ROUND TABLE
WEALTH MANAGEMENT

QUARTERLY REVIEW

SECOND QUARTER 2019

In the second quarter of 2019, capital markets continued their first quarter upward trajectory, albeit at a decelerated rate and with greater intra-month volatility. The S&P 500, which at the end of May was negative 2.6% quarter to date, ultimately recovered to a positive 4.3% return. Fixed income, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, generated a strong quarterly return of 3.8%, benefiting from the Federal Reserve's inclination to *reduce* interest rates coupled with low inflation expectations. Positive returns were not limited to the U.S. with non-U.S. equity and fixed income markets generating strong returns with similar bouts of volatility.

Despite the strong year-to-date returns, we believe the current environment calls for a prudent approach to risk management. Our recommendation earlier in the quarter to reallocate portfolios to lower volatility, hedged and fixed income strategies provided meaningful capital protection during May, which saw the S&P decline by over 6%.

Benchmark Returns through June 30, 2019

	QTD	YTD	1 Year	2 Years	3 Years	5 Years	10 Years
S&P 500	4.3%	18.5%	10.4%	12.4%	14.2%	10.7%	14.7%
Russell 2000	2.1%	17.0%	-3.3%	6.6%	12.3%	7.1%	13.4%
MSCI World Ex. US Index	4.1%	15.1%	1.8%	4.7%	9.6%	2.6%	7.3%
MSCI Emerging Markets	0.7%	10.8%	1.6%	5.0%	11.1%	2.9%	6.2%
Bloomberg Barclays U.S. Aggregate	3.1%	6.1%	7.9%	3.7%	2.3%	2.9%	3.9%
Bloomberg Barclays Municipal Bond	2.1%	5.1%	6.7%	4.1%	2.6%	3.6%	4.7%
Bloomberg Barclays U.S. High Yield	2.5%	9.9%	7.5%	5.0%	7.5%	4.7%	9.2%
FTSE Nareit All REITs	1.8%	18.8%	12.7%	8.6%	6.2%	8.8%	15.6%

Source: Bloomberg *Periods greater than one year are annualized

The Big Picture (click here for full article)

U.S. real gross domestic product increased 3.1% in the first quarter, and based on a survey by the Philadelphia Federal Reserve, this figure is expected to decelerate to 1.9% in the second quarter. The same survey does not indicate a pending U.S. recession, but does indicate a continued decline of real GDP growth through 2021. The current economic cycle may continue for some time given low inflation expectations and a Federal Reserve willing to keep interest rates low. Business cycles do not end due to age, but rather a buildup of excesses that push business fundamentals out of balance and lead to a recession. Our concern remains that equity valuations may be too high in the context of future earnings growth prospects.

The Federal Reserve changed its outlook to what will be forever known as "Powell's Pivot." In our 4Q 2018 letter, we mentioned that rising rates posed a challenge for investments. As we progressed through 1Q 2019, the Federal Reserve, based on its revised outlook, stated its reluctance to raise rates in 2019 and potentially raise only once in 2020. Today, the Federal Reserve has implied a willingness to reduce rates, hence the name, "Powell's Pivot." Futures markets are predicting with an 80% probability that the Federal Reserve will reduce rates by about 0.25% (25 bps) at the Federal Reserve Open Market Committee's (FOMC) July meeting. This reduction is aligned with press releases by the Fed stating that its estimate for the neutral interest rate consistent with long term economic growth had decreased to 2.5%, which is 25 bps below its March estimate.

While Chairman Powell cites the rate as "neutral," we view the Pivot as an indication that the U.S. economy is more fragile than previously thought. Supporting evidence for this view is illustrated by the fixed income market's demand for the U.S. 10-Year Treasury Bond that pushed yields down from 2.84% in June 2018 to 2.01% at June 2019.

The U.S. is not the only developed economy considering lower rates. Mario Draghi, head of the European Central Bank, which represents an economic block of advanced European and non-European economies, has indicated a willingness to lower rates in an effort to boost economic growth and push inflation expectations higher. On news of Draghi's speech, German 10-year Bunds traded to a negative yield of 32 bps—investors were willing to pay the government to own its debt. Rest assured this is not an investment we would consider!

Emerging markets, while up for the YTD period, have remained under a cloud of uncertainty due to trade tensions between the U.S and China. (Others have been targeted by Washington at various points including the European Union, Mexico and more recently Vietnam and India.) The pressure exerted by the trade impasse was demonstrated after the announcement by Treasury Secretary Mnuchin that a deal was nearly "90% done." Emerging markets rallied on the news, yet some of the euphoria may be waning as investors reflect on how much time the remaining 10% will require.

The above-mentioned issues are only a few of the outstanding items posing risk to capital markets. Others include the U.S. Presidential election, Hong Kong/Mainland China civil unrest, and U.S./Iran military tensions. Longer-term investors will recognize that geopolitical and economic issues never go away. However, as investors we have the ability to moderate risk while not materially altering our long-term asset allocations.

Summary of Allocation Recommendations

Asset Class	Recommendation	Comment	Asset Class Summary Link
U.S. Large Cap	Neutral/Underweight	Earnings growth rates decline in 2019; Valuations rebound to premium level again; look to value-style, hedged or reduced allocation	U.S. Large Cap Review
U.S. Small & Mid Cap	Neutral/Underweight	Earning projections have declined materially since start of 2019; debt at smaller cap companies remains high; focus on mid cap sector over small cap	U.S. Small Cap Review
Non-U.S. Developed	Neutral/Underweight	European economic growth remains subdued amid IMF downgrade; trade issues with China have impact on developed economies	International Equity Review
Emerging Markets	Neutral/Underweight	U.S./China trade deal: 90% is not complete; valuations remain favorable but corporate earnings growth uncertain; local currency should be a tailwind to asset class	International Equity Review
Fixed Income	Overweight	Inverted yield curve combined with Powell's Pivot suggest maintaining safe-haven assets	Fixed Income Market Review
Tactical	Neutral	Robotics and cybersecurity	Tactical Investments Review
Alternative	Hedge Funds & Private Equity	For appropriate allocations; liquid hedge strategies in ETF format; private credit funds and private equity	Contact your Wealth Advisor

The Outlook

We continue to recommend a neutral/underweight allocation to U.S. Large Cap Equities. Earnings growth is challenging, leaving near-term returns subject to valuations and dividends. While some additional expansion may be feasible given low long-term rates, the sustainability of such a rally given the underlying catalysts for low rates would be highly suspect. If the economy does begin to trend downward, markets will eventually give notice regardless of a rate cut. We foresee continued volatility against a backdrop of political developments hanging in the balance. We accordingly maintain our defensive posturing by tilting the portfolio towards hedged and value-focused investments. Our outlook remains neutral/underweight within large cap equities.

We are recommending a neutral/underweight allocation to U.S. SMID Cap Equities. Currently no clear major catalyst seems present that will help propel small caps higher on a relative basis. Continued weakness in the global economy and margin pressure are likely to persist if trade negotiations are not resolved. For these reasons, we maintain our recommendation of underweight small cap relative to large and mid caps. We recommend investors focus on the mid cap area of the SMID universe, as metrics for mid cap are more reflective of the fundamentals and valuations seen in large caps.

We continue to recommend a slight underweight allocation to non-U.S. developed market equities. Our focus is toward quality, value-oriented and defensive strategies to prudently manage the increased market risks. A bright spot in non-U.S. developed equities is the generous yield component. As of quarter-end, European equities displayed a dividend yield of 3.4%—more than a 3% advantage over a 10-year European bond and almost double the dividend offered from domestic equities. This substantial dividend component should help buffer outstanding economic and geopolitical risks that currently exist in the market.

We are recommending a neutral/underweight allocation to emerging markets with a defensive approach. Similar to the previous quarter, our emerging markets exposure favors Asia and remains concentrated in dividend and ESG-integrated strategies. The ESG focus in emerging markets has proven valuable over the last year, outperforming the broad EM market by 1.75%. Our near-term outlook is influenced by the ongoing trade discussions and less robust (albeit positive) economic growth across EM countries. The longer-term view focuses on the fact that emerging market economies are increasingly a larger percentage of global growth. For example, since the Great Financial Crisis, 40% of global economic growth has come from China. As China itself begins to outsource to other EM countries (Vietnam, for example) and continues to develop the One Belt, One Road Initiative, the longer-term growth of EM as an asset class cannot be ignored.

We are recommending an overweight allocation to fixed income. Fixed income investors have benefitted from a strong rally over the last year that has outpaced some equity markets. While we do not anticipate a repeat of the trailing one-year performance, we are reminded that fixed income serves a valuable role within portfolios by helping mitigate equity volatility and drawdowns. We continue to believe that short-duration, high-quality fixed income is the best way to achieve this goal, as yields are favorable with the most price stability should interest rates reverse course and trend higher.

Our Tactical recommendations continue to include investments in robotics and cybersecurity. These investments have performed very well year to date, and we have not altered our longer-term view.

Tax and Financial Planning News

Energy costs tend to rise in the summer months as demand increases, bringing more expensive fuel sources into the distribution chain. While this affects many of us at the gas pumps, loftier energy prices can also be observed in higher home energy bills. If you are considering installing a renewable energy system in your home, this year may be the year to complete the project.

The Solar Tax Credit or Residential Renewable Energy Tax Credit are Federal programs that provide a credit of up to 30% of the total installation costs on an energy efficient residential investment in solar property. For many, the first thought with respect to renewable energy is the installation of solar panels on the roof of a home. While the Residential Renewable Energy Tax Credit does apply to solar panels, it also applies to wind and geothermal systems.

The tax credit, which reduces your tax bill dollar-for-dollar, has existed since 2005 but is set for a reduction from 30% of the cost of the system for projects started in 2019 to 26% in 2020 with further reductions to 22% in 2021 and 10% in 2022. Because of these future reductions in the tax credit and the relative increased efficiency of solar technology (60% less costly in 2018 compared with 2009), 2019 is the perfect opportunity for those looking to upgrade to a renewable energy system.

For those in high federal and state tax brackets in 2019, the Residential Renewable Energy Tax Credit is an effective way to subsidize the cost of the system while offering an annual annuity in the form of lower future energy costs. When considering a home renovation project, consider speaking with a Round Table Wealth Advisor to help determine whether the project can qualify for these or other tax credits.

Firm News

Please join us in welcoming Christopher Turso to the firm. Chris successfully completed an internship with Round Table in 2018 and we are excited to have him as a full-time Wealth Analyst.

Please join us in congratulating Eric Thompson, CFP® on his 5-year anniversary with Round Table. Thank you for your continued dedication!

Respectfully submitted,
Round Table Wealth Management