Plimoth Investment Advisors®
INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

SECOND QUARTER – SUMMER 2019

INVESTMENT SPOTLIGHT

"An ounce of prevention is worth a pound of cure." – Fed Chairman Jerome Powell

When does an age-old adage have the power to move the largest equity and interest rate markets in the world? When it is used by the Chairman of the U.S. Federal Open Market Committee (FOMC) Jerome Powell in discussing monetary policy. "An ounce of prevention is worth a pound of cure," uttered by Chairman Powell in the post-meeting press conference in June was taken to mean that a small cut in the Federal Funds Rate may go a long way to keep the longest economic expansion in history moving in the right direction. Chairman Powell explained in later testimony that despite a stronger than anticipated U.S. jobs report in June, the Fed plans to stick to the accommodative plan laid out following their most recent meeting.

What an amazing year it has been to be a Fed watcher. Even though 2019 is only halfway over, we have gotten what feels like well over a year's worth of headlines from the U.S. monetary policy authority. In addition to being far more open and transparent than past Committees, this group has shown a clear willingness to change course and be responsive to real time data. The downside however has been Committee members' willingness to espouse their own views in seemingly whatever public forum is willing to listen, diluting the carefully crafted official message released after meetings.

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The Fed's willingness to completely reverse course from a tightening to easing bias in only six short months led to a massive drop in the overall levels of interest rates. Global trade and tariff headlines and tweets "trumped" economic data with wild swings in investor sentiment. Risk was on, off and back on again in the latest quarter in a period during which every prognosticator was directionally spot on with their market calls, at least for a handful of days. In the end, the stock market broke through all-time highs yet again and fixed income investors were left searching for yield in an unusual pairing of stock and bond prices rising together. ■

Economic Review & Outlook

Real Gross Domestic Product (GDP) in the U.S. grew by a very respectable 3.1% in the first quarter. The critical input of Personal Consumption however was lackluster at 0.9%. Business Fixed Investment was higher at 2.3%, but companies will likely be seeking clarity on tariffs and trade before determining how to allocate annual budgets going forward. Rising levels of uncertainty are showing up in the form of eroding confidence in business survey results. The more transitory components of growth, including net exports and inventories, were drivers of the latest reading of growth in the amount of goods and services produced in the U.S.

June Retail Sales were stronger than expected, capping a solid quarter for consumption. After the choppy first quarter, the critical Control Group, which factors directly into GDP, was solidly positive in all three months of the second quarter. Internet sales were a key contributor to the strength, up 1.7% in back-to-back months of May and June.

An unexpectedly high Nonfarm Payrolls Report of 224k new jobs in June (on the back of a particularly weak report in May) pulled the three-month average to 170k. The unemployment rate in the U.S. through June stood at 3.7%, just 0.1% higher than the 49-year low recorded earlier in the quarter. Despite the scarcity of workers in certain segments of the economy, Wage Growth hasn't budged, standing at 3.1% on a year-on-year basis.

Inflation remained well in hand and below the Fed's target level. Personal Consumption Expenditures (PCE), the Fed's stated preferred inflation gauge, pulled back to the weakest level in three years. The latest year-on-year reading from May has PCE at 1.5% and the Core reading (excluding food and energy) at 1.6%, both well off the mark of the Fed's 2.0% goal. Through June, the Consumer Price Index (CPI) advanced by 1.6% and the Core CPI at 2.1%. Key components of a modest increase in CPI were apparel, housing and medical care costs, offset by declining energy prices. In the latest official comments from Fed Chairman Powell, the FOMC has finally come to terms with the fact that the shortfall of inflation has been far from "transitory" and dropped the usage of the word relied on numerous times in the past to explain away numbers that didn't fall in line with academic models.

	Q2-2019	YTD-2019
Communication Services	4.5%	19.1%
Consumer Discretionary	5.3%	21.8%
Consumer Staples	3.7%	16.2%
Energy	-2.8%	13.1%
Financials	8.0%	17.2%
Healthcare	1.4%	8.1%
Industrials	3.6%	21.4%
Information Technology	6.1%	27.1%
Materials	6.3%	17.3%
Utilities	3.5%	14.7%

Manufacturing data has cooled around the world, including the U.S. The ISM Manufacturing Index stands slightly ahead of the 50-mark designated as expansionary. Durable Goods Orders (hard goods with a usable life of three years of more) declined by -1.3% in June, continuing the negative trend set in the first two month of the quarter. With respect to our near-term "bend but not break" U.S. economic outlook, the manufacturing segment seems to be preparing to give housing a run for its money in a proverbial limbo contest.

Despite lower mortgage rates and an easing of home price appreciation during the quarter, housing hasn't quite found its sea legs at this stage of the economic cycle. Although Housing Starts held the line through June at a 1.25 million annualized pace, new Building Permits were well off the mark at 1.22 million, a -6.1% decline and the lowest level in two years. Available housing inventory ticked up modestly to just over 4 months of supply. Neither Existing nor New Home Sales have shown signs of sustainable strength through the quarter. ■

Bond Market Review & Outlook

The FOMC held the Fed Funds Rate target steady at 2.25-2.50% in their June meeting. While this was fully expected, the surprise came in the substantial shift in sentiment of the post meeting message delivered by Chairman Powell. After what can only be described as a dramatic shift in Fed policy from the tightening bias at the start of the year to a neutral stance in the first quarter, the Fed took another giant leap in forecasting an easing of rates only one quarter later. The unprecedented nature of the communication sent rates of every variety tumbling and the futures market immediately priced in a 100% probability of a Fed Funds Rate cut in the next meeting on July 31. The yield on the bellwether 10-Year U.S. Treasury plummeted, dropping below 2%, a full half percentage point from the start of the quarter. The yield curve anomalies that seemed to have taken a page from the Netflix original series, Stranger Things, were further exacerbated. The spread between the 3-Month and 10-Year Treasuries that had turned negative (known as a yield curve inversion) slipped deeper into negative territory, while the 2-Year to 10-Year Treasuries maintained a positive spread. Students of economic history or investors with careers dating back through numerous cycles know that this is not a state that can persist. In its simplest form, market participants being rewarded with higher interest payments for lending their capital for a short-term period than those lending for a longer-term period is not a sustainable practice.

In an environment that was profitable for holders of safe haven and risk assets, returns on fixed income investments were positive in the quarter with the Barclays Aggregate Index up by over 3%. In the period of falling rates, bond prices increased across Treasuries, Investment Grade and High Yield Corporates and Municipal Bonds. More interest rate sensitive investments such as preferred stocks and REITs benefitted as well. ■

	Q2-2019	YTD-2019
Cash:		
FTSE 3 Mo. T-Bill Index	0.6%	1.2%
Taxable Fixed Income:		
Barclays US Agg. Bond	3.1%	6.1%
Barclays Govt./Credit Int.	2.6%	5.0%
Barclays Govt./Credit Long	6.6%	13.5%
BofAML High Yield Index	2.6%	10.2%
Tax Exempt Fixed Income:		
Barclays Muni. 5 Yr.	1.7%	3.8%
Barclays Muni. 7 Yr.	2.0%	4.7%
Barclays Muni. TR	2.1%	5.1%

Stock Market Review & Outlook

With few exceptions, returns across asset classes at home and abroad were positive in the second quarter. The S&P 500 had a solid quarter, higher by 4.3%, capping the best first half of a calendar year for the index since 1997. The NASDAQ Composite took a more volatile path given the concentration in technology stocks to finish the quarter up by 3.9%. Small Cap stocks were positive as well with the Russell 2000 Index generating a 2.1% return. While (predominantly domestically-oriented) smaller companies were more insulated from global trade concerns, fear of a slowing economy weighed on valuations. Despite the back and forth swings that took place in the quarter, the primary risk on environment widened the outperformance gap of growth stocks relative to value.

	Q2-2019	YTD-2019
DJIA Index	3.2%	15.4%
S&P 500 Index	4.3%	18.5%
Russell 2000 Index	2.1%	17.0%
MSCI EAFE Index	3.7%	14.0%

Developed International stocks just barely kept pace with the U.S. and a broad basket of Emerging Markets equities lagged.

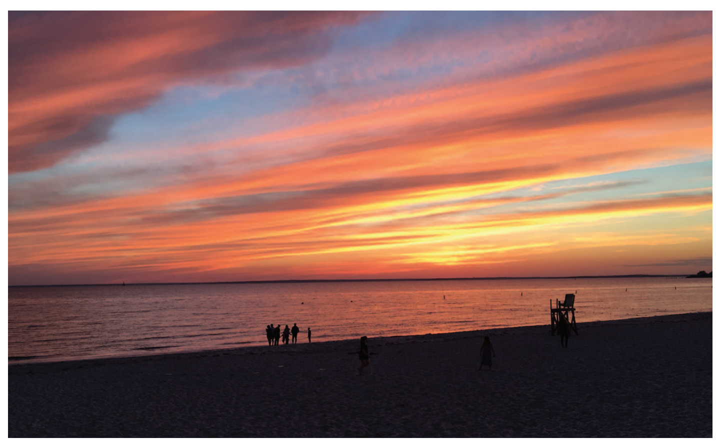
All sectors of the S&P 500 provided positive single digit returns during the quarter with the exception of Energy, down by -2.8%. The potential of increased drug pricing legislation weighed on Healthcare stocks, which ended the period modestly higher by 1.4%. Financials recovered ground in the quarter turning out the strongest sector return of 8.0%. Price gains were once again fueled by P/E (price/earnings) multiple expansion. Stock prices broke through record highs while corporate earnings, despite coming in better than expected, were modestly negative in the first quarter earnings season. Investors willingness to pay more for a dollar of corporate earnings sent the P/E on the S&P 500 higher to 20.1x based on trailing one-year earnings and 18.1x based on forward earnings. Regardless of the new milestones hit by major U.S. market indices on an absolute basis, valuations relative to the past 3-5 years do not look particularly extended. ■

Closing Thoughts

From our vantage point today looking at the longest U.S. bull market in history, now in tandem with the longest economic expansion in history, we pause to consider the significance. Considering an unemployment level in the U.S. a tick off its 49-year low and inflation measures not far off from where they stood when the Fed was comfortable raising rates nine times over a three year period, we can't help but marvel at the idea of a resurgence of quantitative easing around the corner. The velocity of the watershed change in interest rate sentiment is nothing short of remarkable.

It was only last calendar year when all we seemed to read (and write) about were rate hikes around the world. Fast forward six months later and nearly every major Central Bank has changed their tune to more accommodative policy. And unlike the U.S. where the Fed has been merely teeing up accommodation, there have been nearly 40 rate cuts around the globe already in 2019, roughly in line with the number of hikes in calendar year 2018. While President Trump has berated the Chairman of the U.S. Fed on social media for not falling in line with monetary doves and lowering interest rates sooner, the President of Turkey went so far as to sack the head of their Central Bank over a difference of opinion of when reviving their economy with rate cuts would be appropriate. In that case it sounds more like failing to provide an ounce of prevention cost him a pound of flesh.

With an expected "Powell Put" (a rate cut expected to benefit the price of risk assets) around the corner, risk seekers may be feeling shielded from harm and ready to push all in. We will continue to leave short-term speculation to others and seek attractive long-term buy and hold opportunities for our investors in what can most aptly be described as interesting times. If we can be of assistance to you along the way, please do not hesitate to call us at the numbers provided. ■



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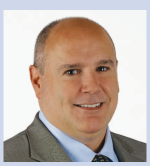

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