Bangor Wealth Management
A Division of Bangor Savings Bank

Wealth Management Newsletter | Market & Performance | Summer Edition 2019

Key Market/Economic Update

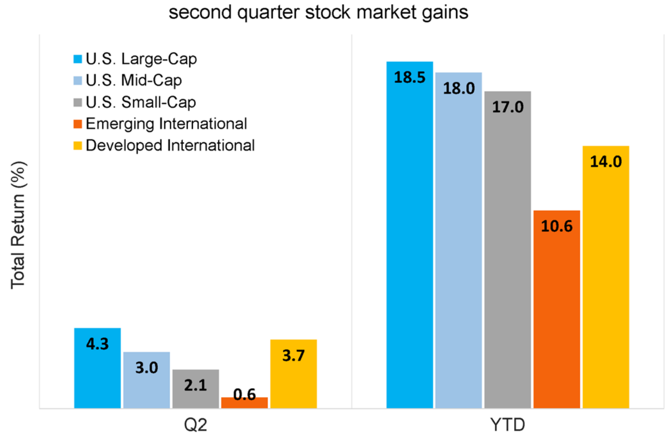
- Uncertainty around international trade disputes has prompted the Fed and other major central banks to adopt an accommodative stance.
- U.S. economic data shows strength as real GDP grew 3.2% in Q1. Labor markets are at their best levels in five decades, as the economic expansion enters a new duration record.
- However, forward looking business surveys continue to decelerate both at home and abroad.
- U.S. corporate profit growth has slowed in the first half this year: S&P 500 earnings are expected to decline this quarter after anemic growth in Q1.
- Both domestic and foreign stock markets produced modest returns after a sharp sell-off in May and a dramatic rally in June.
- Declining interest rates and narrowing credit spreads drove strong bond market returns around the globe.

Stock Market Review

Following the extraordinarily strong performance of the first quarter, large-cap stocks continued to march higher. The S&P 500 index grew 18.5% in the first half, one of the best results in over 22 years.

The strong returns came with a good dose of volatility however. The S&P 500 declined 6.6% in May, driven by fears of an escalating trade war. In early June, the Fed came to the rescue with a vow to "act as appropriate" regarding monetary policy. Not wanting to fight the Fed, investors piled back in to risk assets prompting a 6.9% rally (Fig. 1).

Fig 1. Domestic large-cap and developed international led second quarter stock market gains

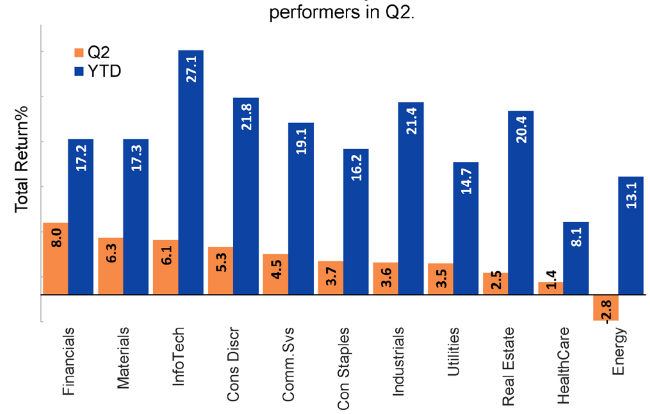


Data Sources: Bloomberg Financial LP, Bangor Savings Bank

Small and mid-cap stocks also rose but failed to match the pace of large-cap stocks. Small-cap in particular has lagged its larger brethren, a pattern we have seen repeat these past few quarters. International developed market as measured by the MSCI EAFE index enjoyed strong results. Returns of 3.7% for the quarter and 14% year to date compared well to the domestic stock market. With China representing a third of emerging markets, lingering concerns over a trade deal have dampened enthusiasm for that asset class, returning only 0.6% for the quarter.

Within stock sectors, financial stocks came out as the top performer for the quarter, buoyed by the news of major banks passing Fed stress tests. In addition, many banks plan to return capital to shareholders via dividend and share buyback programs. On the flip side, the energy sector was the weakest performer as crude oil prices were challenged by soft demand from decelerating economic growth (Fig. 2).

Fig 2. Financial stocks, driven by declining interest rates and successful stress tests for major banks, were the best performers in Q2.

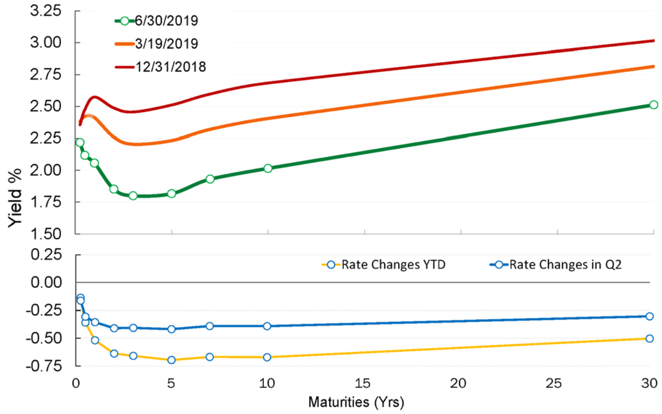


Data Sources: Bloomberg Financial LP, Bangor Savings Bank

Bond Market Review

In yet another surprise policy shift, the Fed signaled their willingness to cut rates in June. Major U.S. Treasury bond benchmark yields declined markedly: the 2-year yield dropped below 1.75% while the 10-year yield broke below 2%. These declines put longer rates well below the current Fed funds target rate of 2.25-2.50%, and inverted portions of the yield curve. An inverted yield curve is generally considered a pre-cursor to slower economic growth, although not always a pre-cursor to recession (Fig. 3). At the same time, sovereign

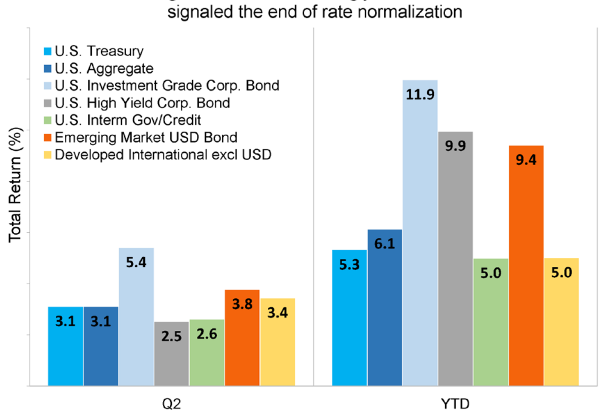
Fig 3. With the possibility of Fed rate cuts now a likelihood, bond yields declined markedly across all maturities compared to 3 and 6 months ago.



Data Sources: Bloomberg Financial LP, Bangor Savings Bank

and credit bond markets rallied to produce similar returns. Investment grade corporate bond returns were the standout, and gained the most from significant spread tightening (Fig. 4).

Fig 4. Bonds rallied strongly after the Fed signaled the end of rate normalization



Data Sources: Bloomberg Financial LP, Bangor Savings Bank

The prospect of a weaker U.S. dollar as a result of rate cuts lifted foreign bond markets. Emerging market bonds returned 3.8% in the quarter and equity like, 9.4% returns year to date.

Outlook - Which Market Is Correct: Stocks or Bonds?

U.S. capital markets have exhibited very interesting dynamics so far this year. A significant decline in longer term rates and a flattening yield curve all signal a potential slowing of economic growth. At the same time, the stock market and other risk assets also rallied late in the quarter. As we write this newsletter, major U.S. stock market indexes are setting new record highs. Given the stock market is a forward looking mechanism, it appears to indicate that the outlook for economic growth is still robust and corporate profit growth will re-accelerate late this year.

The stock market has cheered the Fed policy shift from a tightening stance to one of accommodation. The Fed has been able to succeed in managing market expectations and keeping optimal financial conditions, and hopes to facilitate economic growth, just as they did in 2015-16. The tailwind from an accommodative monetary policy from the Fed and other major central banks could overcome the current deceleration in growth to keep the economic expansion on track.

The bond market may be pointing to trouble further down the road, given a U.S. economic expansion that is the longest on record. Despite solid economic results here in the U.S., global growth has been decelerating since the second half of last year. And U.S. growth has moderated somewhat as well, although still far from recessionary levels. The double-digit growth of U.S. corporate earnings in 2018 has stalled. Earnings are expected to decline this quarter, according to estimates from Bloomberg. The slowdown could be attributed to rising uncertainty from international trade disruptions and fading fiscal/tax stimulus for domestic corporations. The trade war between the U.S. and China, if not resolved, could damage business confidence and disrupt long term capital investment decisions.

Time will certainly tell the ultimate direction for both the economy and market prices. In the meantime, expect volatility to continue as markets sort out some of these discrepancies. The S&P 500 price moves in May and June were the largest monthly moves for those months respectively in over 9 and 65 years! For long term investors, adjusting for these risks through proper asset allocation and trying to filter out market noise will be essential to staying the course.

As always, should you have questions about how our outlook impacts your portfolio, don't hesitate to reach out to either your Portfolio Manager or Relationship Manager.