LPL RESEARCH

MARKET INSIGHT MONTHLY

August Update | As of July 31, 2019

JULY 2019 IN REVIEW

ECONOMY:

CONSUMERS PROPEL U.S. ECONOMY IN JULY

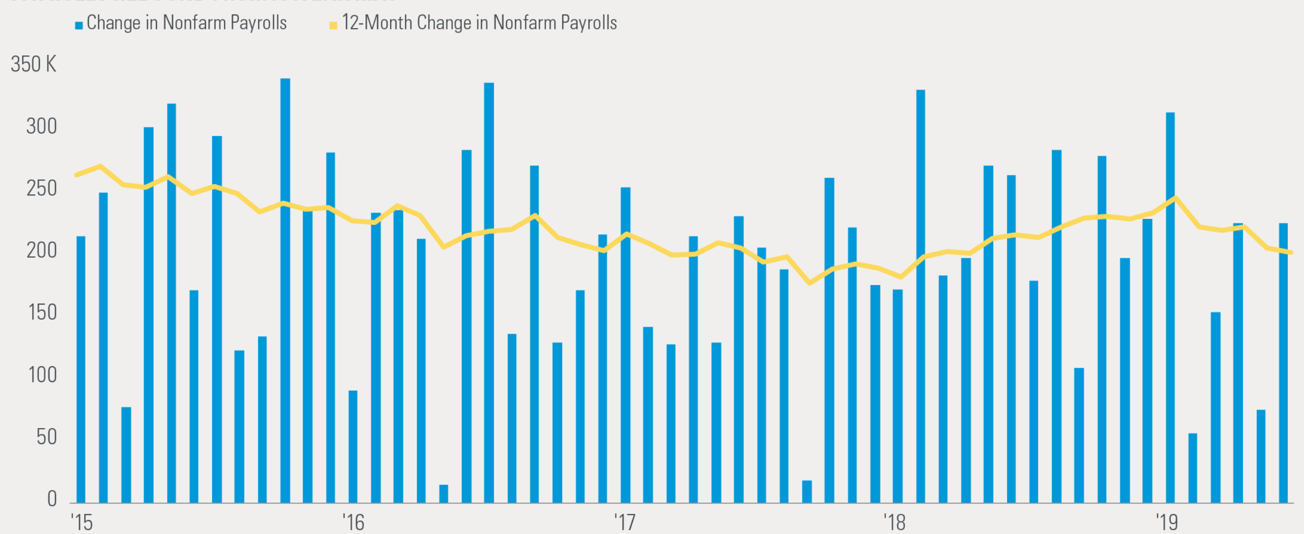
Consumers showed signs of strength in July's U.S. economic data.

Leading indicators fell month over month for the first time in 2019. Still, the Conference Board's Leading Economic Index (LEI) rose 1.6% year over year in June. Even though leading indicators have slowed recently, the LEI continues to expand year over year, signaling future economic growth.

Gross domestic product (GDP) increased 2.1% in the second quarter, bolstered by consumer spending's 2.9% contribution to growth. Government spending added 0.9%, its largest contribution since 2009. Trade and inventories subtracted 1.5% from overall growth, after adding a similar amount in the first quarter, while business spending was a slight drag on growth in the quarter.

The June jobs report, released in early July, showed nonfarm payrolls rebounded after a weak May **[Figure 1]**. The 12-month average pace of payroll gains remained in line with the expansion average.

PAYROLLS REBOUND FROM A WEAK MAY



Source: LPL Research, Bureau of Labor Statistics 07/08/19

The pace of consumer inflation picked up for the first time in seven months. The core Consumer Price Index, which excludes food and energy, increased 2.1% year over year in June, higher than the 2% rate of growth in May. Core personal consumption expenditures (PCE), the Federal Reserve's (Fed) preferred inflation gauge, rose 1.6% year over year in May, below policymakers' 2% target.

Average hourly earnings rose 3.1% year over year in June, an eight-month low. Wage growth has moderated in recent months, but it has remained at a level that should continue to support consumer spending without concerns of overheating. Growth in the core Producer Price Index (PPI), which excludes food and energy prices, grew 2.4% year over year, the slowest pace in 11 months.

U.S. manufacturing deteriorated further, caving to a global trend of weakness in the sector. The Institute for Supply Management's (ISM) manufacturing Purchasing Managers Index (PMI), a gauge of U.S. manufacturing health, fell to 51.7, matching its lowest point since October 2016. Markit's PMI ticked up slightly in June, but preliminary data showed the gauge fell to 50 in July, the threshold between expansionary and contractionary territory.

Consumer sentiment and spending both increased, hinting that the U.S. consumer could continue to buoy growth. The Conference Board's Consumer Confidence Index posted its third-highest reading of the economic cycle in July. Retail sales climbed for a fourth straight month in June.

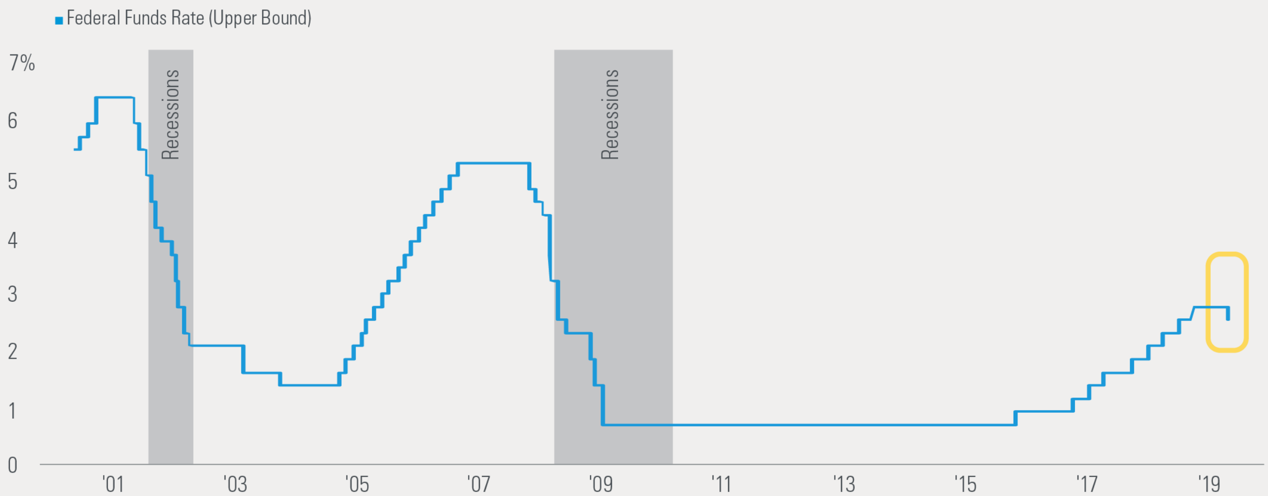
Still, corporate sentiment floundered. The National Federation of Independent Business's measure of business confidence dropped for the first time since January. Year-over-year growth for new orders for nondefense capital goods fell to an eight-month low in May, suggesting that trade tensions are still hampering business spending.

Fed Cuts Rates, Ends Balance Sheet Runoff

The Fed announced a 25-basis point (0.25%) rate reduction July 31, its first in 10 years [Figure 2]. The Fed also said it would end its asset sales on August 1, instead of in October, in order to align its balance sheet and rate policies.

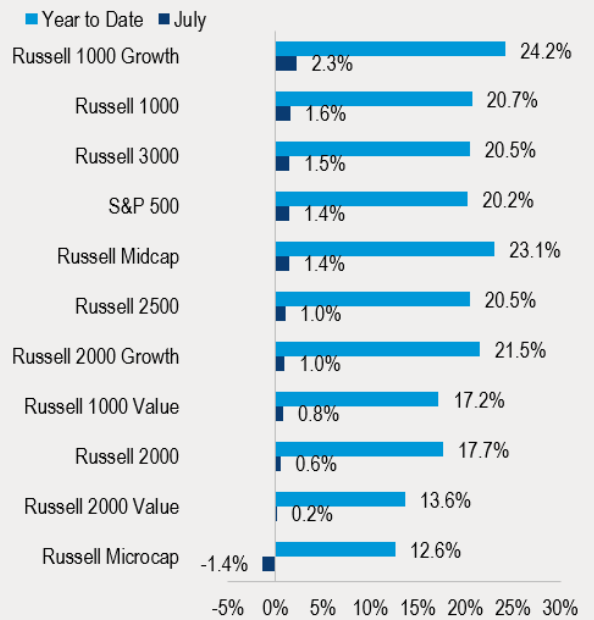
Powell repeated his positive rhetoric on the U.S. economic outlook, going so far as to say he doesn't see any economic sector posing a near-term threat to growth. He pointed out that consumer inflation was slowing, but added that the decision to lower rates was based on several factors, including slowing growth internationally and trade uncertainty.

FEDERAL RESERVE'S FIRST RATE CUT IN 10 YEARS

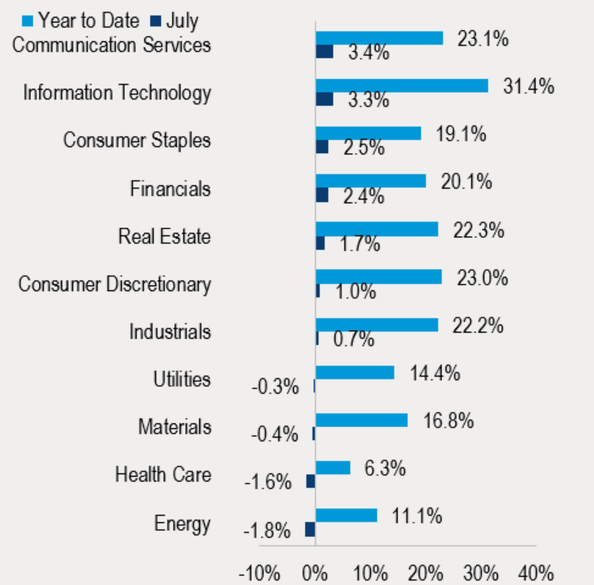


Source: LPL Research, Federal Reserve 07/31/19

DOMESTIC INDEX PERFORMANCE



S&P 500 SECTOR PERFORMANCE



Source: FactSet 07/31/19
Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
Stock investing involves risk, including loss of principal. Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

GLOBAL EQUITIES

STOCKS DELIVERED MODEST GAIN IN JULY

The S&P 500 Index returned 1.4% in July as market participants sent major indexes to fresh new highs despite the ongoing U.S.-China trade dispute. Market participants took comfort from the Fed's U-turn in terms of its policy stance, which culminated in a rate cut at the end of the month. The S&P 500 returned 20% year to date through July, trailing the Nasdaq (23.9%) but ahead of the Dow Jones Industrials (16.7%).

Trade and the Fed dominated investor psychology during the month. Stocks got off to a good start after President Trump and China President Xi agreed to a trade truce at the G20 summit in Japan. President Trump's decision to withdraw threatened U.S. tariffs buoyed investor sentiment, although previous tariffs on Chinese goods remained in place. News of a face-to-face meeting later in the month also helped fuel some optimism that resolution may be forthcoming. However, the tone turned at the end of July after negotiations in Shanghai failed to produce any material progress, and President Trump subsequently announced new tariffs on an additional $300 billion in Chinese goods, effective September 1.

Amid the ups and downs of trade, the Fed provided support for markets. Congressional testimony from Fed Chair Jerome Powell set the tone early in the month, propelling the S&P 500 over 3,000 for the first time ever after Powell solidified the market's expectations for rate cuts. The rate cut came on July 31, but Powell characterized the move as a mid-cycle adjustment, dampening hopes of a series of cuts and contributing to stocks' lackluster finish to the month.

While trade and Fed headlines were most influential on markets, the U.S. economy continued to generate steady but slower growth, bolstered by healthy consumer spending. A budget agreement in Washington, D.C., to secure additional government spending over the next two years and an encouraging start to earnings season also helped reassure reluctant shareholders.

Against this backdrop, large cap stocks outperformed their small and mid cap counterparts during the month. Large caps, which were likely helped by encouraging trade headlines in early July, benefited from strength among big technology and internet stocks. Small caps held up slightly better late in the month as the broad market pulled back.

Mid caps have led year to date with a 23.1% return, ahead of the 20.7% and 17.7% advances for large caps and small caps, respectively, based on the Russell indexes.

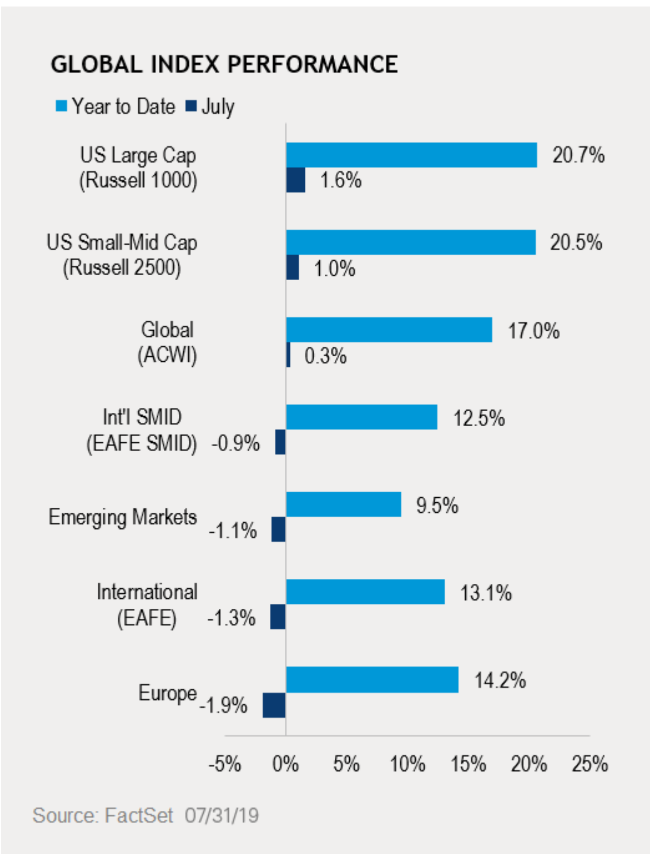
Growth stocks outperformed value in July as the Russell 1000 Growth Index, powered by technology and internet stocks, returned a solid 2.3%. The return to a central bank-driven environment that has marked much of the current bull market generally favors companies that can grow without much help from a slowing global economy. Growth has led value by about 7 percentage points year to date based on the Russell 1000 style indexes.

The internet-heavy communication services sector led all S&P sectors for the month, followed by technology, while energy and healthcare suffered the biggest declines. Technology has been the clear leader year to date with a 31% return, based on the S&P global industry classification standard (GICS) sectors, while healthcare is the only sector not up at least 10% year to date.

International

International equities, both developed and emerging markets (EM), lagged behind the U.S. market in July, primarily due to the strengthening U.S. dollar. The MSCI EAFE Index fell 1.3% in July while the MSCI EM Index dipped 1.1%. These indexes are well behind the United States year to date, with 13.1% and 9.5% advances compared with the S&P 500's 20.2% return through July 31.

Relative weakness in developed international equities was most acute in the financials, materials, and technology sectors, although healthcare was the only S&P sector in which the MSCI EAFE Index outpaced the S&P 500 during the month. At the country level, Brexit weakness impacted stocks in the United Kingdom, the biggest drag on the developed international equity index. Losses in Germany and France also weighed as economic growth in Europe continued to significantly lag behind the United States. The MSCI Japan index was roughly flat, outperforming the MSCI EAFE but trailing the S&P 500.



Emerging markets also fell during the month, with weakness most pronounced in Asia where the trade dispute has had the most impact. MSCI country indexes in Korea and India fell most among the biggest country allocations, but the modest decline in the MSCI China Index was a big contributor to emerging markets' losses because of its large weight in the index.

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Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

FIXED INCOME

10-YEAR YIELD STALLS IN JULY

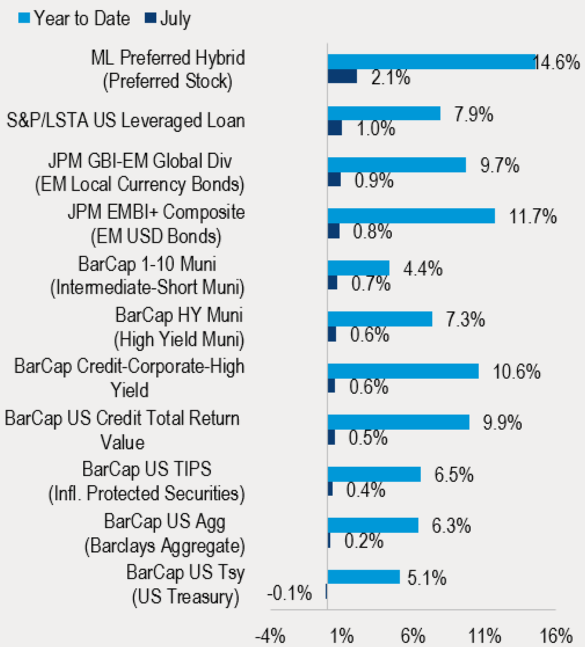
Treasury yields were largely unchanged in July as weakening global growth, trade tensions, and loosening monetary policy hampered a rally from an improving domestic economic picture.

The 10-year Treasury yield rose one basis point (0.01%) in July, closing the month at 2.01%. The benchmark yield hovered around 2% for most of the month after climbing as high as 2.14% on July 11.

Still, the Treasury yield curve remained inverted (long-term yields below short-term yields). The spread between the 3-month and 10-year yield remained in negative territory (-0.05%). The spread between the 2-year and 10-year yields remained positive but fell to 14 basis points (0.14%).

Ten of 11 fixed income asset classes that we track rose in July, as shown in the Fixed Income Performance Table. Riskier debt outperformed in the month, led by preferred shares with a 2.1% gain. The Bloomberg Barclays U.S. Aggregate Index rose for a fifth straight month in June, its longest monthly winning streak since July 2016.

FIXED INCOME PERFORMANCE



US Treasury Yields

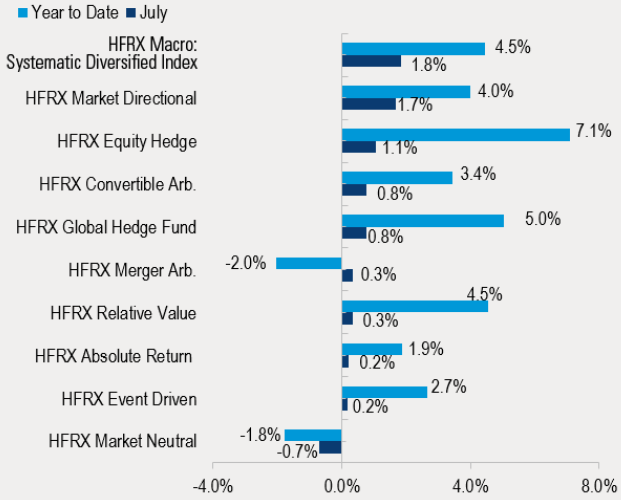
Security	6/30/2019	7/31/2019	Change in Yield
3 Month	2.12	2.08	-0.04
2 Year	1.75	1.89	0.14
5 Year	1.76	1.84	0.08
10 Year	2.00	2.02	0.02
30 Year	2.52	2.53	0.01

AAA Municipal Yields

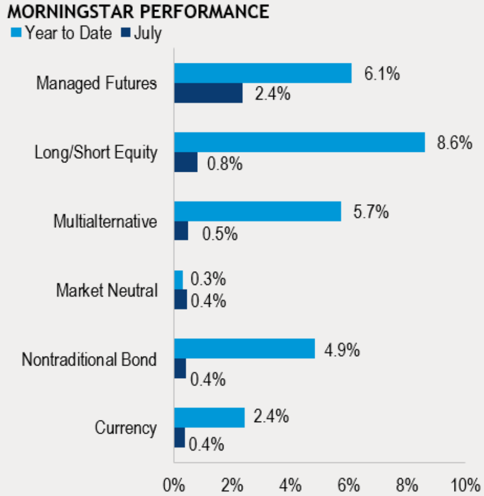
Security	6/30/2019	7/31/2019	Change in Yield
2 Year	1.35	1.20	-0.15
5 Year	1.46	1.34	-0.12
10 Year	1.83	1.73	-0.10
20 Year	2.35	2.26	-0.09
30 Year	2.48	2.40	-0.08

Source: FactSet 07/31/19
Indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.
Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subjec t to availability and change in price.

HFRX INDEX PERFORMANCE



MORNINGSTAR PERFORMANCE



Source: FactSet 07/31/19
Indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results. Alternative strategies may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may acelerate the velocity of potential losses.

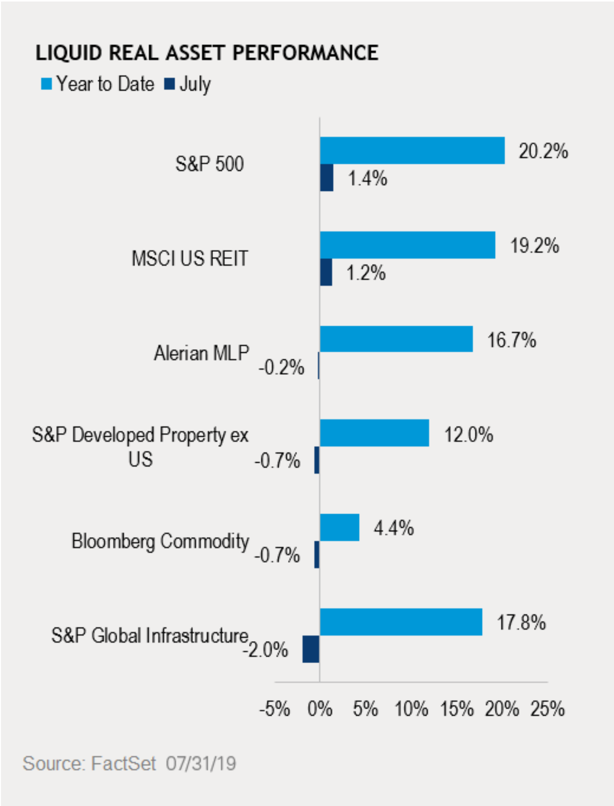
ALTERNATIVE INVESTMENTS

MANAGED FUTURES LEAD GAINS

Alternative investment performance was led by the HFRX Macro: Systematic Diversified Index (3.1%) for the second month in a row, as long fixed income and long equity exposure continued to support portfolios. Currency positioning was also profitable, as short holdings in the British pound and the euro versus the U.S. dollar were positive contributors to performance and provided an attractive source of diversification from traditional markets. Discretionary macro strategies performed well, with the HFRX Macro/CTA Index returning 1.8% during the month and 4.5% on the year. Ongoing trade negotiations between the United States and China, as well as several adjustments by central banks around the world have led to an increasingly attractive opportunity set and additional relative value opportunities within currency and rate trading.

The HFRX Merger Arbitrage Index gained 0.3%, as low rates, CEO confidence, and significant private equity capital available for deployment have all supported the mergers and acquisitions landscape. A widespread position in the wireless telecommunication industry received clearance from the U.S. Department of Justice, conditional on certain assets being divested beforehand. While this was a positive step in the formal completion of the deal, it still faces numerous challenges from state attorney generals.

Long/short equity managers provided attractive risk-adjusted returns, as the HFRX Equity Hedge Index (1.1%) captured 80% of the S&P 500's 1.4% gain, with a beta lower than 0.5. The HFRX Market Neutral Index (-0.7%) continues to struggle, as the long value component across the industry has weighed on returns. The HFRX Relative Value Index continues to perform well (0.3%), specifically managers specializing in structured products, as residential and commercial mortgage-backed securities (MBS) have been supported by resilient real estate market trends.



REAL ASSETS

ONLY U.S. REITS PRODUCED POSITIVE RETURNS

Liquid real assets mostly lagged U.S. and global equities during July. Only U.S. REITs produced positive returns among the major categories we track.

Master Limited Partnerships (MLP)

The Alerian MLP Index slipped 0.2% in July, lagging behind the broad equities indexes despite lower interest rates and generally stable energy prices. The S&P GICS Energy Sector Index slipped 1.2% in July as energy-related investments were generally out of favor. MLPs have produced solid returns so far in 2019 with a 17% year-to-date return, although the group has trailed the S&P 500 Index by about 3 percentage points year to date.

REITs and Global Infrastructure

The MSCI US REIT Index modestly trailed the S&P 500 in July with a 1.2% return, and it trailed the S&P 500 by about 1% during the first seven months of 2019. Office was the best performing real estate sub-sector for the month, outperforming the broad real estate index by more than 2 percentage points. Hotels and lodging was the worst performing sub-sector, even as interest rates moved lower. Since hotel rooms generally turn over daily, the sector's short-duration characteristics present challenges for this group relative to broad real estate as interest rates fall.

The S&P Global Infrastructure also trailed domestic equities in July and underperformed domestic real estate investment trusts (REIT) by more than 3 percentage points. Global infrastructure has now trailed both domestic REITs and domestic equities year to date.

Commodities

The Bloomberg Commodity Index fell 0.7% in July, with strong gains in nickel and silver offsetting agriculture weakness. Year to date, commodities' 4.4% gain continues to significantly trail equities. Nickel exhibited noteworthy strength relative to other industrial metals' more lethargic performance, as market imbalances and shrinking inventories sent prices up more than 14%. Silver spiked higher relative to other precious metals, as investors may expect some catchup to gold's recent impressive run on the Fed's U-turn. Growing skepticism over a trade deal with China, which halted previously signaled significant purchases of U.S. crops, sent agriculture broadly lower with more pronounced weakness in wheat. Crude oil had a rare calm month, finishing little changed, as demand concerns offset geopolitical tensions. Natural gas prices were modestly negative. (Source for all performance data is the Bloomberg Commodity Index).

IMPORTANT DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

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All information is believed to be from reliable sources; however LPL Financial makes no representation as to its completeness or accuracy.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.

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