consequent capital management

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Capital Markets Review and Outlook

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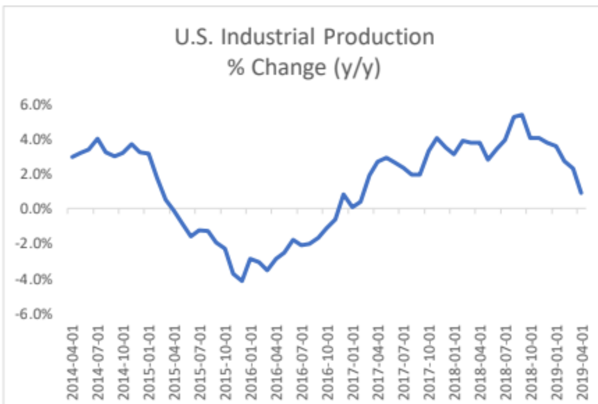
Economy and Outlook

In early May, the abrupt change in tone related to the previously more constructive trade talks between the U.S. and China had a negative effect on economic growth expectations. Robust employment growth together with consumer confidence near record highs have underpinned a firm U.S. economy as seen in the 3.1% growth in real GDP for the first quarter of 2019. However, the industrial side of the economy has softened as illustrated in the chart on the left due to the slowdown in the manufacturing sector which has been negatively impacted by the on-going uncertainty regarding global trade. Weakness in manufacturing is widespread globally. The Purchasing Managers' Index (PMI) is an indicator that reflects the health of the manufacturing sector. A PMI reading above 50 indicates expanding manufacturing activity, while a reading below 50 signifies contraction. While the most recent reading for the U.S. manufacturing PMI remains above 50, it has now declined to its lowest level in over 2 ½ years. The corresponding index for Germany broke below 50 earlier this year and has now steadily declined to below 45. The official manufacturing PMI in China also declined below 50 last month, while a PMI sub-indicator of external demand for Chinese goods fell sharply to 46.5.



Source: Board of Governors of the Federal Reserve System

The prolonged conflict over trade has spilled over into the real economy and also negatively affected business spending plans. The deteriorating economic outlook has now been further exacerbated by President Trump's unexpected declaration, at the end of May, that tariffs would be imposed on Mexico unless the Mexican government takes steps to secure its border and stop illegal immigration into the United States. Mr. Trump is also threatening tariffs against other countries such as India. Despite the increasingly strident rhetoric on the trade front, the most likely outcome is still for a resolution to the current impasse since a trade war is a lose-lose proposition. However, while the seemingly insurmountable issues with trade could be wiped clean by just a tweet, the concern is about how deep of a slowdown in global economic growth might result from the heightened business and investor uncertainty in the interim. To a certain extent, the present low inflation, low interest rates and accommodative monetary policies environment will continue to help counteract the negative effects of the global economic slowdown.

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Equity Markets

After four consecutive months of gains, equity markets experienced sharp losses in May as mounting tensions in the trade conflict between the U.S. and China raised investor fears of a more protracted economic downturn. The broad domestic equity market represented by the Russell 3000 index declined by -6.5% in May. Despite this steep loss, the 2019 year-to-date return remains a strong +10.9%. While equity markets declined across capitalizations, higher volatility in May had a greater impact on the Small Cap sector which saw losses of -7.8% for the month. However, from a style perspective, Growth continued its outperformance over Value across all capitalizations. As expected in a sharp market downturn, Defensive sectors outperformed Cyclicals. The Utilities and Health Care sectors had returns of -1.3% and -2.5% respectively, compared to the Consumer Discretionary and Technology sectors which declined by -7.7% and -8.9% in May. Energy was the one Defensive sector with the worst performance of all 11 major S&P sectors. The steep decline (over -15%) in oil prices together with concerns about rising inventory levels, led to a -11.7% return for the sector. This has sharply cut the Energy sector's year-to-date return to +1.9%, which is the second lowest sector return. Only Health Care with a return of +0.6% is lower. Developed equity markets outside the U.S. also had negative returns for the month but held up better than the U.S. The MSCI Developed Markets index (EAFE) had a return in May of -4.8%. Emerging markets performed worse as the sector's performance was dragged down by steep losses in China resulting from the worsening trade dispute with the U.S. The MSCI Emerging Markets index posted a loss of -7.3 % for the month of May. Year-to-date, returns remain positive with +7.6% for Developed Markets (excluding the U.S.), and +4.1% for Emerging Markets.

Fixed Income Markets

The sharp decline in equity markets in the month of May, led to a flight-to-safety in government bonds. U.S. Treasury yields along the coupon curve tumbled 32 to 37 bp bringing Treasury yields back to almost 2-year lows. Yields at the front-end of the yield curve declined much less reflecting no change in the Federal Reserve's interest rate policy. However, the futures markets have significantly raised the probability of a Federal Reserve interest rate cut by the end of the year. While the recent sharp drop in Treasury yields may reflect investors' nervousness about an increasing likelihood for a recession, another important contributor is investors reaching for yield as 20% of global bonds, representing over $11 trillion, have **negative** yields. For example, the yield on the 10-year German government bond has a record low negative yield of -0.2%.

The weakness in the equity markets in May was reflected in the corporate bond market. Reversing the positive trend for the first four months of the year, investment grade credit spreads widened by 16 bp in May resulting in -126 bp of underperformance over duration-equivalent Treasuries. The corporate quality curve steepened as the BBB-rated sector widened by 21 bp, while the single-A sector widened by 15 bp. Similar to the equity markets, cyclical sectors underperformed defensives. Spreads in the chemicals, automotive and metals & mining sectors widened by an average of 31 bp, while healthcare, pharma and utility spreads widened by less than half as much. The high yield sector was a significant underperformer as spreads widened by 74 bp for the month, almost four times as much as the spread widening in the investment grade sector. This resulted in a -1.2% return for the month. However, year-to-date, the high yield sector still generated a strong total return of +7.5%. Continued strength in the U.S. dollar weighed on the non-U.S. government bond market and led to a lower return of 1.3% for the month. For 2019, the broad U.S. bond market posted a return of 4.8% which is more than double the return of the non-U.S. market.

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				Returns as of 5/31/19 (In %)			
		Month	QTD	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	-6.5	-2.7	10.9	2.5	11.5	9.2
Russell 1000®	US Large Cap Equity	-6.4	-2.6	11.0	3.5	11.7	9.5
Russell 1000® Growth	US Large Cap Growth	-6.3	-2.1	13.7	5.4	15.3	12.3
Russell 1000® Value	US Large Cap Value	-6.4	-3.1	8.5	1.4	8.0	6.5
Russell Midcap®	US Mid Cap Equity	-6.1	-2.6	13.5	1.6	9.9	7.9
Russell Midcap® Growth	US Mid Cap Growth	-5.8	-1.5	17.8	6.9	13.9	10.3
Russell Midcap® Value	US Mid Cap Value	-6.4	-3.3	10.6	-2.1	6.9	6.1
Russell 2000®	US Small Cap Equity	-7.8	-4.6	9.3	-9.0	9.8	6.7
Russell 2000® Growth	US Small Cap Growth	-7.4	-4.6	11.8	-6.9	11.7	8.3
Russell 2000® Value	US Small Cap Value	-8.2	-4.7	6.7	-11.3	7.7	5.0
MSCI ACWI ex-US	Global Equity ex-US	-5.4	-2.9	7.2	-6.3	6.7	1.3
MSCI EAFE	Global Developed Mkts Equity	-4.8	-2.1	7.6	-5.7	5.8	1.3
MSCI EM	Emerging Mkts Equity	-7.3	-5.3	4.1	-8.7	9.9	1.8
Bloomberg/Barclays US Agg	US Core Fixed Income	1.8	1.8	4.8	6.4	2.5	2.7
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	1.3	1.4	3.7	5.7	2.1	2.3
Bloomberg/Barclays US Credit	US Corporate Bonds	1.5	2.0	6.9	7.4	3.7	3.5
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	1.3	1.2	3.4	5.5	2.1	2.5
Bloomberg/Barclays US Corp HY	US High Yield	-1.2	0.2	7.5	5.5	7.0	4.4
FTSE Non-US WGBI	Global Fixed Income ex-US	1.3	0.7	2.2	0.8	1.2	-0.2