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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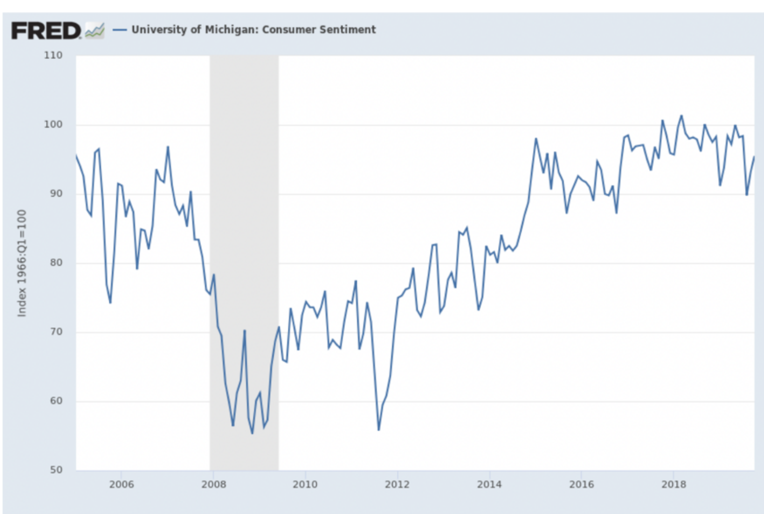
Economy and Outlook

The first impeachment hearings of a U.S. president this century took center-stage in November. Although the end result of an acquittal in the U.S. Senate (if the House passes articles of impeachment) is the likely outcome, this matter will continue to be a distraction for the White House. Away from the political drama that is being played out in Washington, there are cautiously optimistic signs on the economic front. More progress is occurring for some form of an interim agreement between the United States and China on a trade deal. A resolution of the trade dispute would lift the dark cloud hanging over the global manufacturing sector. Economic data have also turned more positive. The Markit index for the U.S. manufacturing sector reached a 5-month high of 52.2 in November after declining steadily since the beginning of the year. Small business optimism (National Federation of Independent Business Index) and retail sales have both rebounded after recent declines. Even the Eurozone has seen signs of improvement. In Germany, the largest economy in the Eurozone, industrial orders rose for the first time in the 2nd half of 2019. Improvement in growth has helped Germany narrowly avoid a recession. The unemployment rate in France is near a 9-year low as labor reforms are implemented. Even China has seen some positive signs – after pointing to contraction for six months, a key index for the manufacturing sector has rebounded.



The easing of monetary policies globally in response to slowing economic growth and the absence of inflationary pressures has been a powerful stimulant for consumers and businesses. As the chart on the left shows, after declining to its lowest level in three years this August, the

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University of Michigan's U.S. consumer sentiment index has increased sharply to 95.5. The housing market has also benefitted from the Federal Reserve's recent interest rate cuts. Housing starts declined for a year and a half since 2018 as the Fed raised rates but have moved back up to near 10-year highs.

Rebounding economies, accommodative monetary policies and benign inflation continue to paint a positive backdrop for risk markets. However, investors need to be mindful that with U.S. equity markets making record highs on almost a daily basis amidst exceptionally low volatility, risks are rising for a market reversal especially in the short to medium term. This is further underscored by a likely contentious U.S. presidential and congressional election year in 2020.

Equity Markets

Despite the frequent headline "breaking news" regarding the impeachment hearings, equity markets took their cues from improving economic data and renewed central banks' monetary policy accommodation. The broad domestic equity market represented by the Russell 3000 index rose +3.8% for the month bringing its return for the first 11 months of the year to an impressive +27.3%. For the third consecutive month, Small Cap outperformed Large Cap. The +30 bp outperformance in November brought Small Cap's quarter-to-date outperformance to +90 bp. However, year-to-date, Small Cap continues to lag Large Cap by over -570 bp. From a style perspective, Growth has continued its outperformance over Value. November's +149 bp outperformance widens Growth's lead over Value to +911 bp year-to-date. Improved investor sentiment enabled the Cyclicals sectors to outperform Defensives for the third consecutive month. Financials and Technology led the way with returns of +5% and 5.4% respectively for the month, while Utilities and Real Estate lagged with negative returns of almost -2% each. Health Care had a second consecutive strong month with a return of +5%. Waning public support for the Medicare For All platforms from the leading contenders for the Democratic presidential nomination has helped the Health Care sector rebound strongly from its losses earlier this year.

Improved signs of economic growth across a number of international regions including China and the Eurozone helped international equity markets post a positive return in November despite the stronger U.S. dollar which rose over +1%. The MSCI Developed Markets equity index gained +1.1% in November which increased its year-to-date return to +18.2%. Emerging Markets lost some ground in November after the strong return the previous month. The Emerging Markets index was fractionally lower (-0.1%) for the month. However, year-to-date, the index is up +10.2%.

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Fixed Income Markets

The strong rally in the equity markets weighed on the Treasury market as investors moved into a risk-on mode. Treasury yields rose with the short to intermediate part of the Treasury curve bearing the brunt of the rise in yields. While the yield on the 30-year Treasury bond increased by +4 bp in November, yields on 2-year out to 10-year Treasury maturities rose by +9 to +13 bp. As a result, the Treasury yield curve reversed its steepening trend for the prior two months, and the curve flattened with the 2-year/30-year spread differential narrowing by 5 bp to +60 bp.

The corporate bond market also benefitted from investors' bullish sentiment, and corporate bond spreads tightened for the third consecutive month. The spread on the Bloomberg Barclays Investment Grade Credit index narrowed by 5 bp to end the month at +100 bp generating +55 bp of outperformance over duration-matched Treasuries. As is typically seen when the corporate bond market has a positive tone, the corporate credit curve as well as the quality curve both flattened in November. Investors increased exposures to longer maturity and lower quality corporate bonds. Long maturity corporates outperformed short and intermediate-term issues by an average of +63 bp, while the BBB-rated sector outperformed the Single-A sector by +19 bp. Similar to the equity markets, Health Insurance was one of the best performing credit sectors in November with an excess return of +139 bp. The worst performing sectors included Supranationals and Foreign Agencies which underperformed by 4 to 5 bp. In the High Yield sector, the up-in-quality trade continued for the second consecutive month as lower quality sectors underperformed higher-rated sectors, unlike the investment grade sector. On a total return basis, the BB-rated sector was up +0.6%, while the CAA sector lost -1.0%. Year-to-date, the overall High Yield sector posted a strong return of +12.1%. Yields continued to rise modestly in developed markets outside the United States on signs of improvement in global economic growth. Rising yields coupled with a stronger U.S. dollar weighed on the non-dollar government bond market which lost -1.7% in November, lowering its year-to-date return to +4.5%.

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				Returns as of 11/30/19 (In %)			
		Month	QTD	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	3.8	6.0	27.3	15.5	14.2	10.6
Russell 1000®	US Large Cap Equity	3.8	6.0	27.7	16.1	14.7	10.8
Russell 1000® Growth	US Large Cap Growth	4.4	7.4	32.4	21.0	19.8	13.7
Russell 1000® Value	US Large Cap Value	3.1	4.5	23.2	11.3	9.6	7.8
Russell Midcap®	US Mid Cap Equity	3.6	4.7	27.6	15.0	11.6	8.9
Russell Midcap® Growth	US Mid Cap Growth	5.0	6.9	33.9	21.8	17.0	11.3
Russell Midcap® Value	US Mid Cap Value	2.7	3.2	23.3	10.4	7.7	7.1
Russell 2000®	US Small Cap Equity	4.1	6.9	22.0	7.5	8.6	8.2
Russell 2000® Growth	US Small Cap Growth	5.9	8.9	25.6	10.9	12.2	9.5
Russell 2000® Value	US Small Cap Value	2.3	4.8	18.3	4.0	5.0	6.8
MSCI ACWI ex-US	Global Equity ex-US	0.9	4.4	16.5	11.2	9.2	3.8
MSCI EAFE	Global Developed Mkts Equity	1.1	4.8	18.2	12.4	9.6	4.3
MSCI EM	Emerging Mkts Equity	-0.1	4.1	10.2	7.3	9.0	3.1
Bloomberg/Barclays US Agg	US Core Fixed Income	-0.1	0.2	8.8	10.8	4.1	3.1
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-0.1	0.3	6.5	8.1	3.2	2.5
Bloomberg/Barclays US Credit	US Corporate Bonds	0.2	0.8	13.5	15.2	5.9	4.3
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.1	0.4	6.1	8.0	3.2	2.6
Bloomberg/Barclays US Corp HY	US High Yield	0.3	0.6	12.1	9.7	6.3	5.4
FTSE Non-US WGBI	Global Fixed Income ex-US	-1.7	-0.9	4.5	7.1	3.9	1.5