The Cobblestone Advisor

Investment Brief

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COBBLESTONE CAPITAL ADVISORS

Mixed Signals

US equity markets struggled to generate gains during the third quarter but ultimately ended the period modestly higher (+1.7%). It was a volatile three months, with the S&P 500 climbing to new highs in late July only to then suffer a -6.0% trade-related selloff into the first two weeks of August. From there, US equities rebounded, accompanied by a sharp rotation in market leadership away from Growth, Momentum, and Large Cap stocks, to Value-oriented and Small Cap stocks. Notably, Value outperformed Growth by 3.6 percentage points in September—one of Value's best relative performances in more than a decade. International stocks—driven by developed markets—delivered modestly positive local currency returns during the quarter, but a strong US dollar led to negative returns for US investors.

US fixed income markets delivered positive returns for the three months through September (+2.3%), with corporate bonds outpacing the returns of the rest of the investment-grade bond market. Bonds continue to play an important role in diversification, cushioning against equity selloffs by acting as portfolio stabilizers.

Further deterioration in global economic conditions and persistent uncertainty regarding US-China trade policy remain overhangs on financial markets. In contrast to the global synchronized expansion that first materialized in late 2017, economies across the globe are now experiencing a synchronized deceleration. Driving factors include acute deterioration in manufacturing activity and global trade. The majority of countries (approximately 60%) surveyed by data provider IHS Markit showed manufacturing activity contract in September, with the global measure marking the fifth consecutive month of contraction (below exhibit). Similarly, the latest trade data show year-on-year world trade volumes sharply declining from +5.5% in October 2018 to -0.9% in July, marking the second consecutive month of contraction.

Uncertainty surrounding global trade policy has weighed on investment and demand for capital goods. A closely watched proxy for US business spending has contracted year-over-year for two consecutive months. The decline in capital expenditure plans over the trailing twelve months suggests that trade-related headwinds may continue to cloud the

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Purchasing Managers' Indices Indicate Deteriorating Economic Conditions Globally

Country/Region	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
Global	54.4	54.3	54	53.2	53.4	53	52.9	52.7	52.5	52.1	52	51.9	51.4	50.8	50.6	50.5	50.4	49.8	49.4	49.3	49.5	49.7
DM	56.2	56.3	55.7	54.8	55.1	54.7	54.4	54.0	53.8	53.6	53.2	52.8	52.3	51.8	50.4	49.9	50.2	49.2	48.9	48.6	48.8	48.6
EM	52.1	51.8	51.9	51.3	51.3	51.1	51.2	51.0	50.8	50.3	50.5	50.7	50.2	49.5	50.6	51.0	50.5	50.4	49.9	50.1	50.4	51.0
US	55.1	55.5	55.3	55.6	56.5	56.4	55.4	55.3	54.7	55.6	55.7	55.3	53.8	54.9	53.0	52.4	52.6	50.5	50.6	50.4	50.3	51.1
Canada	54.7	55.9	55.6	55.7	55.5	56.2	57.1	56.9	56.8	54.8	53.9	54.9	53.6	53.0	52.6	50.5	49.7	49.1	49.2	50.2	49.1	51.0
Japan	54.0	54.8	54.1	53.1	53.8	52.8	53.0	52.3	52.5	52.5	52.9	52.2	52.6	50.3	48.9	49.2	50.2	49.8	49.3	49.4	49.3	48.9
Eurozone	60.6	59.6	58.6	56.6	56.2	55.5	54.9	55.1	54.6	53.2	52.0	51.8	51.4	50.5	49.3	47.5	47.9	47.7	47.6	46.5	47.0	45.7
UK	55.7	55.2	55.3	54.8	53.8	54.3	54.0	53.9	52.9	53.7	51.1	53.3	54.3	52.8	52.1	55.1	53.1	49.4	48.0	48.0	47.4	48.3
Germany	63.3	61.1	60.6	58.2	58.1	56.9	55.9	56.9	55.9	53.7	52.2	51.8	51.5	49.7	47.6	44.1	44.4	44.3	45.0	43.2	43.5	41.7
France	58.8	58.4	55.9	53.7	53.8	54.4	52.5	53.3	53.5	52.5	51.2	50.8	49.7	51.2	51.5	49.7	50.0	50.6	51.9	49.7	51.1	50.1
Italy	57.4	59.0	56.8	55.1	53.5	52.7	53.3	51.5	50.1	50.0	49.2	48.6	49.2	47.8	47.7	47.4	49.1	49.7	48.4	48.5	48.7	47.8
Spain	55.8	55.2	56.0	54.8	54.4	53.4	53.4	52.9	53.0	51.4	51.8	52.6	51.1	52.4	49.9	50.9	51.8	50.1	47.9	48.2	48.8	47.7
Austria	64.3	61.3	59.2	58.0	58.0	57.3	56.6	56.8	56.4	55.0	53.8	54.9	53.9	52.7	51.8	50.0	49.2	48.3	47.5	47.0	47.9	45.1
Ireland	59.1	57.6	56.2	54.1	55.3	55.4	56.6	56.3	57.5	56.3	54.9	55.4	54.5	52.6	54.0	53.9	52.5	50.4	49.8	48.7	48.6	48.7
Netherlands	62.2	62.5	63.4	61.5	60.7	60.3	60.1	58.0	59.1	59.8	57.1	56.1	57.2	55.1	52.7	52.5	52.0	52.2	50.7	50.7	51.6	51.6
Brazil	52.4	51.2	53.2	53.4	52.3	50.7	49.8	50.5	51.1	50.9	51.1	52.7	52.6	52.7	53.4	52.8	51.5	50.2	51.0	49.9	52.5	53.4
China	51.5	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	50.0	50.1	50.2	49.7	48.3	49.9	50.8	50.2	50.2	49.4	49.9	50.4	51.4
Czech Republic	59.8	59.8	58.8	57.3	57.2	56.5	56.8	55.4	54.9	53.4	52.5	51.8	49.7	49.0	48.6	47.3	46.6	46.6	45.9	43.1	44.9	44.9
Greece	53.1	55.2	56.1	55.0	52.9	54.2	53.5	53.5	53.9	53.6	53.1	54.0	53.8	53.7	54.2	54.7	56.6	54.2	52.4	54.6	54.9	53.6
Indonesia	49.3	49.9	51.4	50.7	51.6	51.7	50.3	50.5	51.9	50.7	50.5	50.4	51.2	49.9	50.1	51.2	50.4	51.6	50.6	49.6	49.0	49.1
Poland	55.0	54.6	53.7	53.7	53.9	53.3	54.2	52.9	51.4	50.5	50.4	49.5	47.6	48.2	47.6	48.7	49.0	48.8	48.4	47.4	48.8	47.8
South Korea	49.9	50.7	50.3	49.1	48.4	48.9	49.8	48.3	49.9	51.3	51.0	48.6	49.8	48.3	47.2	48.8	50.2	48.4	47.5	47.3	49.0	48.0
Taiwan	56.6	56.9	56.0	55.3	54.8	53.4	54.5	53.1	53.0	50.8	48.7	48.4	47.7	47.5	46.3	49.0	48.2	48.4	45.5	48.1	47.9	50.0
Turkey	54.9	55.7	55.6	51.8	48.9	46.4	46.8	49.0	46.4	42.7	44.3	44.7	44.2	44.2	46.4	47.2	46.8	45.3	47.9	46.7	48.0	50.0
India	54.7	52.4	52.1	51.0	51.6	51.2	53.1	52.3	51.7	52.2	53.1	54.0	53.2	53.9	54.3	52.6	51.8	52.7	52.1	52.5	51.4	51.4
Mexico	51.7	52.6	51.6	52.4	51.6	51.0	52.1	52.1	50.7	51.7	50.7	49.7	49.7	50.9	52.6	49.8	50.1	50.0	49.2	49.8	49.0	49.1
Russia	52.0	52.1	50.2	50.6	51.3	49.8	49.5	48.1	48.9	50.0	51.3	52.6	51.7	50.9	50.1	52.8	51.8	49.8	48.6	49.3	49.1	46.3
Vietnam	52.5	53.4	53.5	51.6	52.7	53.9	55.7	54.9	53.7	51.5	53.9	56.5	53.8	51.9	51.2	51.9	52.5	52.0	52.5	52.6	51.4	50.5

Source: Markit, Bloomberg

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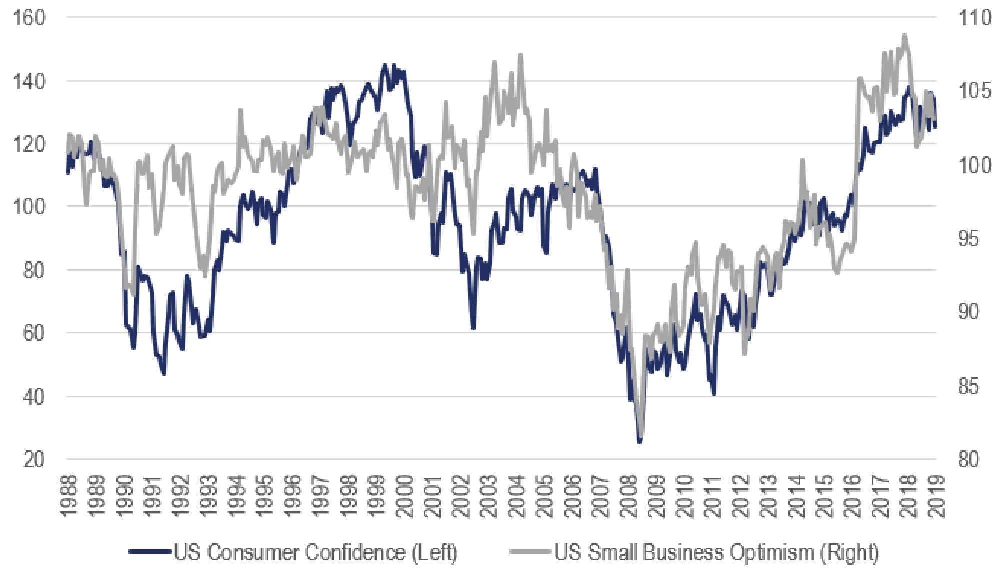
outlook.

Offsetting some of the weakness in manufacturing and trade is relatively healthy activity across most of the global services sector. Services activity has supported robust labor markets, healthy wage growth, and strong consumer spending within developed markets. With the US consumer accounting for approximately 70% of US GDP and confidence among the cohort remaining strong (right exhibit), these dynamics could bode well for overall economic activity going forward.

Despite pockets of strength here at home and abroad, financial vulnerabilities that have emerged have not gone unnoticed by central bankers. In the US, Federal Reserve policymakers lowered the target range for the federal funds rate twice during the third quarter, marking the first rate cuts since the depths of the Global Financial Crisis (GFC) in 2008. Coupled with economic, trade, and geopolitical headwinds, the willingness of Fed policymakers to provide stimulus has pushed rates lower across the US yield curve. Lower yields equate to lower borrowing costs for business and consumers, which can help offset rising input costs for companies and inflation pressures for consumers.

Major central banks abroad have also eased to reduce downside risks to growth and prevent a decline in inflation expectations. Recent data show the share of central banks lowering interest rates worldwide accelerated from 0% in late 2018 to 59%. Inclusive of other policy measures, approximately 70% of economies have adopted a more accommodative monetary stance according to the IMF, marking the highest proportion of easing among global central banks since the GFC.

Though Business and Consumer Confidence Remains Elevated



Source: Bloomberg

Within this context, we believe current conditions indicate intensifying downside risk, with risk factors both endogenous (policy, impeachment inquiry) and exogenous (trade, Brexit, China growth, Hong Kong unrest). These risks are balanced by robust services sector activity nearly globally, and a healthy consumer in advanced economies. Importantly, though we acknowledge the increase in risk over the course of the last year, we maintain our view that we are not yet at the point in the cycle that indicates imminent recession.

Additionally, and considering the risks and the precarious outlook, we urge investors to lower their return expectations. This view is supported by current valuations and yields, which suggest more modest long-term forward returns for both equities and fixed income. All told, it is an opportune time to work with your team at Cobblestone to assure that your asset allocation and risk exposures are appropriate based on your long-term goals and tolerance for risk.

Total Return (%), Ending 9/30/2019				Annualized		
	Qtr	YTD	1 Year	3 Years	5 Years	10 Years
S&P 500 Stock Index	1.70	20.55	4.25	13.39	10.83	13.23
Russell 2000 (Small Cap Stocks)	-2.40	14.18	-8.89	8.23	8.18	11.19
MSCI EAFE (International Stocks)	-1.07	12.80	-1.34	6.48	3.27	4.90
MSCI EM (Emerging Markets)	-4.25	5.89	-2.02	5.97	2.33	3.37
Bloomberg Barclays US Aggregate Index	2.27	8.52	10.30	2.92	3.38	3.75
Dow Jones US Select REIT	6.83	24.64	16.41	6.48	9.70	12.69
Consumer Price Index (% Chg over Period)	0.41	1.44	1.73	2.07	1.54	1.73