

# Economic & Market Commentary

## Market Update – July 2019

Kicking off the third quarter, U.S. stocks continued their rally with a slight tick upward, while international stocks gave back some of the gains made in the first half of the year. Bonds were mostly flat in July with the exception of international bonds. Despite mixed returns across asset classes, managed futures led alternatives as well as all stock and bond asset classes in terms of return for the month of July.

### Economy

- Inflation (Consumer Price Index) fell to +1.7% year-over-year.
- The first estimate of second quarter Real GDP Growth came in at an annualized +2.1%, slowing from +3.1% in the first quarter.
- On July 31, Jerome Powell announced the first rate cut in over a decade, dropping rates to a range of 2.00%-2.25%.

### Stocks

- U.S. stocks made modest gains in July with the S&P 500 (+1.4%) leading the way.
- Conversely, international stocks saw losses in July with Spain (-4.2%) as the biggest detractor among developed nations.
- Emerging market stocks (-1.2%) also struggled with South Korea (-6.2%) and India (-5.2%) falling the most.

### Bonds

- With interest rates remaining steady, U.S. short-term (+0.1%) and U.S. intermediate-term (-0.0%) bonds were essentially flat.
- International bonds posted another solid month (+1.4%), continuing its strong year-to-date (+7.7%) performance.

### Alternatives

- Managed futures (+1.6%), reinsurance (+0.8%), and global REITs (+0.7%) were all positive to kick off the third quarter while commodities (-0.7%) trended lower.

## Stepping in a New Direction

Less than a year ago, the U.S. Federal Reserve (Fed) was on a path of raising short-term interest rates, also known as the Fed Funds rate, which is the rate at which banks lend reserves overnight. That came to an end in December 2018 with rates at 2.5%.

This week, the Fed made an about face and lowered rates by 0.25% to a lower bound of 2.0%. While this move was fully expected by markets based on the Fed's advance communications, it might seem to some that the move was not necessary being that the U.S. economy has positive economic growth, historically low unemployment, and solid consumer balance sheets.

While we cannot fully explain how the Fed arrives at its decisions, we can describe what type of tools the Fed has in its toolbox to respond to a slowing economy. Typically, the tools would be used in the order listed.

- 1) **Cut rates;** policy easing of rates all the way to zero if needed
- 2) **Quantitative easing (QE);** purchasing U.S. Treasury securities (and other securities if needed) to support markets
- 3) **Negative interest rate policy (NIRP);** a less conventional tool

In the most recent rate cut environment, the Fed lowered rates to 0.25%, its lowest point on record, in December 2008 after ten rate cuts within a year's timespan. Prior to that, the lowest Fed Funds rate was 1.0% in 2003 to combat the 2001 recession.

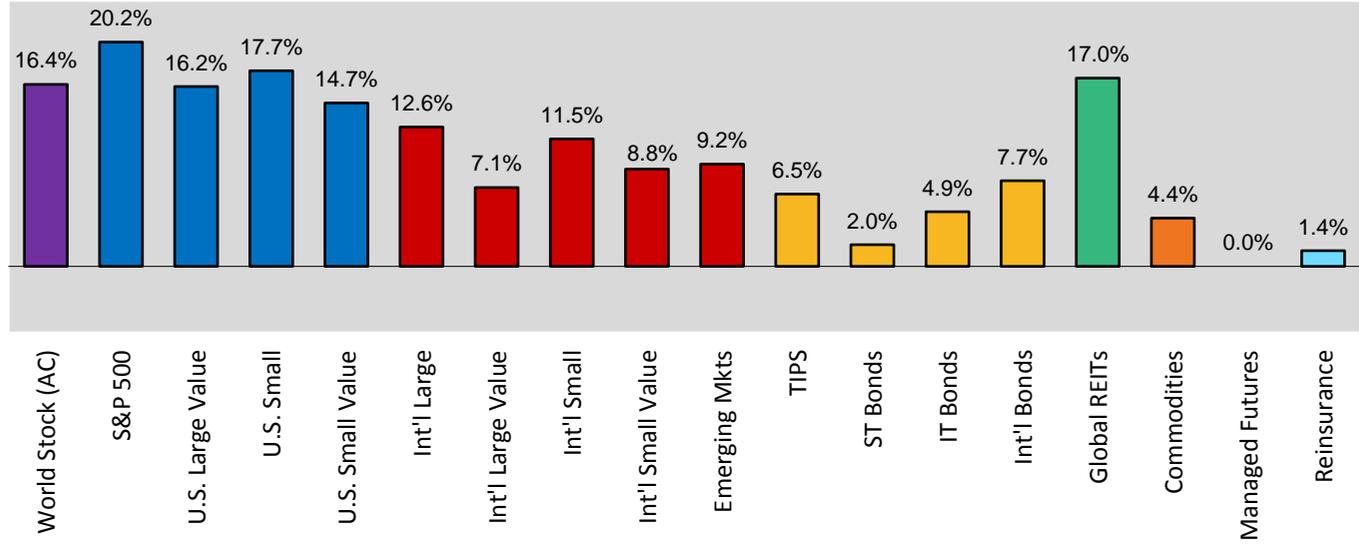
There will be more guidance from the Fed in coming months and there will be three more meetings in 2019 (Sept. 17-18, Oct. 29-30, Dec. 10-11) for potential action.

Changes in interest rates affect investments most notably in the short-term bond allocation. While rate changes should be gradual, the impact of rate cuts on other investments can be good for stocks as companies are able to borrow at lower costs.

*Sources: St. Louis Federal Reserve, Morningstar, Wells Fargo*

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**MARKET RETURNS**  
Year-To-Date as of 7/31/2019



**MARKET RETURNS - Longer Term Annualized as of 7/31/2019**

	1 Month	YTD	1 Year	3 Years	5 Years	10 Years	15 Years
<b>STOCKS</b>							
S&P 500	1.4%	20.2%	8.0%	13.4%	11.3%	14.0%	9.1%
U.S. Large Value	1.0%	16.2%	5.3%	10.0%	8.8%	12.5%	8.1%
U.S. Small	0.6%	17.7%	-4.4%	10.4%	8.5%	12.5%	8.7%
U.S. Small Value	0.8%	14.7%	-5.8%	7.5%	6.9%	12.1%	8.4%
Int'l Large	-1.3%	12.6%	-2.6%	6.9%	2.4%	5.8%	5.5%
Int'l Large Value	-2.2%	7.1%	-7.0%	5.8%	-0.1%	4.3%	4.5%
Int'l Small	-1.2%	11.5%	-7.8%	6.5%	4.8%	8.8%	8.1%
Int'l Small Value	-1.5%	8.8%	-9.5%	5.1%	3.7%	8.4%	8.0%
Emerging Mkts	-1.2%	9.2%	-2.2%	8.4%	1.8%	4.6%	8.7%
World Stock (AC)	0.3%	16.4%	2.1%	9.9%	6.4%	9.4%	7.5%
<b>BONDS</b>							
TIPS	0.4%	6.5%	5.7%	1.9%	1.8%	3.7%	4.0%
Short-Term Bonds	0.1%	2.0%	2.9%	1.2%	0.8%	0.5%	1.5%
Interm-Term Bonds	0.0%	4.9%	6.9%	1.9%	2.4%	3.1%	3.6%
International Bonds	1.4%	7.7%	9.8%	3.6%	5.0%	4.6%	4.9%
<b>ALTERNATIVES</b>							
Global REITs	0.7%	17.0%	9.8%	3.3%	6.6%	12.4%	8.1%
Commodities	-0.7%	4.4%	-5.4%	-0.7%	-8.3%	-4.1%	-2.7%
Managed Futures	1.6%	0.5%	5.0%	-2.7%	4.1%	1.8%	5.5%
Reinsurance	0.8%	1.4%	0.3%	2.6%	3.7%	6.5%	6.9%

Source: Morningstar Direct. Indices used in above graphs: S&P 500 Index, U.S. Large Value-MSCI U.S. Prime Market Value Index, U.S. Small-Russell 2000 Index, U.S. Small Value-MSCI U.S. Small Value Index, Int'l Large-MSCI EAFE Index, Int'l Large Value-MSCI EAFE Value Index, Int'l Small-S&P EPAC Small Index, Int'l Small Value-S&P EPAC Small Value Index, Emerging Mkts-MSCI Emerging Markets Index, World Stock Index-MSCI All Country World IMI Index, TIPS-Barclays Gbl Infl Linked US TIPS Index, Short-Term Bonds-Ibbotson 1 Yr Treasury Const Mtly Index, Interm-Term Bonds-Barclays Interm-Term Govt/Credit Index, International Bonds-JPM GBI Global Ex US Hdg, Global REITs-S&P Global REIT Index, Commodities-Bloomberg Commodity Index, Managed Futures-Credit Suisse Mgd Futures Liquid Index, Reinsurance-SwissRe Global Cat Bond Index.

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## Economic Indicators

### Leading Economic Index Year over Year Change (%)



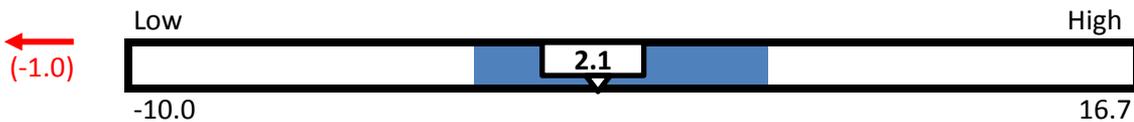
### Unemployment (%)



### Inflation CPI (YOY %)



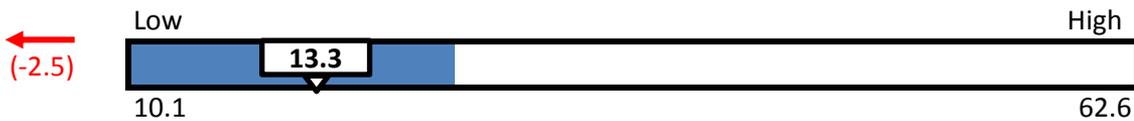
### Real GDP Growth (%)



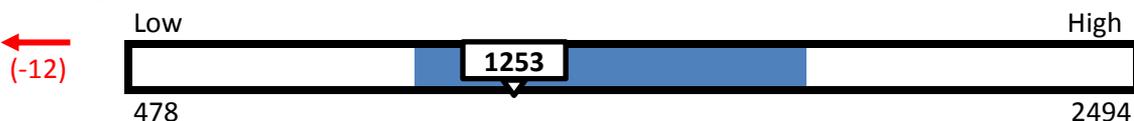
### Consumer Confidence



### VIX - Market Volatility



### Housing Starts (000s)



### 10-year Treasury Yield (%)



 Typical range (within 1 standard deviation of the median)

 Current Value

 Historical Range

  Change in value since last month

\*See appendix for sources and data ranges

## Appendix

### Leading Economic Index Year over Year Change (%)

The Leading Economic Index is composed of 10 indicators used to forecast the direction of the economy. A fall in the index over three consecutive months is seen as a sign of a recession. The value shown represents the 12-month change in the index level. *(Data Source: The Conference Board. Monthly data since 1/1/1959)*

### Unemployment

The unemployment rate measures the percentage of workers that are out of work in the U.S. labor force. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

### Inflation CPI (YOY)

The Consumer Price Index (CPI) measures the change in the price level for a broad basket of goods in the U.S. economy. The value shown represents the percent change in the index from a year ago. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

### Real GDP Growth

Real GDP Growth represents the change in the market value of all output in the U.S. economy. It is an annualized quarterly measure. *(Data Source: U.S. Bureau of Economic Analysis. Quarterly data since 4/1/1947)*

### Consumer Confidence

The Consumer Confidence Index measures the level of optimism among U.S. consumers on the economy and their overall financial situation. *(Data Source: The Conference Board. Monthly data since 1/31/1991)*

### VIX

The CBOE Volatility Index (VIX) measures the volatility of the S&P 500 index. An increase in the index level represents a spike in market volatility. Conversely, a decrease in the index represents a move towards stability. *(Data Source: Chicago Board Options Exchange. Daily data since 1/2/1990)*

### Housing Starts

The number of housing starts (new construction) in the U.S. each year. *(Data Source: U.S. Bureau of the Census. Monthly data since 1/1/1959)*

### 10-year Treasury

The annualized return that would be realized for holding a 10-year Treasury bond to maturity. The 10-year Treasury yield is the primary benchmark for measuring interest rate movements. *(Data Source: U.S. Board of Governors of the Federal Reserve System. Daily data since 1/2/1962)*

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