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Nauset Market Commentary
Second Quarter 2019

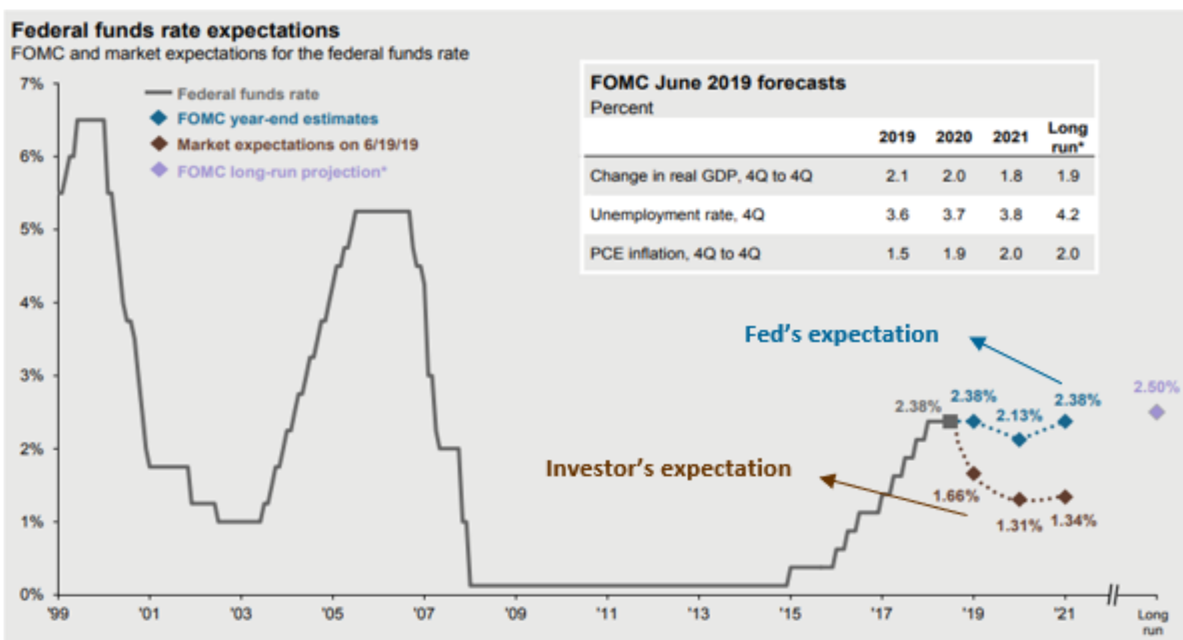
Market Performance Recap: **Back on Top**

Stocks set new all-time highs in June after trade tensions caused a sharp May decline. Markets appear to have anticipated a potential rate cut or two to keep the US economy on track amid slowing global growth. The Russell 1000 US stock index tacked on +4.2% in Q2, paced by strong gains in financials and consumer services. International stocks also posted gains as the MSCI EAFE index increased +3.7%, while MSCI Emerging Markets were up only slightly at +0.6% for Q2. For the quarter, bond prices boosted by anticipation of possible Fed rate cuts led to gains of +2.6% in the Barclays Intermediate Gov't/Credit bond index.

Economic & Market Discussion: **Game of Rates**

Interest rates are one of the three key factors along with earnings and valuations that drive our outlook for stocks. Therefore, a decisively dovish shift by the Federal Reserve regarding rates is a critical development. Let's take a closer look at what may happen and the implications.

- Rate Expectations – In May, the Fed signaled to investors it may cut the Federal Funds rate if domestic economic data continues to weaken due to trade disruptions and slowing global growth. This recent shift by the Fed has given investors confidence to drive stocks to all-time highs. Is the market set up for disappointment either by the Fed not cutting or by lower rates failing to extend the economic cycle? We think it is a possibility.



Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.

- China Syndrome – A major factor in the Fed's potential rate cut is the effect of slowing global growth on the US economy, which is directly linked to US-China tariff warfare. A continuation of these tensions will reinforce the Fed's intention to cut rates as soon as late July. However, a US-China trade deal at some point in the second half of 2019 would likely relieve some growth pressures and may delay or change the Fed's action. We believe progress on the trade war will be driven by political pressure to enter an election year with positive economic prospects.
- Will Lower Rates Help? – Views on this question are mixed. We think it is unlikely that a ¼ or ½ point rate cut will spark a great resurgence of economic activity. The optics of lower rates and the change in direction from tightening to accommodation will likely be viewed as positive. It is possible that the economy will remain resilient on its own regardless of whether the Fed cuts rates. Under most

scenarios, we see a degree of uncertainty around economic outcomes for the latter half of the year. For these reasons, we are cautious going forward as we await the Fed's rate decisions.

Portfolio Strategy: **Managing Risk**

With the stock market at an all-time high and valuations a bit stretched, we see risks increasing due to trade tensions and slowing global growth. Even with a Fed rate cut, we will proceed with caution in the latter half of the year with a focus on managing volatility. Currently, most portfolios are at or near target weight for equities, slightly underweight in real assets and alternatives, and overweight in income and cash holdings.

- Equity Quality – While equity allocations are at equal weight, we have diversified stock risk using low-volatility US and international large cap ETFs as well as healthcare holdings, which have defensive qualities.
- Fixed Income Defense – With rates lower in the first half of the year, we remain defensive in our income allocation as we expect longer-term rates may move higher from current levels even with a cut in the Fed funds rate. We continue to monitor rates closely and will seek new opportunities as rates fluctuate.
- Overweight Income & Cash – With some degree of economic uncertainty going forward, we are using multiple tools to manage risk. Our primary risk buffers remain fixed income and cash allocations. Additionally, we expect the aforementioned low volatility equity ETFs to assist in managing volatility.

Market Performance % Change for Periods Ended 6/30/2019

Market Index	Second Quarter	2019 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	4.25	18.84	10.02	14.15	10.45
MSCI EAFE – Non-US	3.68	14.02	1.08	9.11	2.25
Russell 2000	2.09	16.98	-3.31	12.30	7.05
MSCI Emerging Markets Equity	0.61	10.58	1.21	10.66	3.49
DJ US Real Estate	1.82	19.21	12.81	6.37	8.57
NASDAQ 100	3.87	21.33	7.78	19.56	13.97
Barclays Gov't/Credit Interm. Bond	2.58	4.97	6.93	1.99	2.39
Wilshire Liquid Alternative	1.34	4.60	1.73	2.20	0.68
3-Month T-Bill	0.61	1.21	2.29	1.36	0.84