

The third quarter of 2019 witnessed the Federal Reserve lower its Fed Funds Target Rate twice, with a cumulative reduction of 0.50% from 2.5% to 2.0%. The initial rate reduction on July 31st helped foster a fixed income rally that pushed the Barclay's U.S. Aggregate Index up 2.6% in August, while equity investors may have hoped for a larger cut evidenced by an S&P 500 performance that declined 1.6% during the same month. The Fed cut its Target Rate again in September by an additional 25 basis points and the equity market rallied into quarter end for a September return of 1.9% and a quarterly return of 1.7%. The bond index added to its strong year-to-date performance by finishing the quarter up 2.2%.

Low and even negative interest rates globally (at least the U.S. has positive rates!) are influencing investment decisions similar to those that occurred in 2010. Then, as now, equity sectors that provide a meaningful yield advantage over high-grade fixed income are attracting capital flows. For example, during the third quarter the real estate and utility sectors of the S&P were up 7.7% and 9.3%, respectively, outpacing the next closest sector, information technology, by 3.4%. Capital markets are currently pricing in at least one more rate reduction through yearend. The Federal Reserve in its history has never commenced reducing rates from such a low starting point and in our view this creates more concern than euphoria.

The combination of global central banks focusing on monetary easing, corporate earnings estimates that are susceptible to downgrades and the numerous geopolitical issues concurrently developing poses challenges for domestic and international investors. However, we are not of the "doom and gloom" perspective: domestically, the U.S. consumer remains the bright spot providing more than its historical contribution of 70% of U.S. gross domestic product in the second quarter. Notwithstanding, we continue to believe a greater emphasis on risk management is appropriate in the current market environment.

### Benchmark Returns through September 30, 2019

	QTD	YTD	1 Year	2 Years	3 Years	5 Years	10 Years
<b>S&amp;P 500</b>	4.3%	18.5%	10.4%	12.4%	14.2%	10.7%	14.7%
<b>Russell 2000</b>	2.1%	17.0%	-3.3%	6.6%	12.3%	7.1%	13.4%
<b>MSCI World Ex. US Index</b>	4.1%	15.1%	1.8%	4.7%	9.6%	2.6%	7.3%
<b>MSCI Emerging Markets</b>	0.7%	10.8%	1.6%	5.0%	11.1%	2.9%	6.2%
<b>Bloomberg Barclays U.S. Aggregate</b>	3.1%	6.1%	7.9%	3.7%	2.3%	2.9%	3.9%
<b>Bloomberg Barclays Municipal Bond</b>	2.1%	5.1%	6.7%	4.1%	2.6%	3.6%	4.7%
<b>Bloomberg Barclays U.S. High Yield</b>	2.5%	9.9%	7.5%	5.0%	7.5%	4.7%	9.2%
<b>FTSE Nareit All REITs</b>	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 2.0% in the second quarter and expectations are for the economy to continue growing around that level. *(The third quarter U.S. GDP growth rate will be released on October 30.)*<sup>1</sup> Despite positive growth, many strategists continue to forecast a higher probability of recession within the next two years. Many market prognosticators cite the inversion of the U.S. Treasury yield curve, meaning short-term rates were higher than long-term rates, as evidence of a pending recession. From a historical perspective, the occurrence of an inverted yield curve has demonstrated a strong track record in predicting the past seven U.S. recessions, albeit with varying time lags until the actual onset.

The Federal Reserve, for its part, is attempting to get in front of a potential slowdown by reducing its Fed Funds Target Rate twice since June 30th. Futures markets suggest additional rate decreases will occur by yearend and several voting and non-voting members of the Federal Reserve’s Open Market Committee support such moves. Investors need to be cautious of the influence low interest rates can have on the capital markets. The Fed’s actions to lower rates in the context of increasing economic risks seems counter to equity investors’ willingness to pay premium valuations, but even here, investors use low rates to justify higher P/E ratios.

International central banks are encouraging low rates to the point where \$17 trillion of global government debt is trading with negative yields. The European Central Bank (ECB) recently reduced its policy rate to negative 0.50% and China reduced its bank reserve requirement ratio, which effectively released \$126 billion for lending purposes. Japan’s policy rate is negative 0.10% as that country continues its fight against deflation. Non-U.S. markets, however, are being viewed with greater skepticism than the U.S. based on valuation. Within Europe, the ECB’s advocating of negative yields raises questions as to the fragility of the underlying economy. The U.S. trade negotiations with China are also having an impact on major developed economies such as Germany, the UK and Japan as their exports to China have slowed considerably. Brexit concerns have weighed on the developed markets with the UK representing 14% of the MSCI World ex-US Index. Recent developments indicate a potential deal with the European Union may be forthcoming, but nothing is final.

Emerging markets continue to exhibit economic growth considerably higher than developed markets, but have been suffering from the weight of trade negotiations between the U.S. and China. The market’s reaction to both positive and negative “tweets” or official announcements from both sides sends market indices quickly up and down. While it is hoped that some agreement of substance will be reached soon, markets are coming to the conclusion that any binding agreement may take longer than anticipated. The history of trade negotiations indicate that agreements take years, not months, and that trade wars are not easy to win. Over the longer-term, we believe emerging markets, and in particular Southeast Asia, provide a compelling growth story, however, ongoing negotiations and Hong Kong protests have raised the risk premium for the region and the emerging market asset class generally.

## Summary of Allocation Recommendations

Asset Class	Recommendation	Comment	Asset Class Summary Link
<b>U.S. Large Cap</b>	Neutral	Earnings growth estimates likely too high for 2020; look to value-style, hedged or reduced allocation	<a href="#">U.S. Large Cap Review</a>
<b>U.S. Small &amp; MidCap</b>	Neutral	Valuations reflect reduced earnings and debt issues; flow of funds data suggest a rotation to small cap	<a href="#">U.S. Small Cap Review</a>
<b>Non-U.S. Developed</b>	Neutral/Underweight	European economic growth remains subdued and ECB reducing rates to stimulate growth; U.S.-China impacting Germany, Japan; Currency becoming a headwind	<a href="#">International Equity Review</a>
<b>Emerging Markets</b>	Neutral/Underweight	U.S./China trade deal reaches a “Phase One” but market lacks confidence in milestone	<a href="#">International Equity Review</a>
<b>Fixed Income</b>	Overweight	Maintain short duration as market is pricing in rate cuts; risk heightened if Fed does not cut rates; safe haven bonds	<a href="#">Fixed Income Market Review</a>
<b>Tactical</b>	Neutral	Robotics and cybersecurity	<a href="#">Tactical Investments Review</a>
<b>Alternative</b>	For appropriate allocations	Liquid hedge strategies in ETF format; private credit funds and private equity	<a href="#">Contact your Wealth Advisor</a>

## The Outlook

We continue to recommend a neutral allocation to U.S. Large Cap Equities. As we approach the end of 2019, S&P 500 earnings for the year are now estimated to grow 1.2%, well off the projected 12% growth at the start of the year. Looking forward to 2020, analysts' consensus earnings estimates project S&P 500 companies to collectively increase earnings by 10.8%. Our view is that earnings estimates are likely to be reduced, although not erased as the year-over-year comparison is easier given the 2019 growth rate. We are also cognizant of the Fed's predisposition to rate easing, which is due to their economic downside concerns. Last, the ongoing trade negotiations, until resolved, will continue to create a headwind for large, multi-national companies within the large cap universe.

We are recommending a neutral allocation to U.S. SMID Cap Equities. Small cap earnings expectations have been reduced to more practical levels and we see less downside risk and the potential to surprise on the upside as we enter 2020. Additionally, we are encouraged by revenue growth that is expected to be relatively stable at just under 3% growth for the third and fourth quarters. Expectations for 2020 are also reasonable given the targeted 4.0% revenue growth. Consequently, within the SMID Cap allocation, we are improving our recommended allocation to small cap from a large underweight to a slight underweight. The improvement to the small cap allocation is driven by an equal reduction in our previous overweight to mid-cap equities.

We continue to recommend a neutral/underweight allocation to non-U.S. developed market equities. We currently do not perceive a meaningful catalyst that would lead to sustained outperformance relative to the U.S. Within our developed markets exposure, we remain focused toward high-quality, value-oriented and dividend-paying companies to prudently manage the risks we see in the market, in addition to certain hedged products.

We are recommending a neutral/underweight allocation to emerging markets with a defensive approach. We maintain this positioning within emerging markets as many headline risks persist in the region, most notably the U.S.-China trade dispute. Our emerging markets exposure remains concentrated in dividend and ESG-integrated strategies, which have helped protect against increased volatility and drawdowns in the market. A substantive trade agreement between the U.S. and China will likely provide a strong tailwind to the asset class.

We are recommending a qualified overweight allocation to fixed income. While we recognize that the fixed income asset class will be under pressure as interest rates normalize to historical levels, we maintain that our portfolios hold fixed income duration lower than the benchmark combined with an overweight to high investment grade bonds. The current Fed Funds Futures Curve is pricing in at least one more rate cut this year. If the Federal Reserve does not decide to cut rates as they have communicated, it is likely that rates would move higher and bond prices would decrease. Portfolios with longer duration bonds would suffer greater losses under this scenario. However, if the Federal Reserve changes their outlook and lowers rates, such movement has already been captured in bond yields and prices. This results in an asymmetric return profile for investors extending duration in the hopes of capturing further declines in rates and is why we are positioned in shorter-duration assets.

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

## Tax and Financial Planning News

"Home is where the heart is," at least it is according to the Internal Revenue Service. After the enactment of the Tax Cuts and Jobs Act of 2017, residents of high income and property tax states like New Jersey, New York, Connecticut and California noticed higher tax bills in 2019 due to the reduction of the state and local tax

deduction to a maximum of \$10,000. Retirees in these states have long considered moves to warmer climates, many of which, like Florida, Arizona and North Carolina have lower state and local tax burdens. A clean break from the old state to a new state may be the “cleanest” solution, but many maintain ties to the old state through a second home, social and professional relationships, and/or official documentation (i.e., voter registration).

Complexities like maintaining property in the old state or spending too much time in that state can trigger a residency audit and may subject you to additional taxes and penalties. A proper change of domicile strategy should include an analysis of both subjective and objective proofs of your new domicile and should ensure you take the proper precautions to document those changes. To learn more about some of the factors to consider for a change of domicile, please read the full article, “Domicile vs. Tax Residency: What is domicile and how do you change it?”, on our blog.

If you or someone you know is considering relocating to another state in retirement, consider speaking with a Round Table Wealth Advisor to determine the best strategy.

## Firm News

Round Table celebrated its 20th anniversary on October 1st. We want to thank all of our clients for their ongoing support of the firm and look forward to the next 20 years!

Please join us in welcoming Saahith Vukanti to the firm as an Investment Analyst.

**Respectfully submitted,**  
**Round Table Wealth Management**

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<sup>1</sup> The Advanced Estimate of third quarter U.S. GDP growth will be released on October 30, 2019