July 10, 2019

Dear Investor,

I hope you had a fantastic 4th of July and are enjoying your summer. I wanted to share with you a post from Brad McMillan, Commonwealth's Managing Principal and Chief Investment Officer. I think his brief review of the second quarter of 2019, and thoughts on the third quarter, provide good insight. As always, please feel free to give me a call if you have any questions.

A Look Back at the Markets in Q2 and Ahead to Q3 2019

Posted by Brad McMillan, CFA, CAIA, MAI
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Q2 2019: it was the best of times, it was the worst of times. Okay, it wasn't either, but last quarter we did see something that looked like both. After hitting new highs in April (the best!), markets declined significantly in May for the first time all year (the worst!) and then bounced back in June close to all-time highs. Internationally, we saw the same story, although to a lesser extent, as both developed and emerging markets echoed U.S. performance with an up-down-up pattern. We closed the quarter on a positive note, though, with all major indices up around the world. As far as the stock market is concerned, it was a good quarter.

A look back

Risks remain. Interestingly, this good quarter happened despite some real concerns. Corporate earnings growth rolled over and is expected to be negative through the third quarter as well. Worries about slowing global economic growth underlined the risks here. Further, some weak data reports, especially around confidence and hiring, also pointed to trouble ahead. Despite the strong performance of financial markets for June and the quarter as a whole, we are not out of the woods.

Declining rates. The Fed and the bond markets both agree with this risk assessment. The Fed came out with a much more dovish stance in its most recent meetings, making lower interest rates a more likely outcome—possibly this month. The bond market has already acted on that likelihood, pushing long-term rates down nearly half a percentage point over the quarter, from about 2.5 percent to 2 percent. Clearly, the bond markets are showing more worry than even the headlines.

Economy still growing. Despite all the worries, the data shows that the stock market may have it right—although the economy may be slowing, it is still growing. Job growth, for example, had two slow months during the quarter. Looking at the year-on-year changes, however, it remains at the levels of most of 2018—and above those of 2017. The same can be said for wage growth. Similarly, although consumer confidence is down from the highs, it remains above the highest levels dating back to 2016. With consumers getting jobs and raises—and confident enough to spend—we also saw healthy increases in personal income and spending during the quarter, which drives more than two-thirds of the economy. People may be worried, but they are still working and spending.

FPS Financial, Inc., 919 Old Highway 8 NW, Suite 400, New Brighton, MN 55112 · 651.633.2689 · info@fpsfinancial.net · www.fpsfinancial.net

Business sector better than expected. Like the consumer, business confidence was down during the quarter, but it remains positive. Although investment growth has slowed—like hiring—it remains at healthy levels, which should support continued growth. Government, the last direct sector, has actually been spending more, which should also help keep growth going.

Politics in play. With the economy still growing, the real worries last quarter were political. Fears of a trade war with China shook confidence, while worries about the Mueller report and Washington drama also took their toll. North Korea, Brexit, and even the Fed caused shoppers and investors to pull back. The worries were—and are—real.

At the same time, as of the end of the quarter, the Mueller report had come and gone, conflict between Congress and the White House continues but has not sunk the ship of state, and the trade war remains at the cold stage rather than getting worse. There has been damage and slowing, but not enough to derail the economy as a whole.

A look ahead

Worries keep economy moving. In fact, in many ways, the worries have helped keep the economy moving. Lower interest rates are likely to help revive a weakening housing market and help consumer spending growth keep going. Lower oil prices, prompted by growth fears, also put money into consumers' pockets. For all the worries, to some extent these problems solve themselves—another reason to be less concerned going forward.

Fundamentals remain solid. As we look into the rest of the year, that is the real lesson of the second quarter: as long as the economic fundamentals—hiring and confidence—remain solid, the headline risks will stay just that instead of turning into bigger problems. It was a good quarter overall. The likelihood is that trend will hold for the third quarter, despite the headlines.

Sincerely,

Mike

Mike Ovshak, CFP®
President/Owner

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