LPL RESEARCH
MARKET INSIGHT QUARTERLY

THIRD QUARTER 2019 IN REVIEW

October 2019

1 Q3 2019 AT A GLANCE

	Q3 2019
Gross Domestic Product*	1.9%
S&P 500 Index	1.7%
Bloomberg Barclays Aggregate Bond Index	2.3%
Bloomberg Commodity Index	-1.8%

Source: LPL Research, Bloomberg, FactSet 09/30/19

*Bloomberg consensus as of September 30, 2019.

Figures for S&P 500 Index, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodity Index are total returns from 06/30/19 – 09/30/19 (Q3).

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

Stocks Stall, Yields Fall Amid Economic Mixed Signals

- **U.S. economy sends mixed signals.** Gross domestic product (GDP) rose 2% in the second quarter. Consumer spending added 3 percentage points to overall growth, while trade and inventories were a 1.6 percentage point drag. Business spending was still a slight drag on growth.

  Overall, leading indicators pointed to low odds of a recession in the next 12 months, and GDP likely grew 1.9% in the third quarter, according to consensus estimates.

  Coincident economic data was mixed amid global trade and political uncertainty. Gauges of manufacturing health dropped to fresh multi-year lows as global demand weakened. Consumer confidence improved, but business sentiment faltered as corporations digested growing uncertainty. The U.S. labor market stayed resilient against trade tensions. Payrolls grew at a solid rate, and the unemployment rate hovered near a cycle low. Wages grew at a healthy, manageable pace while price inflation was contained.

  The Federal Reserve (Fed) enacted its first interest rate cuts of the economic cycle during the quarter. Policymakers reduced interest rates by 25 basis points (0.25%) on July 31, then cut rates by 25 basis points (0.25%) again on September 18.

- **The S&P 500 Index returned 1.7% during the third quarter.** Continued economic growth and Fed rate cuts helped support stocks amid ongoing trade uncertainty. Large caps bested small caps, although small caps narrowed the gap some during September when several market trends reversed. Growth still outpaced value over the entire quarter, even though value stocks made up some ground in September's trend reversal. Higher-yielding

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The economic forecasts set forth may not develop as predicted.

interest-rate-sensitive sectors paced the market's gain, led by consumer staples, real estate, and utilities, while the energy and healthcare sectors suffered the biggest losses during the quarter.

Globally, U.S. stocks outpaced international, as the developed international MSCI EAFE Index and MSCI Emerging Markets Index lost 1% and 4.2%, respectively. Losses in Europe and a strong U.S. dollar weighed on international equity market performance. The S&P 500 has returned 18.7% year to date, the best start to a year since 1997, well ahead of the 13.4% and 6.1% returns for the developed international and emerging market equity indexes.

- **Yields slide further.** Rates across the curve slid in the third quarter as global monetary policy easing and signs of slowing global growth weighed on sovereign debt yields. The 10-year Treasury yield dropped 34 basis points (0.34%) in the quarter. The 2-year Treasury yield fell 13 basis points (0.13%). The yield curve inverted further through August, culminating in the spread between the 2-year and 10-year Treasury yields briefly falling negative for the first time this cycle. Then, the yield curve steepened through the end of the quarter.

  High-quality debt outperformed during the quarter. Preferred stocks led all sectors with a 4% gain. The Bloomberg Barclays U.S. Aggregate Index rose 2.3%. Unhedged foreign bonds fell 0.1%, the lone decline among sectors we track.

- **Managed futures lead once again.** The HFRX Systematic Diversified Index gained 3.8% during the third quarter, with long fixed income exposure delivering a majority of the returns. Long U.S. dollar exposure versus several European currencies also supported portfolios over the course of the quarter, while equity and commodity trading performance was mixed. The HFRX Market Neutral Index fell 0.9%, the only subcategory in negative territory. Value's relative underperform to growth continues to act as a headwind for the category.

- **Commodities dip.** The Bloomberg Commodity Index fell 1.8% in the third quarter, with gains in precious metals offset by declines in more economically sensitive segments of the commodities market. Commodities' 3.1% gain year to date has significantly trailed that of equities. A flare-up in trade tensions and increasing economic concerns saw investors bid up precious metal prices in spite of a stronger dollar, while industrial metals such as copper fell. One notable exception was nickel, which surged due to international supply constraints and electric vehicle battery demand. Oil prices whipsawed throughout the quarter, as investor focus shifted between demand concerns and supply constraints following the September attack on Saudi Arabia's oil production facilities. Prices ended down more than 7% for the quarter. Many agriculture prices, such as corn, fell as heavy rains did not affect output as much as initially feared.

A Look Forward

We tweaked our economic and market forecasts in August to reflect increased risk to economic growth and corporate profits from the U.S.-China trade conflict. While we expect the United States and China to keep talking, our timetable for a potential agreement has been pushed out. We reduced our 2019 U.S. GDP growth forecast to 2%, down from 2.25–2.5%, as tariffs remain in place and uncertainty about future trade actions remains high, and may continue to weigh on capital investment decisions.

In August, we also lowered our year-end forecast for the 10-year Treasury yield to 1.75–2%, down from 2.25–2.75%. We expect a softer economic growth outlook, combined with mild inflationary pressures in the United States and record-low yields internationally to translate into lower domestic yields. We do not interpret the recent yield curve inversion—the 2-year Treasury yield was above the 10-year Treasury yield for a short time during the quarter—as a sign of imminent recession. Long-term Treasury yields have been weighed down by intense global demand and negative sovereign debt yields internationally.

We also lowered our 2019 S&P 500 earnings per share (EPS) forecast from $170 to $165 in August due to the impact of tariffs, lower business investment, and trade uncertainty.

Finally, we have maintained our year-end fair value S&P 500 target of 3,000. Although we lowered our earnings forecasts, we expect Fed rate cuts, mild inflation, and lower market interest rates to support higher price-to-earnings ratios for stocks.

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U.S. Treasuries may be considered “safe haven” investments but do carry some degree of risk including interest rate, credit, and market risk. They are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

Please see our *Midyear Outlook 2019* publication for additional descriptions and disclosures.

2 UTILITIES LED SECTOR RETURNS

S&P 500 Index Sector Performance
Ranked by Third Quarter Returns

Sector	Q3 2019
Utilities	9.3%
Real Estate	7.8%
Consumer Staples	6.1%
Technology	3.3%
Communication Services	2.2%
Financials	2.0%
S&P 500	**1.7%**
Industrials	1.0%
Consumer Discretionary	0.5%
Materials	-0.1%
Healthcare	-2.2%
Energy	-6.3%

3 LARGE CAP STOCKS OUTPERFORMED

Domestic and International Asset Class Performance
Ranked by Third Quarter Returns

Sector	Q3 2019
S&P 500	**1.7%**
Large Growth	1.5%
Large Value	1.4%
Mid Value	1.2%
Russell 3000	1.2%
Small Value	-0.6%
Mid Growth	-0.7%
Large Foreign	-1.0%
Emerging Markets	-4.1%
Small Growth	-4.2%

4 BONDS CONTINUED TO RALLY

Bond Market Performance
Ranked by Third Quarter Returns

Sector	Q3 2019
Preferred Stocks	4.0%
Foreign Bonds (Hedged)	3.5%
Investment-Grade Corporates	3.0%
High-Yield Munis	2.8%
U.S. Treasuries	2.4%
Bloomberg Barclays U.S. Agg	**2.3%**
Munis	1.6%
MBS	1.4%
TIPS	1.3%
EM Debt	1.3%
High-Yield Corporates	1.3%
Bank Loans	1.3%
Foreign Bonds (Unhedged)	-0.1%

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg Barclays U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg Barclays U.S. MBS Index; Investment-Grade Corporate – Bloomberg Barclays U.S. Corporate Bond Index; Municipal – Bloomberg Barclays Municipal Bond Index; Municipal High-Yield – Bloomberg Barclays Municipal High Yield Index; TIPS – Bloomberg Barclays Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg Barclays U.S. High Yield Loan Index; High-Yield – Bloomberg Barclays U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

Sources: LPL Research, FactSet 09/30/19

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

The sectors are represented by the 10 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset classes based on Russell 1000, Russell 3000 Growth and Value Indexes, Russell 2000, Russell Midcap Index, MSCI EAFE, and MSCI Emerging Markets Index.

IMPORTANT DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. The economic forecasts set forth in this material may not develop as predicted. All performance referenced is historical and is no guarantee of future results.

All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy.

DEFINITIONS

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Yield is the income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value, or its face value.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year, and 30-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.