2019 Mid-Year Update

July 2019

Investors on Edge

- Global growth slowed over the last six months. In April, the International Monetary Fund (IMF) forecast for world Real Gross Domestic Product (GDP) growth in 2019 of 3.3 percent was down 0.3 percent from 2018[1]. Some slowdown in the U.S. was expected as benefits of tax-driven fiscal policy diminished; however, slumping exports and lower investment in emerging market economies contributed to the slowdown as well.

- Since GDP data is reported with a lag, and often subject to revisions, we monitor global Purchasing Managers Index (PMI) data, revealing additional weakness in business activity across the globe. Given the modest, but expansionary level of business activity through June, we expect corporate earnings results and management guidance to play a more prevalent role in the second half of the year.

- In response, the Federal Reserve and other central banks ended gradual and anticipated tightening of monetary policy. Central banks reiterated stand ready to deploy accommodative policy to support slowing growth.

- Our resulting capital market updates are not material enough to warrant a rebalance, however, we recommend caution and would advise against investors attempting to reach for risk given potential for slower growth, full valuations and macroeconomic uncertainty.

At the beginning of 2019, we published our long-term capital markets outlook along with relevant long-term themes we viewed as important to frame our expectations. As we begin the second half of 2019, we provide insight into how our thoughts have evolved.

Growth Remains, but on Less Stable Footing

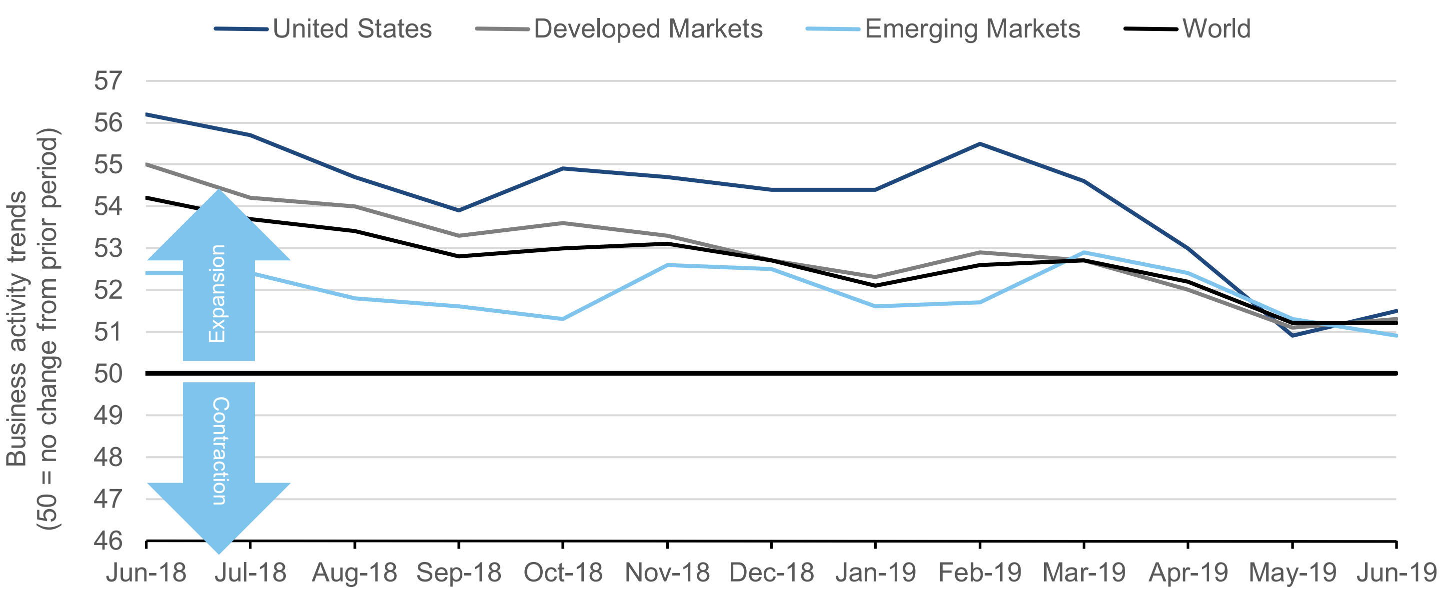
Key Observation Beginning 2019 – With fewer tailwinds, the pace of economic growth should abate and may weigh on corporate earnings estimates and fuel bouts of short-term volatility as investors react more dramatically to companies missing or beating consensus estimates.

Mid-Year 2019 Update – Incoming economic data suggest the pace of global growth slowed during the first half of 2019 but remains on track with baseline expectations for slower, but still positive real GDP growth. IHS Markit Purchasing Managers Index (PMI) Composite trends revealed a slowdown in global business activity in developed markets that began in July 2018. While it is difficult to discern if growth is set to rebound in the near term, confidence that central banks can contain downside risks of slowing global growth anchored the rebound in risk-assets through the first half of the year.

Therefore, the most significant risk to this rebound and the recent decline in equity volatility is central banks losing control of this narrative. Fundamentals, particularly corporate earnings and forward earnings guidance, can be particularly informative data points to monitor. Investors will assess if already reduced estimates are low enough, as 2020 estimates begin to come into focus.

Is This the Bottom?

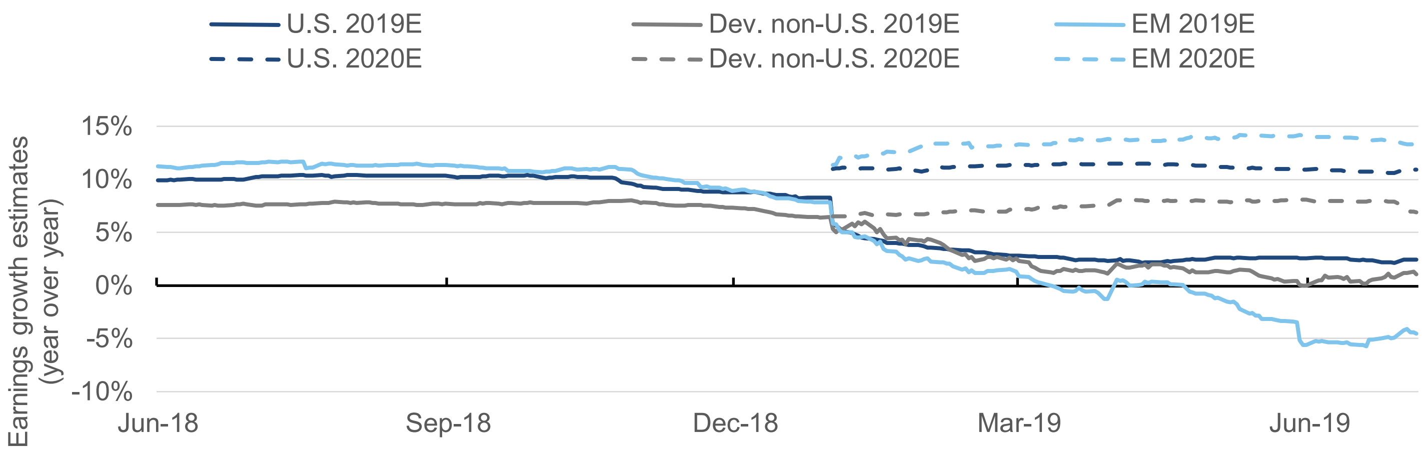
Global PMI Composite trends show business conditions slowed through June, strengthening the case for fiscal and monetary policy accommodation.



Source: Bloomberg, IHS Markit. Monthly data through June 2019.

Investors' Earnings Growth Expectations Have Moved Lower, but…

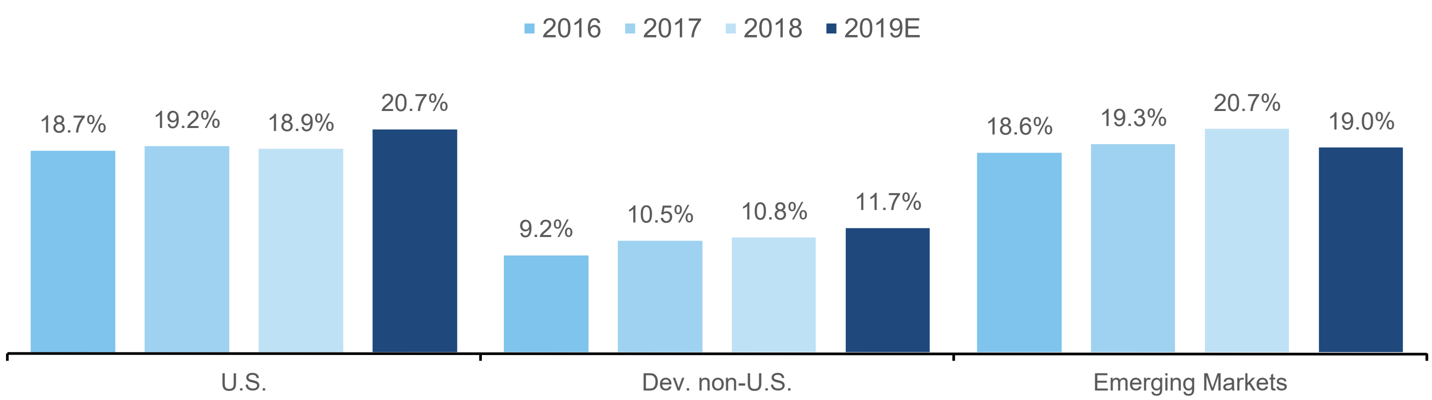
Earnings estimates for 2019 moved lower as business conditions slowed in the first half of this year, but 2020 estimates have not changed much.



Source: Bloomberg consensus earnings estimates. S&P 500 Index, MSCI EAFE Index, MSCI Emerging Markets Index. Daily observations through June 2019.

…Investors Still Expect Operating Margin Expansion.

We are skeptical that U.S. firms can increase operating margins in a slow growth environment with tight labor market conditions.



Source: Bloomberg consensus estimates. Earnings before Interest Taxes Depreciation and Interest (EBITDA) margins. S&P 500 Index, MSCI EAFE Index, MSCI Emerging Markets Index. Daily observations through June 2019.

Portfolio Impact – Despite the strong rebound in equity valuations, global business activity appears on edge. We caution against increasing a strategic allocation to equities and favor reassessing total portfolio risk tolerances.

Slowing Separation

Key Observation Beginning 2019 – With global policy divergence slowing, the U.S. dollar is less likely to continue its incessant march higher, creating opportunities among various asset classes.

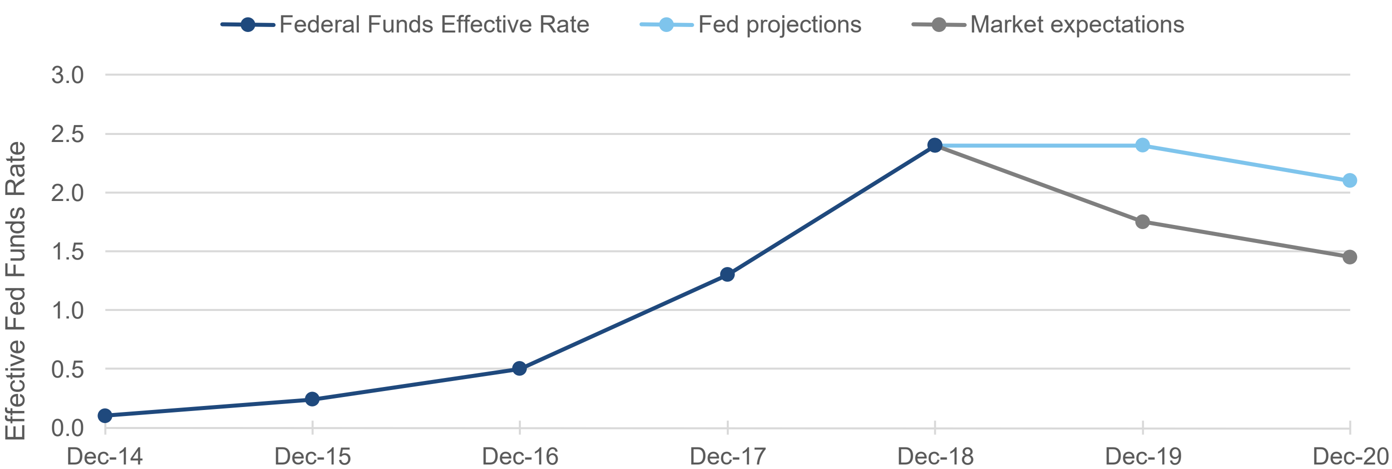
Mid-Year 2019 Update – In concert with slowing economic growth and expectations for Fed policy accommodation, market-implied measures have priced in almost three 25 basis point rate cuts by year-end. In contrast, the median forecast from Fed policymakers signals zero rate cuts in 2019.

That said, seven of the 17 Federal Open Market Committee (FOMC) participants forecast two – 25 basis points cuts by year-end. We would expect the eventual outcome to fall somewhere in between, which should curb U.S. dollar strength longer-term as interest-rate differentials narrow. The short-term risk to this scenario would be if global growth continues to slow, other central banks ease further and foreign investors seek safety in U.S. denominated assets, which could put upward pressure on the U.S. dollar.

We will learn more during the FOMC's July meeting.

The Path of Convergence Matters

The meaningful gap between Fed projections and market expectations leaves room for modest U.S. dollar strength. However, a clear path of more accommodative monetary policy and interest rate parity should weight on the U.S. dollar long-term.



Source: Bloomberg, Federal Reserve Bank Summary of Economic Projections (June 2019).

Resilient U.S. Dollar Strength

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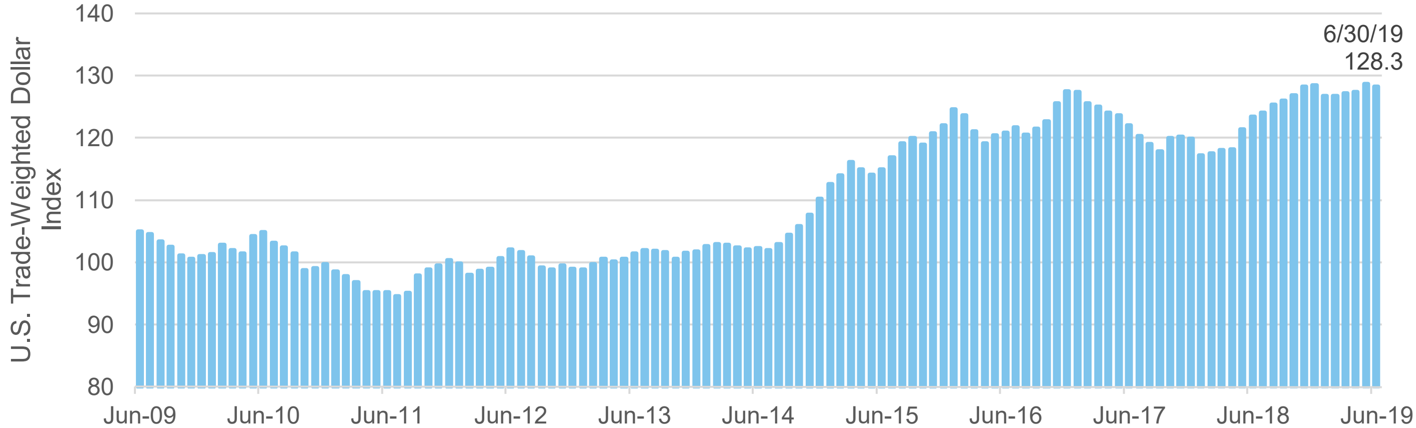
Despite a dovish Fed pivot in the first half of 2019, the U.S. dollar traded sideways through the first six months of the year.



Source: Bloomberg, U.S. Trade-Weighted Dollar, monthly observations.

Portfolio Impact – Increased probability for rate cuts in the U.S. and the Fed curbing its balance sheet normalization program provides the opportunity for long-term investors to take advantage of foreign assets with more attractive relative valuations.

Volatility is Back

Key Observation Beginning 2019 – Asset prices will likely be more sensitive to incremental information causing short-term volatility. Short-term volatility should not be confused with a decline in asset prices but should caution investors to avoid the temptation to react to short-term news.

Mid-Year 2019 Update – Volatility in 2019 has largely been to the upside as assets across the globe have moved higher. However, we believe this point stands as important today as it did in January of 2019. As markets have moved higher, they have done so with deteriorating economic growth and lower earnings expectations. That means higher market prices have largely come on the back of investor sentiment in the form of higher valuations in anticipation of more accommodative monetary policy. Failure to meet these expectations without additional support from strong economic growth or earnings would most likely manifest itself in downside volatility.

Economic Growth Waning

Despite higher prices, PMI Composite data show business activity slowed year to date.

	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
Developed Markets	55.0	54.2	54.0	53.3	53.6	53.3	52.7	52.3	52.9	52.7	52.0	51.1	51.3
Emerging Markets	52.4	52.4	51.8	51.6	51.3	52.6	52.5	51.6	51.7	52.9	52.4	51.3	50.9
United States	56.2	55.7	54.7	53.9	54.9	54.7	54.4	54.4	55.5	54.6	53.0	50.9	51.5
World	54.2	53.7	53.4	52.8	53.0	53.1	52.7	52.1	52.6	52.7	52.2	51.2	51.2

Source: Bloomberg, IHS Markit. Monthly data through June 2019.

Portfolio Impact – We continue to believe that the low volatility of recent years is less likely to persist and the stage has been set for normal (rather than recently abnormally low) volatility. Portfolio allocations should remain thoughtfully diversified with this in mind, but investors may need to reset expectations with a clear discussion of potential implications normalized volatility may have on their account balances.

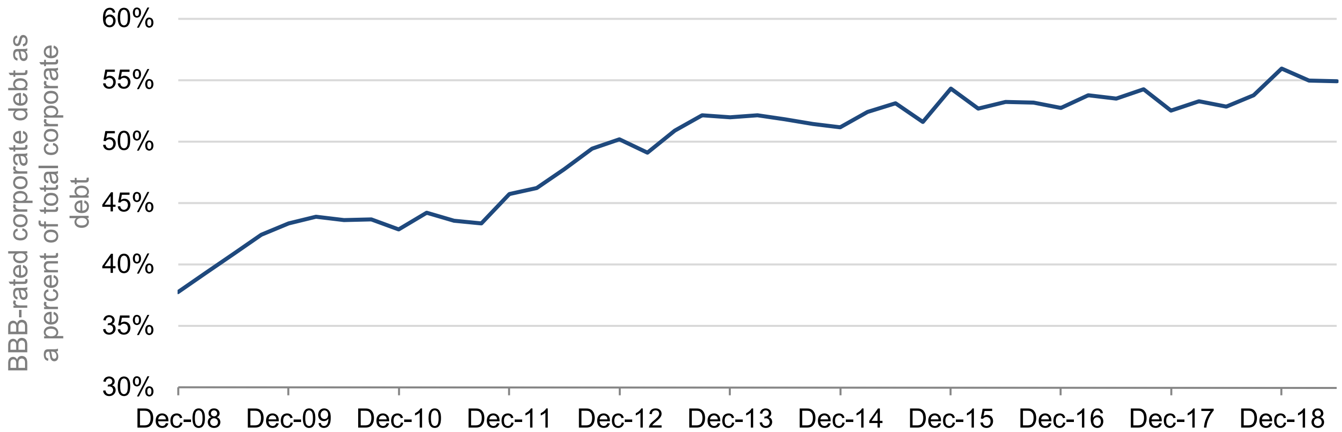
Be Cautious of Credit

Key Observation Beginning 2019 – With downside risks to economic growth emerging and higher interest rates, investment- and non-investment grade corporate debt should be evaluated with greater skepticism. Today, lower-quality corporate bonds, within the investment-grade market, constitute a greater proportion of the investment grade market and may not provide less downside protection during volatile periods. The non-investment grade market may struggle to refinance debt at attractive interest rates given higher financial or operational leverage.

Mid-Year 2019 Update – Corporate debt levels are growing, particularly in the lowest-rated segment of the investment grade sector. Expectations for Fed rate cuts and more accommodative monetary policy do not change our views on the sector, but we acknowledge that the dovish pivot and yield-seeking investor behavior should give corporations cover to roll existing debt and issue new debt at lower levels for longer than expected.

Growth in BBB-Rated Corporate Debt

Lower-quality investment grade corporate debt issuance now accounts for more than half of total investment grade corporate debt outstanding.



Source: Bloomberg. BBB-rated corporate debt outstanding as a percent of total investment grade corporate debt. Quarterly data through June 2019.

Portfolio Impact – More tempered allocations to credit and thoughtful utilization of active bond managers to navigate the level of quality in today's market are prudent adjustments.

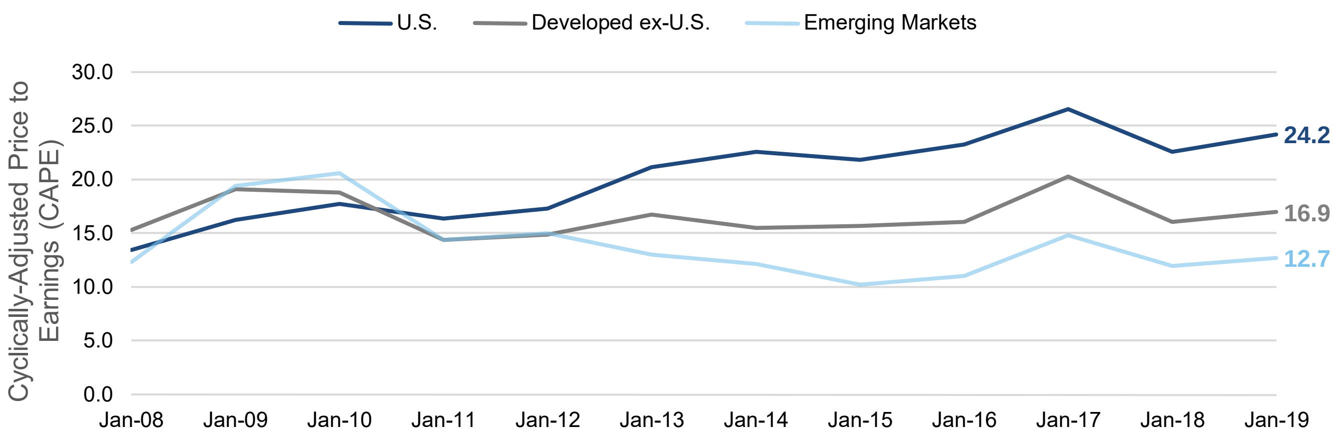
International Developed and Emerging Market Equities Remain Attractive

Key Observation Beginning 2019 – Foreign markets are more attractive today than U.S.-based assets and offer an opportunity to enter or add to the asset class at reasonable valuations. However, valuation, growth and currency movements are not short-term catalysts and should be considered with a long-term time horizon.

Mid-Year 2019 Update – Trade tensions, U.S. dollar strength and political uncertainty in Europe remain sources for headline risk among international and emerging market equities, but relatively favorable equity valuations should reward long-term investors. Furthermore, as the trajectory of U.S. monetary policy tracks closer to global central bank policies, we have more conviction in foreign-denominated equities.

Global Equity Valuations

Lower valuations outside of the U.S. provide an opportunity for long-term investors.



Source: Bloomberg. DiMeo Schneider & Associates, LLC.

Portfolio Impact – We continue to recommend thoughtfully adding to international allocations to take advantage of opportunities outside of the U.S.

For more information and assistance, please contact any professional at Cordasco Financial Network Inc.

Disclosures

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When referencing asset class returns or statistics, the following indices are used to represent those asset classes. Each index is unmanaged and investors can not actually invest directly into an index: Cash –Citigroup 90 Day T-Bill; TIPS – Bloomberg Barclays US Treasury TIPS; Aggregate Bond – Bloomberg Barclays US Aggregate Bond Index; Municipal Bond – Bloomberg Barclays Municipal 5-Year Bond; High Yield – Bloomberg Barclays US Corporate High Yield; Foreign Bond – Bloomberg Barclays Global Aggregate Ex USD; Local Currency Denominated Emerging Markets Debt – JPMorgan GBI-EM Global Diversified Unhedged Index; Large Value – Russell 1000 Value; Large Blend – S&P 500; Large Growth – Russell 1000 Growth; Small Value – Russell 2000 Value; Small Blend – Russell 2000; Small Growth – Russell 2000 Growth; International – MSCI EAFE; Emerging Markets – MSCI EM; REITs – FTSE NAREIT Equity REITs; Commodities – Bloomberg Commodity Index; MLP – Alerian MLP; Hedge Funds – HFRI Fund of Funds Composite Index; Balanced – 5% Bloomberg Barclays US Treasury TIPS, 10% Bloomberg Barclays US Aggregate Bond Index, 4.5% Bloomberg Barclays Global Aggregate Ex USD, 4.5% Bloomberg Barclays Global Aggregate Ex USD (Hedged), 9% Bloomberg Barclays US Corporate High Yield, 2% JPMorgan GBI-EM Global Diversified Unhedged Index, 16% S&P 500, 5% Russell 2000, 12% MSCI EAFE, 7% MSCI EM, 5% FTSE NAREIT Equity REITs, 5% Bloomberg Commodity Index, 5% Alerian MLP, 10% HFRI Fund of Funds Composite Index; Domestic Equity Indices – Russell 1000, Russell 1000 Growth, Russell 1000 Value, Russell Mid-Cap, Russell Mid Cap Growth, Russell Mid-Cap Value, Russell 2000, Russell 2000 Growth, Russell 2000 Value; International Developed Markets – MSCI EAFE; US Dollar – US Dollar Index; Unhedged Developed Fixed Income – Bloomberg Barclays Global Aggregate Ex USD (Hedged); Real Assets – Bloomberg Commodity Index; Materials, Financials, Energy, Oil & Gas, Healthcare, Information Technology, Consumer Related Sectors – Dow Jones Sector Indices; Small Cap Securities – Russell 2000, Russell 2000 Growth, Russell 2000 Value; Large Cap Securities – Russell 1000, Russell 1000 Growth, Russell 1000 Value; Mid Cap Securities Russell Mid Cap, Russell Mid Cap Growth, Russell Mid Cap Value; Growth; Russell 1000 Growth, Russell Mid Cap Growth, Russell Small Cap Growth; Value – Russell 1000 Value, Russell Mid Cap Value, Russell 2000 Value; Fixed Income Markets – Bloomberg Barclays US Treasury TIPS, Bloomberg Barclays Municipal 5-Year Bond, Bloomberg Barclays Aggregate; Investment Grade Corporate Securities – Bloomberg Barclays US Credit; Long Maturity Treasuries –Bloomberg Barclays US Treasury 20+ Year; Shorter Dated Issues – Bloomberg Barclays US Treasury 1-3 Year; Industrial-, Financial-and Utility- Related Credits – Bloomberg Barclays Fixed Income Sector Indices; BB-Rated, B-Rated and CCC-Rated – Bloomberg Barclays Fixed Income Credit Quality Indices; MBS –Bloomberg Barclays US MBS; ABS – Bloomberg Barclays ABS; Crude Oil – Bloomberg Composite Crude Oil; Australia, New Zealand, Japan, China, India, Taiwan, South Korea, Brazil, Mexico, Chile, South Africa, Turkey, Egypt, Hungary, Poland, Russia, Canada, United Kingdom, Spain, Germany, Italy, France – MSCI Country Index Gross Return USD; Natural Gas – Bloomberg Natural Gas.