John C. Robinson
Chief Executive Officer
Tel: 404-883-2577
john@consequentcm.com

Capital Markets Review and Outlook

By: Cyril M. Theccanat, Chief Investment Officer

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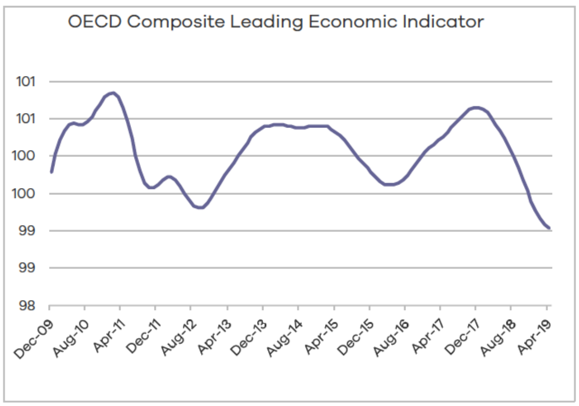
Economy and Outlook

The final month of the 2nd quarter was marked by the Federal Reserve's about-face with regards to monetary policy. Responding to growing concerns that the ongoing trade conflict between the U.S. and China was having a more pronounced negative effect on the U.S. economy, the Fed changed its posture on interest rates. After having telegraphed its intentions since the beginning of the year to keep interest rates on hold, the Fed indicated in June that it was now likely to cut interest rates in the 2nd half of the year. The trade war between the world's two largest economies has engulfed other parts of the world as well due to the interdependency of global markets in an inter-connected world, especially with supply-chains. The chart on the left shows the sharp decline in a composite leading economic indicator for the world's 30 developed markets including the U.S. The primary reason for this decline is the widespread softening in the manufacturing sector which is heavily dependent on trade. JP Morgan's Global Purchasing Managers' Index (PMI) recently posted its lowest reading in almost 7 years. The concern of investors and policymakers, including the Federal Reserve, is that the sharp slowdown in the manufacturing sector could negatively affect hiring and investment activities of companies, thereby weakening the services sector and consumer confidence. By signaling possible interest rate reductions, the Federal Reserve is attempting to proactively prevent a downward spiral which could lead to a recession if the slowdown in manufacturing continues unabated. Additionally, inflation has been stubbornly below the Federal Reserve's target of 2%, as measured by the change in the core personal consumption expenditures (PCE) index. This, in turn, provides the Fed with additional leeway to cut interest rates since one of its mandates is to achieve stable prices.



Amplitude Adjusted
Source: Organization for Economic Co-Operation and Development

The meeting between the presidents of the United States and China at the World Trade Organization meeting in Japan at the end of June resulted in a trade war truce and a resumption of negotiations. While this is a positive development, the jury is still out until a trade deal is signed. Other encouraging developments for a reacceleration of global economic growth include accommodative monetary policies across a wide swath of central banks, and the monetary and fiscal stimulus policies that are being undertaken in China to combat its trade-war-induced economic slowdown. The magnitude of central banks' monetary easing is reflected in the fact that 25% of global developed market debt, representing $13 trillion, have negative yields. Ultra-low (and negative) interest rates are a

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powerful catalyst for economic growth through the strong incentives these low rates provide for both businesses and consumers.

Equity Markets

The equity markets' steep losses in May were reversed in June as investors reacted euphorically to a combination of positive news – the likelihood for interest rate cuts by the Federal Reserve and a trade war truce with China. The broad domestic equity market represented by the Russell 3000 index surged +7.0% in June resulting in a return of +4.1% for the 2nd quarter of 2019. This brought the year-to-date return to +18.7%. While equity market gains for the month were similar across both capitalizations and styles, Growth outperformed Value by +70 bp in the Small Cap category. As expected in a risk-on environment and declining volatility, Cyclical sectors outperformed Defensives. In June, the Materials and Technology sectors had returns of +11.7% and +9.1% respectively, while Utilities and Consumer Staples rose by +3.3% and +5.2% respectively. However, the sharp rise in oil prices led to a significant gain for the Energy sector which rose by +9.3% in June. Although the Energy sector is the only major S&P sector with a negative return for the 2nd quarter (-2.8%), the sector had a strong return of +13.1% for the first half of 2019. Improvements in investor sentiment were reflected in equity markets outside the U.S. as well. Non-U.S. developed markets returned +5.9% for the month, while emerging markets were slightly ahead with a return of +6.2%. For the 1st half of 2019, non-U.S. equity markets as a group had a strong return of +13.6%.

Fixed Income Markets

In May, Treasury yields declined on the back of a flight-to-quality as equity markets sold-off sharply. Despite the strong rebound in equity markets in June, Treasury yields continued to decline as investors anticipated with near-certainty that the Federal Reserve would begin cutting interest rates in the 2nd half of the year. The drop in Treasury yields led to a bullish steepening in the Treasury yield curve as 2-year yields declined by 20 bp while yields at the long end of the Treasury market declined by only 6 bp. The strong rebound in equity markets in June was reflected in the corporate bond market as investment grade credit spreads narrowed by 12 bp resulting in +127 bp of outperformance over duration-matched Treasuries. As is typically seen when the corporate bond market has a positive tone, the corporate credit curve flattened with long maturity corporate bonds outperforming short and intermediate-term issues by an average of +186 bp in excess return. Likewise, the corporate quality curve also flattened with the BBB-rated sector outperforming the Single-A sector by +48 bp in excess return. Similar to the sector performance differentiation in the equity markets, cyclical sectors outperformed defensives in the corporate bond market. Spreads in the chemicals, automotive and metals sectors narrowed by an average of 22 bp, while utility and REIT spreads narrowed by less than half as much. The high yield sector was a strong performer in June as spreads narrowed by 51 bp leading to a +2.3% return for the month. For the first half of 2019, the high yield sector produced a total return of +9.9%. Investor perceptions of a reversal in the Federal Reserve's interest rate policy led to a broad decline in the U.S. dollar against most other currencies. The dollar's decline together with lower non-U.S. bond yields resulted in a +3.2% return for the non-dollar government bond market and brought the return to +5.5% for the 1st half of 2019.

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			Returns as of 6/30/19 (In %)				
		Month	2nd Qtr	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	7.0	4.1	18.7	9.0	14.0	10.2
Russell 1000®	US Large Cap Equity	7.0	4.2	18.8	10.0	14.1	10.5
Russell 1000® Growth	US Large Cap Growth	6.9	4.6	21.5	11.6	18.1	13.4
Russell 1000® Value	US Large Cap Value	7.2	3.8	16.2	8.5	10.2	7.5
Russell Midcap®	US Mid Cap Equity	6.9	4.1	21.3	7.8	12.2	8.6
Russell Midcap® Growth	US Mid Cap Growth	7.0	5.4	26.1	13.9	16.5	11.1
Russell Midcap® Value	US Mid Cap Value	6.8	3.2	18.0	3.7	8.9	6.7
Russell 2000®	US Small Cap Equity	7.1	2.1	17.0	-3.3	12.3	7.1
Russell 2000® Growth	US Small Cap Growth	7.7	2.7	20.4	-0.5	14.7	8.6
Russell 2000® Value	US Small Cap Value	6.4	1.4	13.5	-6.2	9.8	5.4
MSCI ACWI ex-US	Global Equity ex-US	6.0	3.0	13.6	1.3	9.4	2.2
MSCI EAFE	Global Developed Mkts Equity	5.9	3.7	14.0	1.1	9.1	2.2
MSCI EM	Emerging Mkts Equity	6.2	0.6	10.6	1.2	10.7	2.5
Bloomberg/Barclays US Agg	US Core Fixed Income	1.3	3.1	6.1	7.9	2.3	2.9
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	0.9	2.4	4.7	6.7	2.0	2.5
Bloomberg/Barclays US Credit	US Corporate Bonds	2.3	4.3	9.4	10.3	3.7	3.9
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.7	2.0	4.2	6.2	2.1	2.6
Bloomberg/Barclays US Corp HY	US High Yield	2.3	2.5	9.9	7.5	7.5	4.7
FTSE Non-US WGBI	Global Fixed Income ex-US	3.2	3.9	5.5	4.5	0.8	0.2