STONEBRIDGE Capital Advisors

The Stonebridge Market Commentary

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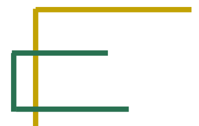
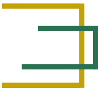




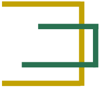
Equity Market Commentary

With the end of summer comes the third quarter earnings season, college and pro football, autumn and impeachment. The Fed has cut interest rates and the economy is slowing somewhat. There is the China trade war to worry about as well. We hear on a daily basis that a recession is coming (when isn't it?) as if the opinion writers can't wait for this icky bull market to end. All of this had an effect on September and the third quarter as a whole, but not so much as to turn the market lower as the S&P added 3.23% for the month, 1.26% for the quarter and 18.15% year to date.

About the "impeachment." So far, the market seems to have taken the announcement of an investigation with a grain of salt. Running with a whistle blower complaint Speaker Pelosi kicked off an investigation. Rule changes in 2018 makes the whole thing as partisan as possible. These things can be unpredictable and new facts can arise. This could get bad for the President, but as of now the market seems to be taking it in strides.

Now we enter the fourth quarter with last year's correction fresh in our minds. The most important determinant of how we finish out 2019 is this quarter's earnings season and the comments looking forward. This quarter's earnings are expected to be okay with a slight upward bias generally. What about the fourth quarter and beyond? Things are slowing in China, Europe and the U.S. You can bet that companies will pepper their commentary on those facts as well as the whole tariff/trade war meme. Since these facts are well known the question is where will the surprises come from? Last year's fourth quarter rout kicked off in August when Facebook got hit. That bled over to the rest of the FAANG stocks and the rest of tech followed. That set up is not present today. As I write (9/30/19) the S&P is trying to break to new highs over 3000 on the index. That 3000 level has been resistance since mid-July and breaking out could lead to a good year end rally. This bull market has been viewed skeptically by many, with nervousness and sometimes abject fear among

Table 1



investors. It is important at this point to take a look at risk tolerance. This bull market is ten years old and with earnings slowing, at least for now, it may make sense for investors to take steps to reduce risk somewhat. For many, this means more cash and short-term bonds. There are many factors that are unresolved that if resolved could kick the market higher. China and the trade war is probably the biggest. Getting the 737 Max in the air is another. However this all shakes out, I think October could be bumpy. Like lots of Octobers…

Fixed Income Commentary

Investors added $1.6 billion in new cash to municipal mutual funds during the last week of September, capping off nearly 40 straight weeks of inflows. That's not exactly what you would expect when interest rates are moving in a downward direction. But there are some good reasons for the fund flows. Demand is being driven by the value of the tax-exemption for highly taxed investors and the hunt for incremental yield in fixed income vehicles. Even with rates at nominal lows, there are still reasons to like municipals. Relative value ratios comparing tax-exempt yield to Treasuries have rebounded some, with most of the curve in the 80 to 95% range. And that's for AAA rated benchmark securities. Smaller issues and lesser rated investment grade bonds can yield 100% or more, before the exemption is factored in. While September municipal performance was slightly negative, overall the quarter was still positive. iShares National Muni Bond ETF (ticker MUB), sometimes used as a proxy for the market, returned 1.60% for the quarter. The very short end of the curve changed very little during the last three months, reflecting that the market had largely priced in the near-term Fed easing. The intermediate to long end of the curve moved the most dramatically. 10-year yields fell 22 basis points to end the quarter at 1.42% and 30-year yields fell 30 basis points to end at 2.01%. Taxables were positive as well. The ICE BofAML 1-10 Year US Corporate and Government Bond Index returned 1.50%. Worldwide the amount of negative yielding bonds is approaching $15 trillion. While nominal domestic rates across sectors may seem low right now, at least we are still being paid rather than the other way around! Still, as we have said before—particularly as we continue to reach market highs across asset classes—it is never a bad time to review your portfolio to make sure your allocation between equites and bonds is still inline with your risk tolerance and investment time horizon.

Sources:
Data sourced through Bloomberg, Morningstar and StockCharts.
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