Bonds Soar- Stocks Plod Ahead

The third quarter was all about the bond market and interest rates. In the first half of the quarter interest rates collapsed with the 30-year Treasury yield hitting an all-time low of 1.94%. The yield curve inverted decisively raising recession fears. Still the US remains the high-yielding bond market since there are about $15 trillion in negative-yielding bonds around the world. The return for long term Treasuries during the quarter was over 8% far outpacing the S&P 500 which increased by 1.7%.

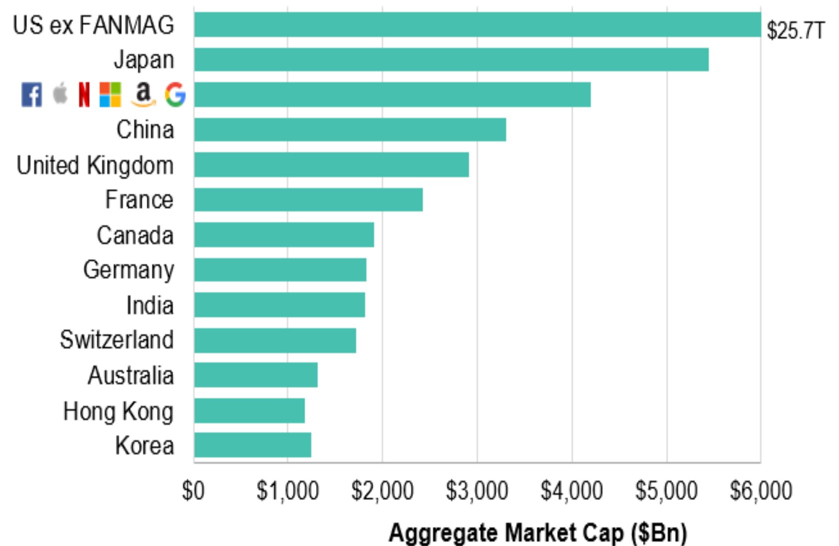
The other significant development was **a rotation out of growth stocks into value stocks**. We have written on multiple occasions about the huge performance difference between growth and value over the last decade. The month of September saw value rise by 3.7% with growth only advancing by 0.3%. While one month doesn't confirm a trend change, we think the possibility that one is occurring is high and have added a couple of Value positions to the portfolios. (see chart below detailing remarkably high valuations in certain popular and expensive growth issues.)

The volatility in the bond market is mostly in response to what can now only be described as a global manufacturing recession. The rest of the world has been weak with the US bucking the trend, but the US has finally succumbed to the softness. The ISM manufacturing index slumped to 47.8 in September following up on August's 49.1 reading, with gauges of employment and new export orders also weakening.

The S&P 500 has been stuck in a decent sized trading range of 2600 to 3000 since January 2018 with only a brief time below 2600 in December 2018. It will probably be hard for the market to break out to the upside without an improvement in global manufacturing. This is a possibility as the current weak readings are a reflection of the Federal Reserve's tightening cycle which ended about nine months ago. **Now the world central banks are all in easing mode. These actions should support the economy down the road. Moreover, the softness is largely attributed to the trade war between the US and China, a hinderance that could improve at any time.**

How Expensive are FANMAG

(Facebook, Apple, Netflix, Microsoft, Amazon, & Google)?



It is equally unlikely that the market will break down without some new development. While manufacturing is in a slump it is only 11% of GDP and the consumer is in rude health. From the *Wall Street Journal*: "The Bureau of Economic Analysis (BEA)…**published its annual revisions to personal income data, and the surprise was the huge jump in disposable income and employee compensation**. The revisions show that employee compensation rose 4.5% in 2017 and 5% in 2018—some $4.4 billion and $87.1 billion more than previously reported. The trend has continued into 2019, with compensation increasing $378 billion or 3.4% in the first six months alone… "This should make the current economic expansion more durable since consumption isn't being pumped up largely by increased household debt. Instead consumer spending has increased as wage growth has accelerated amid a tight labor market." Add in low gas prices and low unemployment and it's hard to see the consumer stumbling anytime soon.

Another factor supporting the theory of stock market resiliency is our belief the real nuttiness has occurred outside of traditional markets. Last year the speculative money was chasing crypto currencies instead of stocks. Additionally, the extreme valuations were found in private equity. Many of these companies have come to public markets this year and done very poorly. The poster child was WeWork which had a private funding round over $40 billion but couldn't find buyers at any price in the public market and cancelled their IPO. So, while overall stock valuations are not cheap, they are far from extreme and will almost certainly do better than bonds over the long term. Best of all there are many industries and stocks that do look quite attractive.

Early in the fourth quarter the stock market returned to its volatile ups and downs. At lower levels, it may be a good time to use the rest of the cash in the portfolios.

Jim Tillar, CFA and Steve Wenstrup

The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities listed herein will remain in an account's portfolio at the time you receive this report. It should not be assumed that any of the securities holdings listed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable. In addition we do necessarily agree with or endorse any outside commentary within this newsletter. If you have received this electronic transmission in error, please notify us by telephone (937) 428-9700 or by electronic mail: info@twadvisors.com. For illustrative purposes only. Factor strategies seek to outperform the broad market while maintaining a similar level of risk. Minimum volatility strategies may help reduce losses during declining markets while still experiencing gains during rising markets. There is no guarantee that such outcomes will be achieved. Chart Source: Research Affiliates.