

Nauset Market Commentary Third Quarter 2019

Market Performance Recap: **Mixed Results**

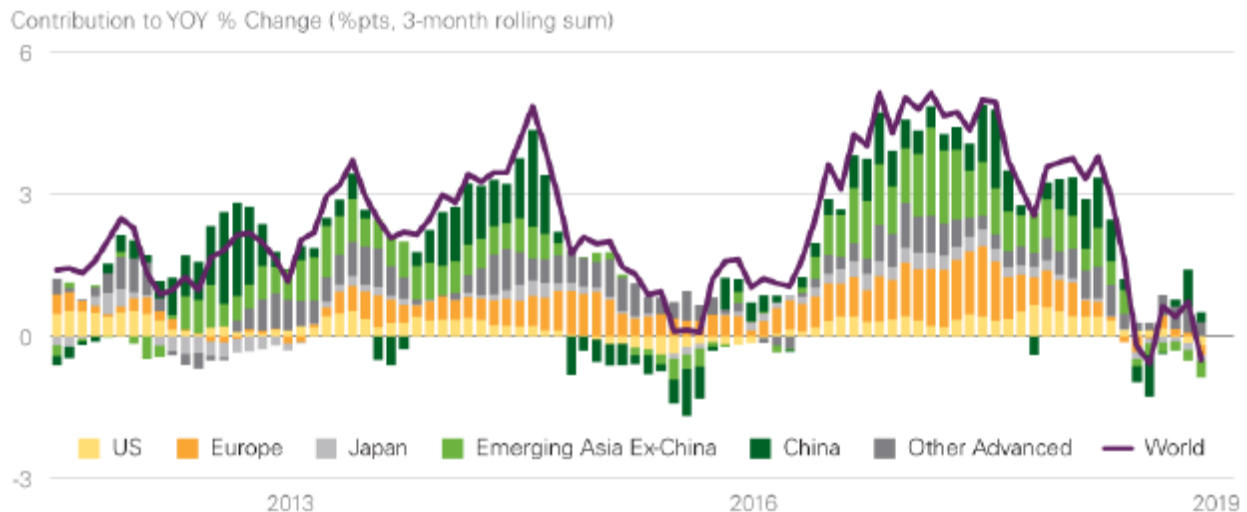
Large cap stocks posted minor gains as the Fed addressed an ongoing economic slowdown with two rate cuts during the quarter. The Russell 1000 US stock index edged up +1.4% in Q3, paced by strong gains in utilities, real estate and consumer staples. However, smaller cap US stocks slid -2.4% per the Russell 2000 Index. International stocks also posted losses, with MSCI EAFE index down -1.1%, and MSCI Emerging Markets off -4.2% in Q3. Fed rate cuts helped drive up bond prices as the Barclays Intermediate Gov't/Credit bond index gained +1.4%.

Economic & Market Discussion: **Stew of Worries, Dash of Hope**

The drumbeat of warnings regarding a possible US recession is getting louder. Reports of flagging global trade, slumping US manufacturing and meager earnings growth highlight this current window of economic weakness. While a recession seems increasingly close, there is a reasonable possibility the path forward pushes out the recession timing. Let's review the key factors affecting the US economy.

- **Trade War Wounds** – The global trade war is definitely biting into global growth as evidenced by flat and declining trade volumes in the chart below. Increasing economic pain is ratcheting up the pressure on the US and China to reach some type of deal. While a comprehensive deal seems unlikely, a limited agreement before year end is possible driven by political motivation as much as economic factors. Even a narrow deal could spark a degree of recovery in trade and broader economic activity.

Global Trade Volumes are Falling – Haver Analytics



- **Rates to the Rescue?** – The Fed has already cut rates twice so far in 2019 with additional cuts possible at October and December meetings. While the Fed has expressed its intent to combat economic weakness, the question remains whether this set of cuts will help or are even needed. While lower rates may not help spur a major growth revival, the lower direction of rates could bolster investor and business sentiment, which is important to economic stability.
- **Political Wild Cards** – Political issues cut both ways. Currently, the markets are factoring in negative aspects of uncertainties surrounding impeachment proceedings, the 2020 Presidential race, and international geopolitical conflicts. The upside from political headwinds often results from their resolution or minimization as economic drivers. As such, a lessening of political conflicts and tensions would be a positive for markets, while of course, the opposite would also be true.

In summary, the resilient US economy of the past several years is undergoing a challenging period. It may end in a 2020 recession, or a number of factors could serve to extend the current expansion into 2021. We remain cautious and defensive going forward as we watch to see which scenario develops.

Portfolio Strategy: Active on Defense

With our cautious economic outlook, we have shifted to a slightly defensive position in our basic portfolio allocations with an underweight in riskier equity sectors, while increasing our allocation to fixed income and cash.

- Upping Income-Producers – With the direction of rates now flat or slightly lower, we have expanded our allocation to fixed income with an emphasis on multi-sector bond funds, preferred stock ETFs, and where appropriate, municipal bond funds. We continue to monitor rates closely and will seek new opportunities as rates fluctuate.
- Focused Equity – Our slightly underweight stock allocations are focused on large cap US equity, as we have reduced international and small cap exposure. And we have increased our use of low-volatility large cap US ETFs to help buffer downside equity risk.
- Risk Buffers – Under current uncertain economic conditions, we continue to use fixed income and cash allocations as our primary risk management tools. To that mix, we recently added BlackRock Event-Driven Equity fund, a liquid alternative that seeks returns uncorrelated to equity prices mainly through merger arbitrage.

Market Index	Market Performance				
	% Change for Periods Ended 9/30/2019				
	Third Quarter	2019 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	1.42	20.53	3.87	13.19	10.62
MSCI EAFE – Non-US	-1.07	12.80	-1.34	6.48	3.27
Russell 2000	-2.40	14.18	-8.89	8.23	8.19
MSCI Emerging Markets Equity	-4.24	5.89	-2.02	5.97	2.33
DJ US Real Estate	7.54	27.58	21.62	8.88	10.52
NASDAQ 100	0.18	21.54	0.52	15.88	13.51
Barclays Gov't/Credit Interm. Bond	1.37	6.40	8.16	2.40	2.68
Wilshire Liquid Alternative	0.45	4.90	1.05	1.83	0.78
3-Month T-Bill	0.56	1.81	2.39	1.54	0.98