead, we still see a high degree of uncertainty and a wide range of plausible outcomes looking out over the next 12 months (and beyond).*** But at the margin we think the macro risks have increased. Trade uncertainty has damaged global business confidence in what by many measures is an already weak global economy. While this is for now being offset by easier monetary conditions, the inevitable impact of any additional central bank rate easing is certainly muted.

- ***We believe our portfolios are positioned to both generate attractive returns over the next five to 10 years, and to be resilient across this wide range of potential shorter-term risk scenarios.*** If central banks are successful with their renewed stimulus efforts, our analysis indicates that will favor our positions in global equities and flexible income funds.

- ***On the other hand, should markets turn south, our portfolios will benefit from our "ballast" positions in core bonds, lower-risk hybrid and alternative strategies.*** These lower-risk, "insurance" positions have been a drag on our returns over the past several years as U.S. stocks have been in a record-long raging bull market. But we've seen their benefits during the occasional market corrections, including in last year's fourth quarter. They also present us with potential capital to re-allocate back into U.S. stocks at lower prices and much higher expected returns if and when the opportunity should arise.

Disclosures

- Please remember that past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by the adviser), will be profitable or equal to past performance levels.

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