LPL RESEARCH
MARKET INSIGHT QUARTERLY

SECOND QUARTER 2019 IN REVIEW

July 2019

1 Q2 2019 AT A GLANCE

	Q2 2019
GDP*	1.8%
S&P 500 Index	4.3%
Bloomberg Barclays Aggregate Bond Index	3.1%
Bloomberg Commodity Index	-1.2%

Source: LPL Research, Bloomberg, FactSet 06/30/19

*Bloomberg consensus as of June 30, 2019.

Figures for S&P 500 Index, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodity Index are total returns from 03/31/19 – 06/30/19 (Q2).

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 Rise, Rates Fall as Investors Position for Lower Rates

- **U.S. economy sends mixed signals amid uncertainty.** Second quarter data continued to paint the picture of a slowing but still growing economy.

  First quarter gross domestic product (GDP) rose 3.1%, according to the first revision released May 29. Although headline growth was revised down, it was still the biggest first-quarter GDP gain since 2015, showing the U.S. economy remained resilient against trade and political headwinds. However, inventories and net exports accounted for about half of first quarter GDP growth, a temporary boost that may take away from growth in future quarters.

  Gauges of manufacturing health came in ahead of expectations, but at the slowest rate of growth since 2016. Despite slowing growth, the U.S. job market continued to be a bright spot. Payrolls rose at an above-average pace for the expansion, and the unemployment rate hovered near multidecade lows. In addition, wages grew at a healthy, manageable pace, and productivity grew at its strongest pace since 2010. Overall, leading indicators pointed to low odds of a recession over the next 12 months, even as coincident data wavered.

  The Federal Reserve (Fed) chose to keep rates unchanged in the second quarter but opened the door to cuts later this year, dropping the word "patient" from its post-meeting press conference. Fed Chair Jerome Powell stated that policymakers will "act as appropriate to sustain the expansion." Eight of the 17 Fed members projected a rate cut by the end of 2019 (in the June "dot plot"), and fed fund futures are now pricing in a 100 percent chance of a rate cut at the July meeting.

Please note: All return figures are as of June 30, 2019, unless otherwise stated.

Past performance is not indicative of future results.

The economic forecasts set forth may not develop as predicted.

- **The S&P 500 Index returned 4.3% during the second quarter, capping off its best first half in more than 20 years.** Gains came in April and June, which sandwiched May's losses amid U.S.-China trade-war fears and slowing global economic growth. Gains in June, which sent the three major averages to record highs, were driven primarily by increasing speculation that the Fed would cut interest rates and by progress in U.S.-China trade talks, including the tariff cease-fire reached at the G20 Summit in Japan at the end of the month. The S&P 500 returned 18.5% in the first half of the year, the best start to a year since 1997.

  More globally focused large cap stocks outpaced their smaller peers during the quarter, as tends to occur as economic cycles age, and which may reflect progress on trade talks with China. Strength in the technology sector and weakness in the energy sector helped propel growth stocks over value despite leadership by financials. U.S. stocks outpaced their international counterparts during the quarter. The developed international benchmark, the MSCI EAFE Index, lagged marginally with a 4% return, while the MSCI Emerging Markets Index, up just 0.7%, trailed the S&P 500 by 3.6 percentage points.

- **Rates fall, bonds gain.** Falling interest rates and a generally healthy credit environment drove broad bond market gains, led by investment-grade corporates. The Bloomberg Barclays U.S. Aggregate Index (Agg) returned 3.1% during the quarter as the 10-year Treasury yield fell 40 basis points (0.40%) over the three months. The spread between 10-year and 2-year Treasury yields widened during the quarter while the 3-month/10-year spread inverted in the last five weeks of the quarter.

  Investment-grade corporate debt gained 4.3% during the quarter to lead the major fixed income sectors we track. Corporate bonds benefited from their interest rate sensitivity and improving credit spreads relative to Treasuries. Emerging market debt gained 3.8%. Mortgage-backed securities and bank loans, with less interest rate sensitivity, lagged the Agg with returns of 2% and 1.6%, respectively.

- **Commodities slide.** The Bloomberg Commodity Index fell 1.2% in the second quarter, with gains in precious metals offset by declines in industrial metals and natural gas. Commodities' 5.1% gain in the first half of 2019 significantly trailed equities. Trade tensions and a weaker U.S. dollar boosted precious metals as a whole, while gold received an additional boost by breaking through important technical levels. Oil finished a volatile quarter down slightly, as Iran tensions and trade developments took hold of price action for different periods. Industrial metals lagged on skepticism around a trade deal with China, and natural gas prices fell steeply in part due to seasonal factors. Supply concerns stemming from an unusually rainy planting season boosted wheat and corn.

- **Managed futures lead alternative investment gains.** The HFRX Systematic Diversified Index gained 4.9% during the second quarter, with long fixed-income exposure delivering a majority of the returns. While month-to-month equity market performance was volatile, trend-following strategies that maintained or even increased long equity exposure during the quarter rose. Equity-centric strategies disappointed during the quarter, as the HFRX Equity Hedge and HFRX Market Neutral Index returned 0.02% and -0.51%, respectively. Conservative net market exposure in the long/short equity space and the value tilt employed across many market-neutral strategies weighed on performance. Additionally, June's broad-based equity market gains hindered performance for short exposure.

A Look Forward

At the halfway point of 2019, the U.S. economy has held steady, supported by the continued effects of fiscal stimulus and growing corporate profits. At the same time, trade tensions are weighing on the economic outlook, and slowing global growth and ongoing political uncertainty have forced global central bankers to extend extraordinary support.

We still believe fundamentals are supportive of moderate U.S. GDP growth this year. We believe fiscal stimulus from the Tax Cuts and Jobs Act of 2017, along with decreased regulation and increased government spending, will continue to support the U.S. economy. Progress on trade is central to our forecast. We recently reduced our GDP forecast for the United States slightly to 2.25–2.5%.

Fixed income investors have benefited from falling rates due to subdued consumer inflation, a pause in Fed rate hikes, and demand for U.S. Treasuries. Factoring in our expectation for progress on trade, we look for the 10-year Treasury yield to reach the 2.5–2.75% range in the next 6 to 12 months.

Market valuations remain favorable and within historical norms. We recently reduced our S&P 500 earnings per share forecast to $170 for 2019, mainly because of trade uncertainty, but our year-end S&P 500 fair value estimate remains at 3,000.

The economic forecasts set forth may not develop as predicted.

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

2 FINANCIALS LED SECTOR RANKINGS

S&P 500 Sector Performance
Ranked by Second Quarter Returns

Sector	Q2 2019
Financials	8.0
Materials	6.3
Technology	6.1
Consumer Discretionary	5.3
Communication Services	4.5
S&P 500	**4.3**
Consumer Staples	3.7
Industrials	3.6
Utilities	3.5
Real Estate	2.4
Healthcare	1.4
Energy	-2.8

3 MID CAP GROWTH STOCKS OUTPERFORMED

Domestic and International Asset Class Performance
Ranked by Second Quarter Returns

Sector	Q2 2019
Mid Growth	5.4
Large Growth	4.6
S&P 500	**4.3**
Russell 3000	4.1
Large Foreign	4.0
Large Value	3.8
Mid Value	3.2
Small Growth	2.8
Small Value	1.4
Emerging Markets	0.7

4 ALL BOND SECTORS RALLIED

Bond Market Performance
Ranked by Second Quarter Returns

Sector	Q2 2019
Investment-Grade Corporates	4.27
Foreign Bonds (Unhedged)	3.93
EM Debt	3.76
Foreign Bonds (Hedged)	3.15
Bloomberg Barclays U.S. Agg	**3.08**
U.S. Treasuries	3.01
Preferred Stocks	2.93
TIPS	2.86
High-Yield Munis	2.73
High-Yield Corporates	2.50
Munis	2.14
MBS	1.96
Bank Loans	1.55

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 06/30/19

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

The domestic and international asset class sectors are based on the Russell Midcap Growth, Russell 1000 Growth, S&P 500, Russell 3000, MSCI EAFE, Russell 1000 Value, Russell Midcap Value, Russell 2000 Growth, Russell 2000 Value, MSCI Emerging Markets Indexes.

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.

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