ACADEMY FINANCIAL, INC.
EVALUATE • ENVISION • EXECUTE

2019 3rd Quarter Review

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"Listening to and understanding our client's financial goals allows us to provide the highest level of investment planning advice and service."

Equity Markets

The third quarter continued the rally in U.S. stocks that slowed to a 2% increase as part of an amazing 19% year to date return, as measured by the S&P 500. Once again, the domestic equities outpaced international equities which posted a loss of -1.5%. The other action in the quarter was in the world bond markets drop in yield, whereas equities fluctuated dependent on the newspaper headlines. One day Chinese trade talks were off, the next they were back on. The possibility of impeaching President Trump faded, them came back bigger than ever. Oil prices stayed low throughout the summer, but a drone attack affected oil production, only for prices to return to previous levels.

Our job as long-term investors is to watch the headlines and look for changing trends that affect our outlook. Any one of these events and more could have led to significant market moves. Or they could have been short term bumps followed by sharp reversals. It's one of the reasons we don't time the market.

Looking at the comparison between stocks and bonds, we note that the dividend yield for the S&P 500 was 1.84% while the 10-year U.S. Treasury yielded 1.68%. The same held true on the international front where 10-year government bonds were near zero or negative yields (Japan, Germany), while international equity markets (IEFA) have dividend yields of over 3%.

https://ycharts.com – SPY IEFA

https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/textview.aspx?data=yield

Fixed Income Markets and the Federal Reserve

The striking drop in interest rates continued through the 3rd quarter. Year to date rates dropped almost a full percentage point from 2.66% to 1.68% at the end of September. A similar but more dramatic fall occurred in the international bond markets. As an example, the 10-year yield on the German bond fell from just above 1% to as low as (-0.22%) in August. Why invest today with the promise of getting less in return in the future? There are no satisfying answers to the question. The market prices were established by what people (corporations, pensions, other governments) were willing to pay to keep future money in the most secure investment possible, which were liquid government bonds. That sounds simplistic, but the preference is for security in bonds with a near zero return versus other investments that carry more risk.

https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/textview.aspx?data=yield
https://www.cnbc.com/2019/06/14/fed-rate-cut-could-come-sooner-than-some-expect-but-not-yet.html

Commodities, Real Estate, and Alternatives

The move in oil prices due to a singular military style attack did show the potential volatility in commodities. Oil was the most visible, but there could be other shocks to commodities across the board at various times. By themselves, commodities play an extremely important role in our economy, but in this low inflation environment, we simply don't see justifiable returns at this point.

Real Estate on the other hand has rebounded and has outperformed the S&P 500 in the 3rd quarter (7.1% vs 2.0%) as well as year to date (26% vs 19%). Lower interest rates were a likely cause.

https://ycharts.com – VNQ

U.S. Economy: Overview

The U.S. has been in a news and economic cycle that remained constant throughout 2019. The positives remained: Stock markets higher, interest rates down, inflation contained, unemployment low, and oil and gas prices steady. While on the negative side: earnings growth rate slowed, valuations increased, an inverted yield curve, and initial public offerings have been in weak.

The U.S. has held its long running divergence compared to international markets in nearly all metrics: Higher growth rates, lower unemployment, higher stock valuations, healthier bond markets, and improved tax and regulatory environment

There is always the chance of a shock to the economic system as the drone attack in Saudi Arabia showed. Despite the intense political environment, and the screaming clickbait headlines; we remain in a steady and consistent economic environment. With some exceptions, businesses can plan and are rewarded for prudent expansion. The higher than average valuations still give us pause as do the slow growth international markets. Taken in total, the forecast continues to look for slow, yet solid growth going into the 4th Quarter.

An important reminder with any forecast or market moves: We believe investors should not attempt to time the market and that the key to successful wealth management is to coordinate with your financial planner and establish the risk and return expectations for your unique situation.