WestStar

Wealth Watch

October 2019

3rd Quarter Review & 4th Quarter Outlook

The Calm Before the Storm?

The age-old adage of Wall Street, “the market climbs a wall of worry,” has certainly held true over the first nine months of 2019, as all major investment categories are positive through September. Despite persistent political and economic drama, the market has remained resilient due to solid underlying fundamentals. But are there “clouds” forming on the other side of said wall? In this final Wealth Watch of this decade we contemplate the possibility of an “economic storm” brewing on the horizon. We will also explore how investors can navigate through the choppy waters of political unrest.

Highlights:

- Market strength has extended through the first three quarters of 2019
- Discord in Washington is intensifying ahead of the 2020 election year
- Politics should not be allowed to subvert investment decisions
- Near-term recession remains unlikely at this juncture, though evidence of slowdown is mounting
- Impeachment in and of itself may not cause a sustained market decline
- While stocks tend to perform best during pre-presidential election years, caution remains warranted

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Your wealth, well managed.

Asset Class Index Performance* Year-to-Date As of 9/30/2019

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Real Estate
20.69%

US Large Cap Stocks
20.55%

US Small Cap Stocks
14.18%

International Developed Market Stocks
13.35%

High Yield Bonds
11.41%

US Investment-Grade Core Bonds
8.52%

International Emerging Market Stocks
6.23%

Alternative Investments
5.04%

International Bonds
4.38%

Commodities
3.13%

Cash
1.85%

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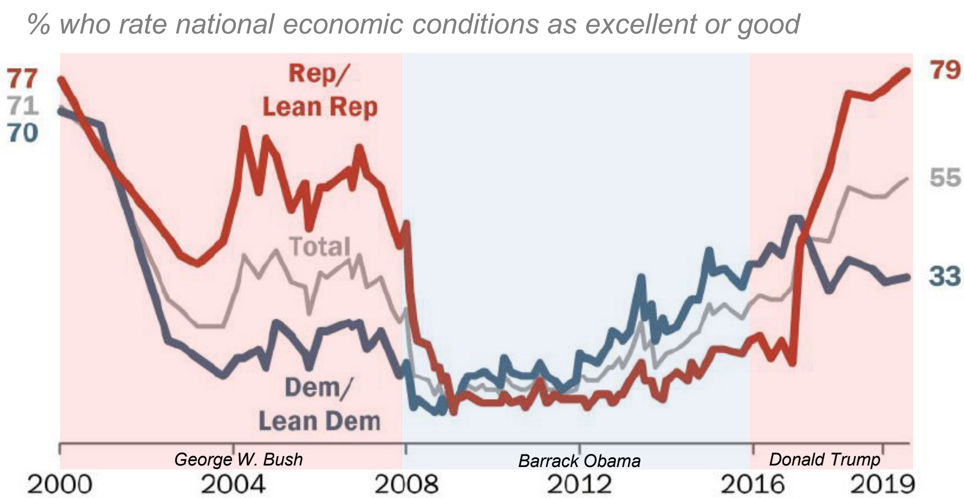
Market Performance & Tactical Strategy: A Rising Tide

Though the "waters" of the capital markets have been choppy, the "rising tide" has lifted all boats in 2019. The single best performing category in the third quarter and, for that matter, the full first nine months of the year was Real Estate (REITs). As interest rates have declined, investors have sought alternative sources of yield—an attractive characteristic of REITs. Indeed, the 10-year Treasury bond yield has declined by approximately 1.25% this year as of this writing. In addition to the boon for REITs, this substantial move in interest rates has also benefitted bonds, whose prices have an inverse relationship and which have increased.

The behavior of the markets to date in 2019 is right in line with our expectations as outlined in earlier editions of the Wealth Watch. We suggested in January that volatility would persist and that interest rates would stabilize. We, therefore, tactically reduced our equity exposure, emphasized Real Assets, increased our exposure to bonds, and continued to overweight Alternative Investments to help defend against an environment of heightened volatility. The result of our successful, proactive positioning has been our strategies outperforming their benchmarks through September 30th.

Navigating Data: The Compass or the Sailor?

In last quarter's issue of the Wealth Watch we discussed perception and the ways in which the same economic data can be interpreted through either an optimistic or pessimistic lens. An interesting aspect to add to the discussion is the effect of political perspective. Analysis concludes, as one might expect, that Republicans tend to have a positive view of economic conditions under a Republican president while Democrats are more optimistic under a Democratic president as shown in the following chart:



Source: Pew Research Center Survey of US adults conducted July 10-15, 2019; WestStar Wealth Management

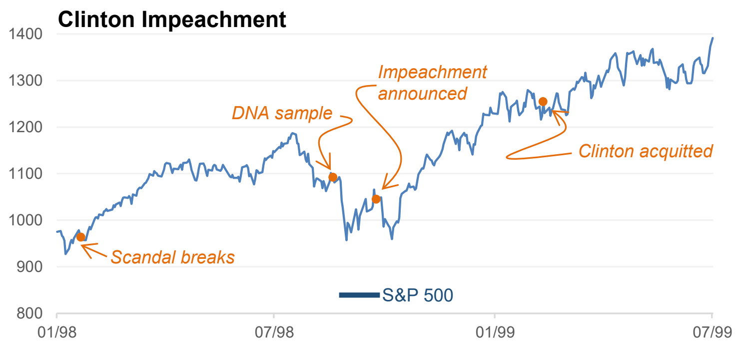
There are several important lessons to glean from this chart in these politically polarized times and considering that 2020 is an election year:

- *Do not allow political views to dictate investment strategy.* The chart shows that, in so doing, Republicans might have missed the strong market during the Obama years and Democrats might have missed the strong market during Trump's tenure.
- *Maintain Objectivity.* Remain cognizant of any political agenda of suppliers of information. Consider the source and try not to let personal political opinions cloud your judgment of facts.
- *Recession protection?* Recessions tend to happen when everyone is pessimistic. Independent of political affiliation, is the fact that a large portion of the population presently remains optimistic an indication that recession is less likely

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets
Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity In

in the near future? That may be an element, though it is only one among a number we monitor. One of our primary resources for data analysis, Ned Davis Research, notes that while there are more signs of slowing economic growth exacerbated by the trade war, only two of their ten key "recession watch" indicators are negative (the Conference Board's CEO Confidence Index and the ISM Manufacturing Index are both presently below their "Key Recession Levels"). As such, the data suggests a slowdown is likelier than a recession in the near future. But what about the market effects of political upheaval in Washington? Is a presidential impeachment enough to send the economy over the edge?

Impeachment Effects on Markets: Will "Walk the Plank" Rock the Boat?



<u>Nixon Impeachment:</u>

- *Market strength continued through 1972 even after the Whitehouse was implicated*
- *Between June 1972 and the release of the Watergate tapes the market generally treaded water*
- *Stocks took a leg down following the tapes release but concurrently there was also the Arab-Israeli war, the oil embargo, Agnew resignation, and the "Saturday Night Massacre"*
- *Market nadir only reached after Nixon resignation—a full 2 years post burglary—which was followed by a solid rebound*

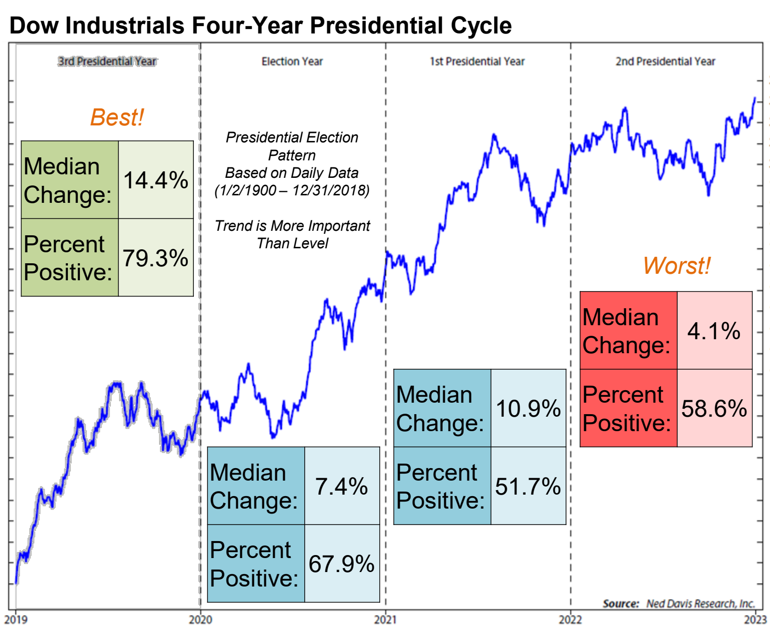
<u>Clinton Impeachment:</u>

- *Market rallied through first half of 1998*
- *Stocks declined to pre-scandal levels following the DNA announcement*
- *Market bounced back and reached new highs over the following year*

The lesson learned is that impeachment in and of itself may not have a material impact on markets.

Maintain Focus on Long-Term Strategy: Batten Down the Hatches but Don't Abandon Ship

The chart at right shows the average market performance in each of the four years within a presidential term going back to the year 1900. We note that the mid-term year (2018 in this case) tends to be the weakest while the 3rd year (i.e. 2019) tends to be the strongest. Currently investors are understandably anxious about the discord in Washington, specifically as it relates to impeachment. Looking through the lens of history, however, we find that such political conflict may not predict a market downturn and, in fact, fundamentals tend to be of greater importance. While we do recognize that there is evidence of "clouds" gathering on the horizon, we do not expect a full-blown recession in the near future. Because we do anticipate market volatility to continue and sailing through choppy seas is likely, we continue to advocate a slightly defensive posture in our investment strategies within our long-term framework. As 2019 comes to a close and we enter 2020, we will, as always, stand ready to adjust our strategy as warranted.



Index; Core Bond: BbgBarclays Aggregate Index; Int'l Bond: BbgBarclays Global Aggregate ex-USD Index; High Yield: BbgBarclays US Corporate High Yield Index; Cash: BofA Merrill
dex; Alternatives: Wilshire Liquid Alternatives Index

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As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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