GREAT LAKES ADVISORS

POINT OF VIEW

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A WINTRUST WEALTH MANAGEMENT COMPANY

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MARKET REVIEW

The story of 2019 continues to be the signs of global economic weakness and, in response, the Fed's pivot earlier in the year toward easier monetary policy. As we entered 2019 the Fed appeared to be leaning toward increasing short term interest rates; it is now clear that they believe they may need to ease in the second half of the year. Interest rates fell precipitously in the second quarter, with the yield on the 10-year Treasury note dropping below 2% in June and closing the quarter at 2.01%. The yield curve is inverted out to 5 years, suggesting that fixed income investors are concerned that economic contraction in the U.S. is a distinct possibility. U.S. equities again moved solidly higher across the board during the second quarter, with a spectacular June accounting for all the gains - and then some. Year-to-date, larger-cap stocks have modestly outperformed smaller-cap stocks. The big differentiator has once again been the dramatic outperformance of growth stocks vs value.

The broader equity market, represented by the S&P 500, gained 4.3% in the quarter and is now more than 18% higher for the year, having set a new all-time high on June 20. Most major European markets have also gained at a double-digit clip thus far in 2019; China, Australia, and New Zealand are all up close to 20% and most of Asia is up 10% or more. The U.S. dollar was unchanged against most major currencies. The Japanese Yen gained about 3%, while the British Pound lost about 3% as the country continues to grapple with Brexit.

Crude oil prices hit their 2019 high of more than $65/barrel in mid-April, but fell precipitously back to $52/bbl by early June, primarily resulting from plentiful inventories in the United States. Crude oil closed the quarter at $58.50/bbl, jumping after the attack on two oil tankers in the Straits of Hormuz and raising the spectre of hostilities in Iran and the Middle East. Corn and wheat prices rose about 8% as poor spring weather hindered farmers' plantings. Copper prices fell 7% with fears rising of global economic weakness, while gold gained more than 9%, likely the result of negative short term interest rates in countries like Germany and Japan (see more below).

MARKET OUTLOOK

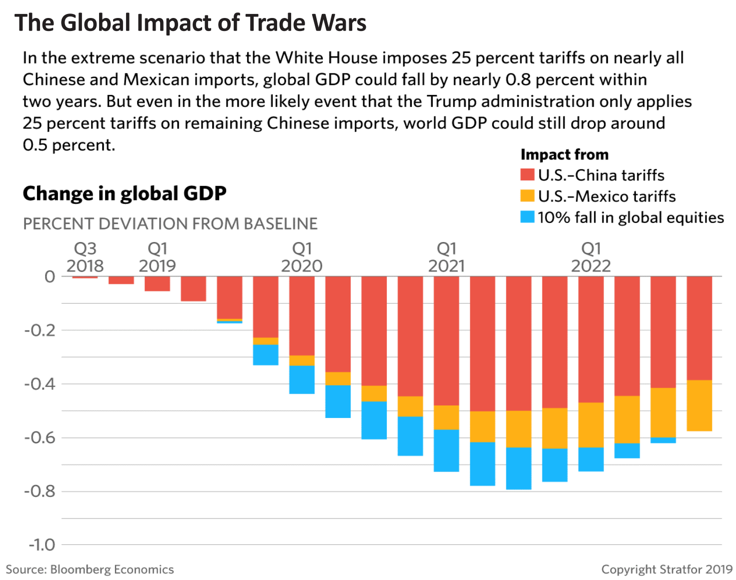
Six months into 2019, the longest (and one of the slowest) expansions remains intact, and a strong first half of 2019 for U.S. equities leaves stocks trading at a premium to historic averages.

The economic picture is fairly good, especially considering how long in the tooth this expansion is. Price pressure is non-existent to this point, despite the very low headline unemployment rate. Payroll growth has slowed a bit, but employment costs remain in check, accelerating less than 3% per year. Consumer confidence remains quite high, just off of recent cycle highs. The recent pull back in interest rates appears to have extended the real estate cycle's expansion as well, albeit at a more moderate rate.

Equity markets have been continuously recalibrating and repricing two events in recent weeks: a trade deal between the U.S. and China, and a Fed rate cut. Mix in continuing signs of global economic issues, geopolitical pressures in the Middle East, and the beginning of the 2020 Presidential campaign, and you get a market backdrop that is growing quite interesting.

As we write this, the G20 summit convenes in Japan, the focus of which will be trade negotiations between the U.S. and China. The Chinese spokesman for the Ministry of Commerce Gao Feng, said in a press conference on June 27 that "…a trade war doesn't have a winner; those who are ultimately hurt are U.S. [and Chinese] companies and consumers." The outcome of these talks could impact the global economy for years and as the accompanying chart from Stratfor suggests, a prolonged trade war could impact annual global GDP growth by more than $600 billion by 2021.

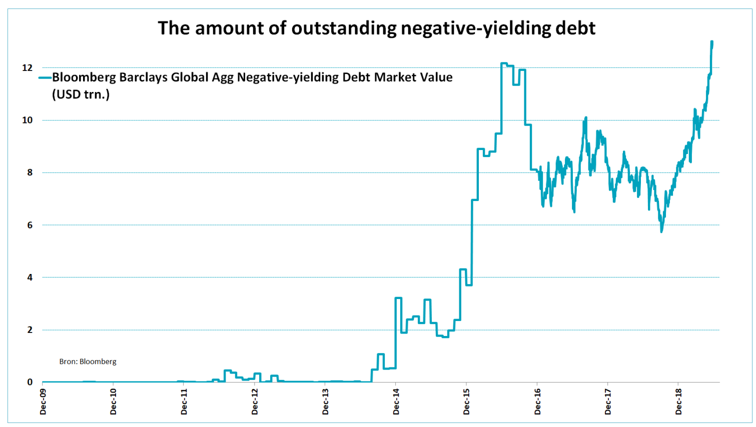
Because of the length of the bull market it is natural there are skeptics regarding its persistence. The pessimist has concerns that the China deal will not materialize – or will not be a meaningful win for the U.S. if the deal materializes. The pessimist keeps an eye on the U.S.'s dealings with Iran, the latter of which has now violated the cap on enriching uranium. The pessimist also worries about acrimony increasing further in our capital, with Democratic debates featuring soundbites excoriating corporate profits (oh by the way, pensioners and 401k beneficiaries benefit by owning shares of profitable U.S. companies), and calling for more testimony from Robert Mueller.



While acknowledging the bearish view of the pessimist, we believe in weighing the evidence objectively and therefore place ourselves more in the realist's camp. The realist knows the market is the ultimate discounting mechanism, and the U.S. economic system is wonderfully self-adapting. While it would be imprudent to expect large returns from U.S. equities in the latter half of the year, we also don't expect an exceptionally bad half of the year.

Turning to interest rates, in June the Fed left short-term interest rates unchanged but clearly signaled a willingness to cut rates later this year, with Chairman Powell saying in his press conference that "many participants now see the case for somewhat more accommodative policy has strengthened." Markets are pricing in a rate cut at the Fed's next meeting in July. Again, a rate cut is seen as a positive by many equity participants; however, if it is in response to slowing economic growth and corporate profits (as the inverted yield curve and the number of corporations providing negative earnings guidance both suggest) the risk to equity prices is that the Fed is behind the curve and the economy will continue to weaken.

In response, slower global growth interest rates around the world have returned to the ultra-low levels of 2016. In fact, more than $13 trillion of global debt currently trades with a negative yield, the most in recorded history. Japanese debt accounts for more than one-half of the total. Low rates help the U.S. finance its $1 trillion (and growing) annual budget deficit, but it is an important and open question as to how long the U.S. will be able to do so. However, with negative rates persisting elsewhere it is hard to imagine, absent a sudden spike in inflation, that U.S. interest rates will be headed higher soon.



We do not attempt to forecast short-term moves in either global equities or global fixed income markets. Instead, we do believe that the global investment environment remains quite uncertain as a result of the rapidly changing geopolitical environment, and the consequent impact these events may have on longer term growth prospects.

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Chart Souce: Bloomberg