DANN ASSET ADVISORS, LLC

Second Quarter 2019 Update

July 12, 2019

2Q19 Highlights

- Following a tough May stocks rebound strongly in June, closing near record levels
- Bond yields continue falling as economic outlook becomes more uncertain
- Fed responds to increased uncertainty indicating higher probability of rate cuts
- International stocks continue to lag, reflecting slower economies and trade conflicts

The table below summarizes the performance of some key indices during the second quarter and year to date:

Market Performance		
Index	% Ch. 2Q19	% Ch. YTD
S&P 500	4.3	18.5
MSCI Developed Markets (excl US)	3.7	14.0
MSCI Emerging Markets	0.6	10.6
MSCI All Country World	3.6	16.2
US Aggregate Bond	3.1	6.1
Liquid High Yield	2.4	10.1
US Dollar Emerging Markets Bond	4.2	12.0

Source: Morningstar, iShares

Equities. U.S. stocks as measured by the large company S&P 500 index had another good quarter despite a temporary decline in May. As has been the case over much of the past several years, large cap growth stocks led the market, with value stocks and small company stocks trailing. More specifically, the Russell 1000 Growth index returned 4.6% for the quarter compared with 3.8% and 2.1% for the Russell 1000 Value and Russell 2000 (small cap) indices, respectively. Despite these divergences, the 18.5% gain over the first half for the S&P 500 represented the largest first half increase since 1997, according to The Wall Street Journal.

The S&P 500 ended the second quarter trading at a moderately expensive 17.6x multiple of 2019 estimated earnings, compared with 16.8x at March 31 and 14.4x at the end of 2018 (estimates from Yardeni Research). The market has risen in 2019 even as earnings estimates have declined roughly 5% (Yardeni Research). In our opinion, the market's advance implies that earnings growth will accelerate significantly later in 2019 or that lower interest rates have caused the multiple expansion and market gains. At this point we don't see a significant acceleration in earnings growth as likely and believe stocks have moved almost entirely due to declining rates.

In aggregate, international stocks lagged in the quarter with developed non-U.S. markets doing better than emerging. Emerging markets in particular were hurt by a stronger dollar until late in the quarter when the Fed indicated greater willingness to reduce rates. Uncertainty over U.S. trade policy combined with a slowdown in China (which impacts European exports and thus economies and stocks) seems to be the main issue restraining international stocks. China has taken steps to solidify growth and the European Central Bank recently indicated it, too, could become more accommodative, similar to the Fed.

Fixed income. The 10 year Treasury yield declined to 2.01% at quarter end from 2.41% at March 31 and after being as high as 3.25% in fall 2018. Two year treasury yields declined 53 basis points (a basis point is 1/100 of a percent) during the quarter, ending at 1.74%. As bond prices move inversely to interest rate changes, it was a good quarter and first half for fixed income returns, as shown in the table.

As mentioned above, rates have moved down as investors have become more concerned about economic growth and the Fed has tilted more dovish. We also note that international rates moved down significantly in the quarter, with German 10 year bond yields hitting a record low of negative 0.33%. In comparison to abroad, U.S. yields continue to look attractive and demand from international investors – searching for yield in a safe environment – likely has helped drive up bond prices/reduce yields.

Market sectors. The leading sectors during the second quarter were financials, technology and materials (chemical and industrial gas companies account for a majority of the last group). Given falling rates during the quarter, we're surprised by and don't have a good explanation for financials' performance (the group usually lags as rates are falling). The only explanation we can posit is that the financials often do well in advance of a strengthening economy – similar to materials and technology companies – so potentially the strength of these three sectors reflects stock market anticipation that the economy will pick up (in contrast to conflicting signs from the bond market). For the first half of the year, technology, industrials and consumer discretionary (last led by Amazon) were the best performing sectors.

The second quarter's worst performing sectors were energy, healthcare and REITs. Oil prices declined roughly 18% intra-quarter (before rebounding in late June as tension with Iran increased), likely causing the energy stocks to underperform. Although many healthcare businesses continue to perform well, the sector continues to be impacted by political pressures and the potential for greater government control, both of which could continue into next year. We believe REITs lagged primarily due to continuing pressure on retail-focused REITs.

Portfolio Positioning

We made no significant changes in fixed income allocations during the second quarter, continuing to be most heavily invested in short duration (which we define as three years or less) investment grade funds. On equities, for most clients, we sold an eclectic, conservatively invested international stock fund. This fund had been held to provide downside protection in tough markets but performed less well than we expected during the fourth quarter 2018 downturn. Accordingly, we decided to sell, with proceeds into already held investments and a little left in cash.

Economy

First quarter GDP growth came in stronger than expected at 3.1% vs. estimates of about 1.5% and compared with 2.2% in the fourth quarter of 2019. The first quarter was aided by strong exports and inventory growth, both of which may reverse in the second quarter. Consumer spending slowed to a 0.9% gain from 2.5% in the fourth quarter, and inflation remained below the Fed's 2% target. Second quarter GDP will be reported in the next couple of weeks and is expected to grow around 1.6% according to a recent Wall Street Journal survey of economists.

In our first quarter update we ended with, "[o]ur guess is that U.S. growth will be stronger later this year." Given the quick and substantial evolution in the Fed's position, we don't feel badly admitting that we're less confident that the economy will be stronger by year end. A lot probably depends on some resolution of trade issues, which to date have not had a huge impact on the economy but are, from what we hear managements saying, having an impact on confidence and willingness to invest. Positively weighing against trade negatives are potential rate cuts by the Fed and that both parties likely will do what they can to keep the economy expanding with elections coming in 2020.