Monthly Market Review

August 2019

What happened in August?

The MSCI All Country World Index fell **-2.4%** in August, while the Barclays US Aggregate Bond Index gained **+2.6%**. Gold rallied another **+6.8%** as it continues to outperform broad commodities—the Goldman Sachs Commodity Index was down **-5.6%** during the month.

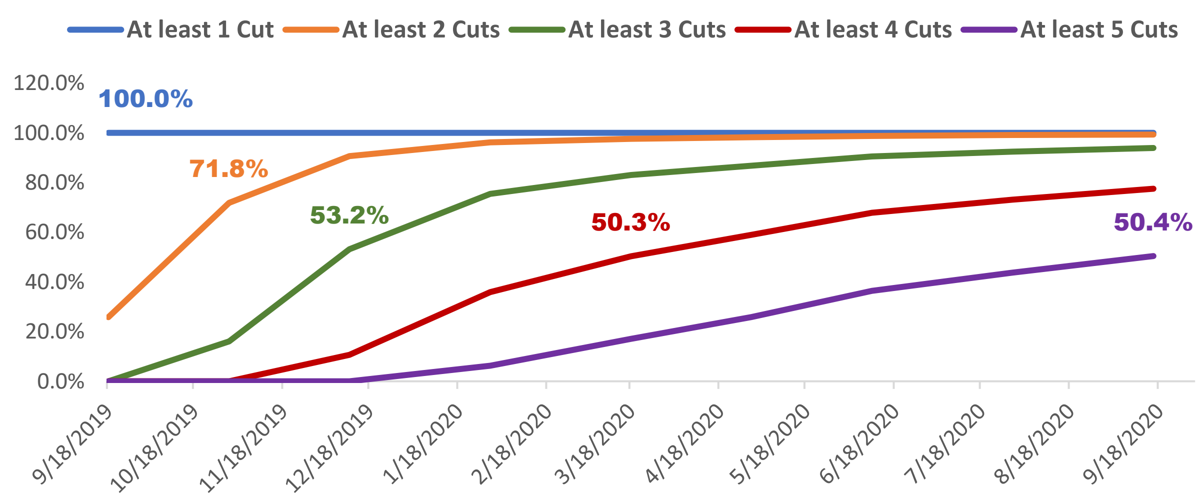
Consumer strengthens; manufacturing wanes.

Retail sales growth continues to accelerate, suggesting that the US consumer remains strong. However, the manufacturing economy continues to slow, and as of August, ISM Manufacturing PMIs sunk below fifty, indicating that the US manufacturing economy is contracting for the first time since August 2016. These divergent trends between the consumer and manufacturing partly lead us to believe that a flatter growth trend lies ahead in the coming quarters.

Market continues to expect a lot from the Fed.

Expectations of Fed rate cuts continue to 1) push bond yields lower, 2) push bond prices higher, and 3) buoy equity markets. The Fed made a 0.25% interest rate cut in July, but that move was already priced in and not enough to quell the thirst of market participants. Currently, the market is pricing in a 100% chance that the Fed makes another 0.25% cut on September 18 and a 53% chance that the Fed makes another three rate cuts by December 11.

Probability of Fed Rate Cuts



Source: Bloomberg, GMAG Research

All other things being equal, should the Fed fail to deliver on those expectations we would expect equity volatility to rise while the yield curve continues to invert–reflecting an increased probability that we enter a recession sooner rather than later.

Respite from growth slowdown could provide backdrop for short-term risk-on.

Easing base effects contrasted by slowing momentum, and a healthy consumer juxtaposed by a slowing manufacturing economy yield a flatter growth trend over the coming quarters. Although flat is not great, it is better than slowing. A pause from the growth slowdown that we have been in over the past year could provide short-term respite from this declining yield environment and an opportunity for risk assets to outperform in the immediate term. If this dictates a change in portfolio positioning, we will let you know.

We continue to favor defensive assets.

Although we manage each portfolio individually, we have generally positioned them conservatively to help protect against the effects of rising recession risks and a slowing-to-flat growth trajectory in the coming quarters.

- **Reduce equities; increase bonds**: We have reduced equity exposure and shifted to more defensive assets such as bonds and other yield-oriented investments.
- **Reduce growth stocks; increase value stocks**: We have shifted exposure from growth equities to defensive equities, replacing technology stocks with utilities, consumer staples, and REITs.
- **Reduce European equities**: We have decreased exposure to European equities because the growth outlook for the region has diminished and the European Central Bank has limited tools at its disposal to combat the next economic contraction.
- **Increase credit quality within fixed income**: We have increased credit quality by reducing corporate bonds and increasing exposure to US Treasuries.
- **Increase duration within fixed income**: We have increased exposure to intermediate and long-term US Treasuries. Longer-duration treasuries have historically performed well when economic growth is slowing and inflation is under control.
- **Increase exposure to gold**: Gold can provide a hedge against 1) lower real interest rates, 2) increased market volatility, and 3) an erosion of purchasing power. We believe that preserving purchasing power will be important in the coming years given the unprecedented levels of monetary and fiscal stimulus (i.e. money printing) that will likely be required to stem the next economic downturn.

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