



OUR VIEW



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Q2 Market Performance

Equities rose in the second quarter despite rising trade tensions with China and slowing economic growth in much of the world. President Donald Trump's threat in May to impose additional tariffs on Chinese goods and to place China's Huawei Technologies on a Commerce Department "blacklist" caused a temporary pullback in equities. The Fed came to the rescue, at least temporarily, by signaling that their next move would likely be a rate cut. The "dovish" signal from the Fed and hopes that the G-20 Summit meeting between U.S. President Donald Trump and Chinese leader Xi Jinping would ease tensions between the two countries fueled a rebound in equities and bonds in the final weeks of the quarter.

Global equities, as represented by the MSCI All Country World Index, returned 3.6% during the second quarter and have gained 16.2% year-to-date through June 30. U.S. large company stocks led the way, returning 4.3% for the quarter and 18.5% year-to-date. U.S. small company stocks have gained nearly 17% year-to-date but lagged relative to large company stocks during the quarter, returning 2.1%. Emerging markets stocks were hurt by tariff fears and rose less than 1% for the quarter. International and emerging markets stocks have still provided double-digit returns year-to-date. Large company value stocks trailed behind growth stocks during the quarter and still lag meaningfully year-to-date. Bonds were a solid counterweight to equity volatility, providing income and market appreciation as interest rates fell. Short-term bonds returned nearly 2% during the quarter and have gained 3.6% year-to-date. Longer-term bonds benefited more from falling interest rates, with the Bloomberg Barclays Aggregate Index returning 3.1% for the quarter and gaining more than 6% year-to-date.

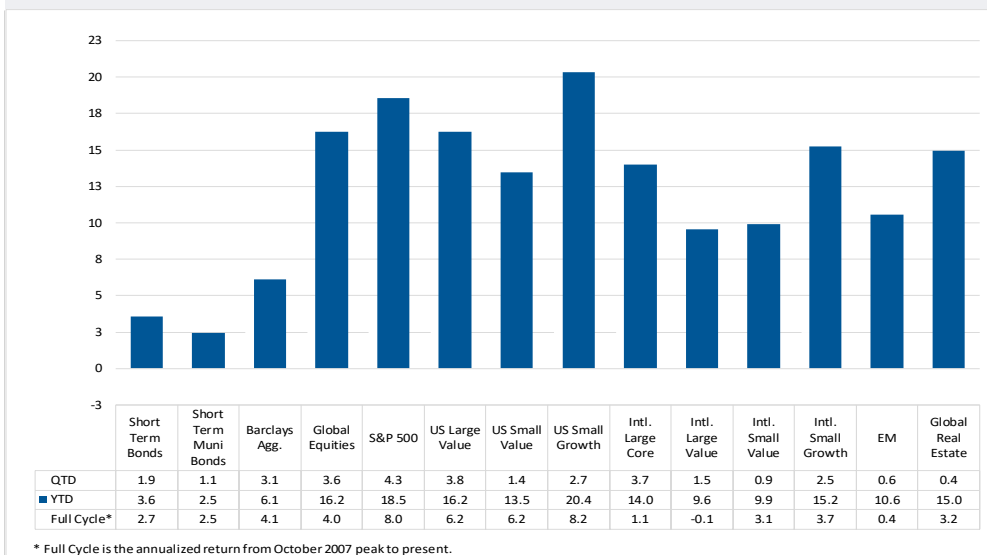
Financials led the S&P 500 rally for the quarter and are now up strongly for the year. Technology stocks also delivered strong results for the quarter and the technology sector remains the performance leader year-to-date. Energy was the only negative performing U.S. sector during the quarter and is the second-worst performer year-to-date. Healthcare lagged during the quarter and is the worst performing sector year-to-date.



Mohamed El-Erian of Allianz, in a recent speech asked an important question: "Are tariffs the destination or part of the journey?" If tariffs are the "destination," economic growth and equity markets are likely to suffer. If tariffs instead are part of a "journey" that leads to greater market access, stronger intellectual property protections and lower overall tariffs, economic growth could rebound sharply.

Quarter To Date Returns

6/30/2019



TFC client portfolios benefited in absolute terms from rising stock and bond markets during the quarter and year-to-date periods. Growth-oriented investments have helped performance with the Vanguard Small Cap Growth Index Fund, Harding Loevner Emerging Markets Fund, and T. Rowe Price International Discovery Fund. U.S. and international small company growth funds among the holdings that contributed to portfolio performance in absolute and relative terms. Growth-oriented emerging markets funds also performed well. In relative terms, however, TFC portfolios have trailed client benchmarks. TFC's value stock holdings, including Dimensional Fund Advisors U.S. Marketwide Value Fund, Dimensional Fund Advisors International Small Cap Value Fund and Dimensional Fund Advisors Emerging Markets Core Fund have been the primary detractors from relative performance.

Market Outlook

Mohamed El-Erian of Allianz in a recent speech asked an important question: "Are tariffs the destination or part of the journey?" If tariffs are the "destination," economic growth and equity markets are likely to suffer. If tariffs instead are part of a "journey" that leads to greater market access, stronger intellectual property protections and lower overall tariffs, economic growth could rebound sharply. Until recently, we expected the economy – particularly employment – to be a binding constraint for Trump. In our view, Trump would be motivated to negotiate a trade deal in order to avoid an economic downturn. Our expectations have changed, and we think that the odds of reaching a comprehensive trade deal with China before the 2020 election are significantly lower. Bipartisan animosity toward China makes Trump vulnerable to accusations of being "soft on China," a label he will be anxious to avoid during a heated election campaign. Consequently, we think that the "cease-fire" on trade resulting from the G-20 Summit meeting between Trump and Xi will be the more likely status quo until after the 2020 election. Economic considerations may temper Trump's inclination to escalate the trade battle, but electoral considerations make a comprehensive trade deal less likely before the 2020 election. Incremental progress in trade talks and extension of the current cease-fire would be a positive near-term outcome for markets. Trade tensions are one dimension of a prolonged rivalry for global leadership between the U.S. and China, with economic nationalism moving the world away from global trade and more toward regional trading blocs. The long-term implications of regional trading blocs could lead to sub-optimal allocations of capital, with negative long-term implications for productivity and corporate profits. Regionalization and rising



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Please join us for the quarterly TFC webinar, scheduled for Wednesday, July 24 at 11:30 am.

use of economic forms of "conflict" increases geopolitical risk and probably reduces some of the "peace dividend" that resulted from the end of the Cold War.

Yield curve inversion has been one of the most reliable leading indicators of an impending recession, and the 3 month to 10-year Treasury yield curve remains inverted. We expect the inverted yield curve to return to normalcy in the near future, either because of Fed policy moves or a change in market expectations. We don't think the importance of the signal has changed, but the typical lag between inversion and recession provides time for the signal to be reversed. In contrast to prior Fed Chairs, the Powell Fed is unlikely to ignore the signal provided by yield curve inversion. The Fed is likely to cut short-term rates if economic growth continues to stall. The cut in short-term rates would help the yield curve to steepen. If economic growth rebounds, long-term rates will likely rise, which would also "cure" the inverted yield curve. We do not see lower rates as a panacea for sluggish economic growth but think that lower rates could weaken the dollar. A weaker dollar would help U.S. multinational companies that benefit from export growth and would ease the pain for emerging markets countries and companies that have borrowed in dollars.

Portfolio Positioning

TFC is positioned roughly in line with long-term strategic targets for stocks, though we are maintaining enough portfolio liquidity to address known cash needs over the next six to twelve months. We expect global growth to resume in the second half of the year, albeit at a muted pace, helped by dovish central bank policies, Chinese stimulus and a temporary easing of trade tensions. The economic backdrop should be reasonably positive for equities. However, policy uncertainty and the longevity of the economic cycle makes heightened volatility and elevated risks an unfortunate reality. Bonds remain a necessary counterweight to equities. TFC continues to favor shorter-term/investment grade credits, but supplement with intermediate-term bonds that provide desirable diversification.

We monitor the market environment and will incrementally adjust the portfolio based on the new information. TFC's headline allocation to stocks is important, but it is important to note that we have intentionally reduced equity risk within the portfolio over the past year by adding several investments that we expect to be more resilient in an economic downturn.

As always, we welcome your comments and questions. Please contact me or your TFC advisor should you have any questions or concerns.

Please join us for the quarterly TFC webinar, scheduled for Wednesday, July 24 at 11:30 am. We'll post the webinar on our website for those who are unable to attend live.

Sincerely,

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