ECONOMY:

OCTOBER DATA SHOWS A SLOWING BUT GROWING ECONOMY

October economic data pointed to a slowing—but still growing—U.S. economy.

The Conference Board’s Leading Economic Index (LEI) rose 0.4% in September, its slowest pace of growth since 2016. However, the LEI is still growing year over year, a good sign for the future of the economic expansion.

Gross domestic product (GDP) grew 1.9% in the third quarter, its slowest pace of growth since the fourth quarter of 2018. Still, GDP increased 2% year over year last quarter, slightly below 2.1% year-over-year average growth since the cycle started in July 2009. Consumer spending contributed 1.9 percentage points to the GDP increase during the quarter, while government spending added 0.4 percentage points.

Nonfarm payrolls climbed in September, according to early October data, and July and August payrolls growth was also revised upward. The 12-month average payrolls change through September was slightly higher than the expansion average.

Inflation data sent mixed signals. Wage growth slowed notably last month, hinting that inflationary pressures could be moderating. Average hourly earnings growth fell to 2.9% year over year, the slowest pace since July 2018.

However, one measure of consumer inflation grew at the fastest pace of the cycle in September. The core Consumer Price Index (CPI), which excludes food and energy prices, rose 2.4% year over year last month [Figure 1].
Core personal consumption expenditures (PCE), the Federal Reserve’s (Fed) preferred inflation gauge, increased 1.7% year over year in September. Year-over-year core PCE growth is still slightly below the Fed’s 2% growth target.

U.S. manufacturing deteriorated further, caving to a global trend of weakness in the sector. The Institute for Supply Management’s (ISM) Purchasing Managers’ Index (PMI) fell to 47.6 in September, the lowest level since June 2009. Markit’s U.S. manufacturing PMI remained just above 50, or the threshold between expansionary and contractionary territory.

Underlying data on the U.S. consumer weakened. The Conference Board’s Consumer Confidence Index slid for a third straight month in October. Retail sales declined in September after six straight months of gains.

Business spending continued to stall. Orders for nondefense capital goods, which excludes aircraft, were flat year over year in September.

The Fed Signals Rate Cut Pause

On October 30, the Fed reduced interest rates by 25 basis points (0.25%) in its third rate cut of the economic cycle. While the headline decision was dovish, the Fed signaled this could be the last rate cut for a while, which would end its third “mid-cycle adjustment” since 1990 [Figure 2].

The clearest hint was policymakers’ removal of language stating they would “act as appropriate to sustain the expansion.” Going forward, the Fed will now “assess the appropriate path of the target range for the federal funds rate.”

Fed Chair Jerome Powell doubled down on this notion in his post-meeting press conference. He kicked off his comments by saying that “monetary policy is in a good place” and that the current state of monetary policy is likely to remain appropriate as long as the economic outlook stays favorable. Powell didn’t drop the Fed’s commitment to flexibility, but he did note that downside risks had subsided.

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**THE FEDERAL RESERVE’S THIRD “MID-CYCLE ADJUSTMENT” SINCE 1990**

- **Upper-Bound Fed Funds Rate**

  - **Jul ’95—Jan ’96:** 3 rate cuts
  - **Sep ’98—Nov ’98:** 3 rate cuts
  - **Jul ’19—Oct ’19:** 3 rate cuts

  Source: LPL Research, Federal Reserve 10/30/19
GLOBAL EQUITIES
S&P 500 INDEX SETS NEW RECORD HIGH

The S&P 500 Index eclipsed the July 2019 all-time highs with a solid 2.2% gain in October. Stocks followed the pattern in recent decades of above-average October performance while also living up to the month’s reputation as one of the more volatile on the calendar. The month got off to a rough start, falling more than 3% over the first two trading sessions on weak manufacturing data and ongoing trade concerns before climbing back on trade progress and signs of stabilizing global growth over the last three weeks of the month. The growth-heavy Nasdaq handily outpaced the S&P 500 with a 3.7% gain for the month, while the Dow Jones Industrials lagged with a mere 0.5% advance. The S&P 500 has produced gains in eight of ten months this year, bringing the year-to-date total return to 23% including dividends.

Optimism that United States and Chinese negotiators would soon finalize a trade agreement—referred to as phase one—was a primary driver of the October advance. It’s no coincidence that the latest leg of the rally began October 9, right before negotiations began in Washington, D.C. Reports that the deal would include more than Chinese agriculture purchases and removal of U.S. tariff threats boosted investor sentiment. Reports late in the month indicated the agreement would include more rollbacks of tariffs than had been anticipated, increased access to Chinese markets for U.S. companies, a currency pact, looser restrictions on China’s telecom giant Huawei, and some intellectual property protections.

Anticipation of an eventual rate cut from the Fed, which the central bank delivered October 30, also helped support stocks during the month in October. Stocks historically have responded well to mid-cycle adjustments, which is how we would characterize the current rate-cutting campaign. Another delay in the United Kingdom (U.K.) exit from the European Union (Brexit), better-than-feared earnings results, better-than-expected third quarter GDP growth, and improving economic signals from bond markets further buoyed investor sentiment.

The reversals of stock market leadership experienced in September were short-lived, as this year’s leaders reasserted themselves in October: Large caps beat small caps, based on the Russell 1000 and Russell 2000 Indexes, and growth beat value, based on the Russell style indexes.
Strength in the large cap growth index was driven by technology, while energy weakness dragged on the large cap value index. Large caps and midcaps are still in a pitched battle for year-to-date leadership with returns just over 23%, ahead of the 17% advance for small caps. Growth has a 7 percentage point performance advantage over value year to date.

Cyclical sectors generally performed better than defensive sectors during October, with two exceptions. Energy is a cyclical sector and was the month’s worst performer amid flat oil prices, and healthcare is more defensive and was the month’s best performer. Healthcare got a lift from strong gains in the pharmaceutical and biotech industries. Economically sensitive sectors that fared well included technology, which was boosted by double-digit gains in Apple shares and semiconductor stocks on positive China trade news. Communication services and financials were also firmly positive, while defensive sectors that lagged included consumer staples, real estate, and utilities. Technology remained the best-performing sector year to date with a 36.5% return.

International

The September outperformance of international stocks relative to their U.S. counterparts continued in October, bucking a years-long trend. The developed international benchmark MSCI EAFE Index returned 3.6% for the month, more than one percentage point ahead of the S&P 500. and has returned a more-than-respectable 17.4% year to date.

Evidence of stabilization in economic growth in Europe and Japan, a weaker U.S. dollar, progress on trade—particularly falling odds of tariffs on auto imports—and another delay in Brexit helped propel international benchmark outperformance. Japan topped the list of country contributors, based on the MSCI country indexes, which was particularly impressive given the consumption tax increase that was implemented at the start of the month. British, French, and German markets were also strong performers.

Emerging markets equities also outperformed the S&P 500 return amid trade progress, the Fed rate cut, and a weaker dollar. The biggest country contributors to gains for the MSCI Emerging Markets Index included Taiwan, China, Brazil, and Korea, all countries sensitive to global trade and the U.S.-China trade conflict. Year to date, the MSCI Emerging Markets Index has returned 10.7%.

Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.
FIXED INCOME

10-YEAR YIELD STALLS IN OCTOBER

U.S. Treasury yields stalled in October as fixed income investors weighed progress in the U.S.-China trade deal with easier monetary policy worldwide.

The 10-year yield increased three basis points (0.03%) in October, taking a breather after its biggest monthly gain since September 2018. The 10-year yield climbed as high as 1.84% on October 28 before falling to a three-week low of 1.69% to close out the month.

The yield curve steepened in October as short-term yields declined. The spread between the 2-year and 10-year yields climbed 12 basis points (0.12%), its biggest monthly gain since November 2016. The spread between the 3-month and 10-year yields turned positive after spending six months in negative territory.

Nine of 11 fixed income asset classes we track rose in October, as shown in the Fixed Income Performance Table. Local-currency emerging-markets debt led with a 2.9% gain, while preferred shares lagged with a 0.3% loss. The Bloomberg Barclays U.S. Aggregate Index (Agg) rose 0.3%, its seventh gain in eight months. The Agg climbed 8.3% year to date through October 31, poised for its best year since 2002.

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**US Treasury Yields**

<table>
<thead>
<tr>
<th>Security</th>
<th>3 Month</th>
<th>2 Year</th>
<th>5 Year</th>
<th>10 Year</th>
<th>30 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/30/2019</td>
<td>1.88</td>
<td>1.83</td>
<td>1.55</td>
<td>1.68</td>
<td>2.12</td>
</tr>
<tr>
<td>10/31/2019</td>
<td>1.54</td>
<td>1.52</td>
<td>1.51</td>
<td>1.69</td>
<td>2.17</td>
</tr>
<tr>
<td>Change in Yield</td>
<td>-0.34</td>
<td>-0.11</td>
<td>-0.04</td>
<td>0.01</td>
<td>0.05</td>
</tr>
</tbody>
</table>

**AAA Municipal Yields**

<table>
<thead>
<tr>
<th>Security</th>
<th>2 Year</th>
<th>5 Year</th>
<th>10 Year</th>
<th>20 Year</th>
<th>30 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/30/2019</td>
<td>1.19</td>
<td>1.27</td>
<td>1.56</td>
<td>2.07</td>
<td>2.19</td>
</tr>
<tr>
<td>10/31/2019</td>
<td>1.17</td>
<td>1.25</td>
<td>1.56</td>
<td>2.08</td>
<td>2.20</td>
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<tr>
<td>Change in Yield</td>
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<td>-0.02</td>
<td>0.00</td>
<td>0.01</td>
<td>0.01</td>
</tr>
</tbody>
</table>

Source: FactSet 10/31/19

Indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results. Bonds are subject to market and interest rate risk. If sold prior to maturity, bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.
ALTERNATIVE INVESTMENTS
EVENT-DRIVEN CATEGORY LEADS GAINS

The HFRX Event Driven Index led alternative investment subcategory gains with a return of 1.3%. The index was supported by strong performance from underlying special situation managers, as well as modest returns provided by merger-arbitrage strategies. Healthy merger deal flow within the information technology and healthcare sectors continued to provide a constructive investment environment and an adequate opportunity set for new investments. Year to date, the HFRX Event Driven Index has gained 5.6%, with a beta to the S&P 500 of less than 0.1%.

As measured by the HFRX Equity Hedge Index, long/short equity funds gained 0.5% during October, bringing year-to-date performance to 8.4%. Since the beginning of September, the industry has continued to reduce momentum-related exposure, while there has also been a marginal net reduction in the relative weights of growth as compared to value exposure. While growth still accounts for a significant portion of the net exposure, this shift remains an important industry characteristic to monitor. The HFRX Market Neutral Index has been a beneficiary of the shrinking gap between growth and value, as strategies within the space typically have a value bias. For the month, the index also gained 0.5% with a beta of 0.03, as compared to the approximately 0.2 beta present in the long/short industry.

The HFRX Systematic Diversified Index declined 2.9% as losses in currency and fixed income trading weighed on performance. Specifically, many programs entered the month with short positions in the British pound and Canadian dollar, both of which experienced a strong rally against the U.S. dollar. Fixed income losses were concentrated in German bund exposure, as a back-up in yields led to losses in the well-established long trends.
REAL ASSETS

INTERNATIONAL REAL ESTATE PACED SOLID MONTH FOR LIQUID REAL ASSETS

October was a solid month for liquid real assets with gains across all major categories we track, with the exception of master limited partnerships (MLP).

Master Limited Partnerships

The Alerian MLP Index lost more than 6% in October, lagging significantly behind the broad equities indexes and other liquid real asset categories we track. Weakness in energy and higher-yielding defensive stocks weighed on the group, while higher natural gas prices and stable, low interest rates provided minimal offset (oil prices rose marginally). An earnings miss by industry giant Enterprise Products Partners also detracted from the group’s performance. Year to date, the Alerian MLP Index has returned 4%.

REITs and Global Infrastructure

The MSCI U.S. REIT Index gained 1.4% during October, trailing the S&P 500 for the month after outperforming in September and during third quarter 2019. The domestic REIT index has outperformed domestic equities by about 5.5 percentage points year to date.

The industrial sector continued its streak as the top-performing sector for the month, outpacing the broad real estate index by nearly four percentage points in October as demand for industrial warehouses and distribution facilities continued to exceed supply. The industrial sector has outperformed the broad U.S. REIT index by more than 20 percentage points year to date. The self-storage sector was the worst performing real estate subsector in October with a loss of 6.6%, while the lodging/resorts subsector also significantly underperformed. Subsector performance is based on the FTSE NAREIT ALL REITs subsector indexes.

The S&P Global Infrastructure Index marginally underperformed U.S. equities in October with its 1.5% return, well behind international real estate but slightly ahead of U.S. REITs.

Commodities

The Bloomberg Commodity Index rose 2% in October, bringing the year-to-date advance for commodities to 5.2%, slightly ahead of MLPs but well behind U.S. and global equities. Progress on trade, a weaker dollar, and the Fed’s anticipated rate cut helped drive solid gains for industrial and precious metals during the month, led by silver. Oil prices rose modestly in choppy fashion amid concerns that global demand would not be strong enough to offset supply despite stabilizing global economic growth and progress on trade. Major agricultural prices were higher on the month but lagged metals. Commodity performance is based on the Bloomberg Commodity Index and its components.

Investing in MLPs involves additional risks as compared to the risks of investing in common stock, including risks related to cash flow, dilution and voting rights. MLPs may trade less frequently than larger companies due to their smaller capitalizations, which may result in erratic price movement or difficulty in buying or selling.

Investing in Real Estate Investment Trusts (REITs) involves special risks such as potential illiquidity and may not be suitable for all investors. Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory development.
Disclosures

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. All performance referenced is historical and is no guarantee of future results.

All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

Economic forecasts set forth may not develop as predicted.

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. Research material was sourced through LPL Financial, LLC.