Macro Summary

- The Federal Reserve met in July and September, lowering its benchmark interest rate by 0.25 percent at each meeting, leaving the Fed funds rate at 1.75 – 2.00 percent at quarter end.
- In March, no members of the Federal Reserve anticipated rate cuts this year. There are now twelve participants that anticipate at least one more interest rate cut in 2019.
- The unemployment rate hit a 50-year low of 3.5 percent in September; however, job creation has shown signs of slowing.
- Average hourly wage growth of 3.2 percent still trails the 3.5 percent historical average, as technology, globalization, the 'Gig Economy,' and reduced bargaining power of employees have stifled wage growth.
- Consumer spending slowed in August, but is growing at almost 3.7 percent year-over-year, while the household savings rate increased to 8.1 percent of income in August.
- Second quarter real Gross Domestic Product (GDP) of 2 percent met expectations and was driven by consumer and government spending.
- Business investment reduced growth for the first time in three years as uncertainties over global growth outweighed the investment incentives of the 2017 tax reform.
- Government spending, driven by fiscal stimulus, was the highest in a decade and is not likely to be repeated any time soon.
- Duke University's September Chief Financial Officer (CFO) Survey found 53 percent of US CFO's believe the economy will be in a recession by the third quarter of 2020 and 67 percent believe a recession will start by the end of 2020.
- Consumer Confidence declined sharply in September from its relatively high levels earlier in the quarter. The escalation in trade and tariff tensions appears to have shaken consumers' confidence.
- Single family housing starts remain slightly below their 20-year average, while multi-family starts have been trending marginally above their two-decade average.
- The economic expansion is the longest in post-war history, but its 2.3 percent average Gross Domestic Product (GDP) trails the 50-year average of 2.7 percent growth.

	Q3 RETURN	YTD RETURN
Standard & Poor's 500	1.7%	20.5%
Balanced Portfolio - 60 / 40	1.9%	15.7%
Dow Jones Industrial Average	1.8%	17.5%
MSCI EAFE	-1.1%	12.8%
Barclays Aggregate Bond	2.2%	8.5%
Barclays Municipal Bond	1.5%	6.7%

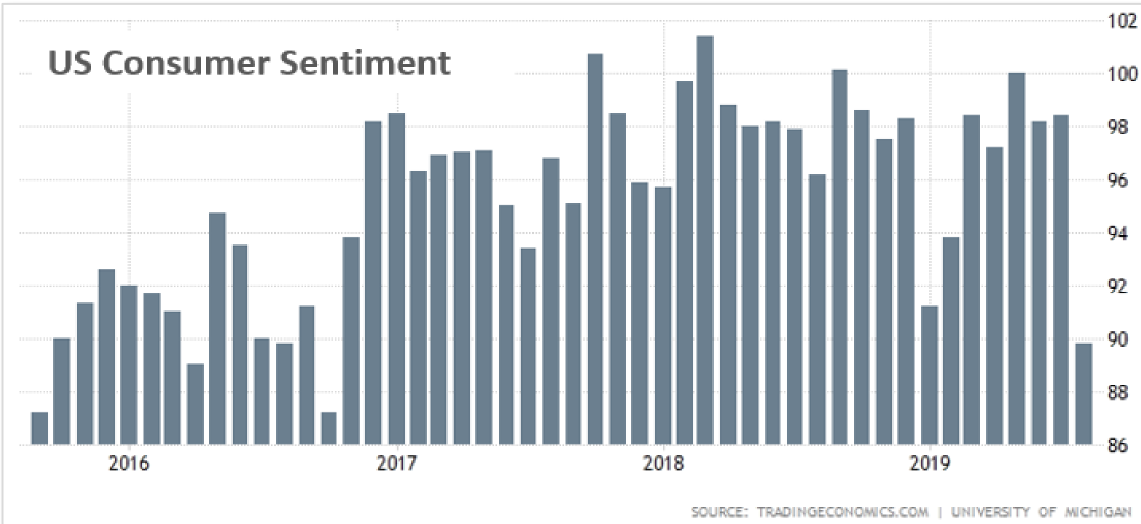
Fear of heights can be either rational or irrational. The irrational kind, called *acrophobia*, often arises from some traumatic experience, and can spark debilitating panic even at relatively safe heights. On the other end, even the entirely rational version, called *basophobia*, can trigger an interesting reaction called *astasia-abasia*: an instinctive need to crouch, and aversion to standing straight up.

The global financial markets, in the third quarter, has been crouching along close to all-time highs, flinching from time to time at the view below. Early in this recovery, much of the fear was irrational, informed by proximity to the 2008 financial crisis. Now, more than 10 years into a bull market, the concern is more rational. The growing weakness of recent economic data at home and abroad, as well as the potential for unsettling shocks ahead, should not be ignored. Yet given the relative prices for safety and risk in today's market, we continue to believe investors should resist the urge to cower.

The Economy

The United States economy has slowed down, and it may be catching a bit of a cold. Although some of the leading indicators of a possible recession have improved since the start of the year, several indicators have declined. Nothing has fallen off a cliff, but several have either stagnated or weakened. The ISM Manufacturing Index fell 1.3 points in September to 47.8, its lowest reading in 10 years and its second month in contraction. The ISM Non-Manufacturing Index fell 3.8 points to 52.6, its weakest expansion reading in three years. Durable goods orders in August were down 3.0 percent from this time last year. Orders for core capital goods - a key indicator of business investment - leveled off last summer and are down slightly (0.4 percent) from a year ago. Each of these reports are declines from their stronger data readings last year.

Even consumer confidence has come down noticeably from its previous record highs, though it remains quite strong, bolstered by continued hiring and modest wage growth. The economy has added an average of 161,000 jobs per month so far this year - down from 223,000 last year, but still a steady increase. Initial jobless claims, which usually tick upwards going into a recession, remain near 50-year lows. Retail sales have risen in seven out of eight months in 2019, and in August increased 4.1 percent from a year ago.



The Atlanta Federal Reserve currently projects US Gross Domestic Product growth of 1.7 percent in the third quarter, while the New York Fed projects 2 percent growth - hardly thrilling, but far from a recession. In late 2015 and early 2016, the United States saw a similar slump, due to a strong US dollar and a collapse in oil prices. Contrary to many on Wall Street, the consumer persevered, bolstered by steady job growth, low inflation, and strong spending. Our investment committee projects this time will not be any different.

Bumps In The Road

China. Over the past several months, the global financial markets have hung almost obsessively over the latest headline touching on President Trump's trade battle with China. The slightest rumor of a deal bumps stock prices up, while new tariff threats send them retreating - but only for a little while. It's entirely possible that short-term political considerations could push both leaders to announce an agreement, but we caution investors to be careful this doesn't blind them to the bigger picture.

The first part of the bigger picture is that China is slowing, for reasons that predate the trade war. China's over-reliance on credit expansion to over-invest in more and more capacity, resulting in an abundance of bad debt to be refinanced, is gradually becoming a heavier impediment to growth, even if the resulting financial stresses get successfully brushed under the rug. A trade agreement won't change this. In fact, China's flagging purchases of autos and machinery have hit Germany's economy hard, pushing its Manufacturing PMI into its deepest contraction (41.7) since June 2009, and its economy to the edge of recession.

Japan, South Korea, Australia, and other economies are facing similar pressure. As we've noted in the past, the long-overdue shift in China's economic gears could produce more positive results, but amid rising trade tensions and heated political unrest in Hong Kong, those benefits have been hard to realize.

The second part is that the United States and China increasingly appear to be on a broader collision course regardless of specific trade issues getting resolved. The 2008 financial crisis proved a hidden turning point: many Chinese stopped seeing the US as a model worth emulating, while many Americans soured on the benefit of globalization. The rising wealth and assertiveness of China, along with its turn towards greater authoritarianism under Xi Jinping, compounded this fracture. The shift in attitudes among our policymakers towards a harder line on China has been profound. To better understand this, don't look to President Trump's latest tweet, but to a speech that Vice President Pence gave in October 2018 in which he outlined a host of areas where the United States has come to see China not as a partner, or even a rival, but a committed and even existential foe. The financial markets got a taste of what this could mean this spring when the Administration placed a ban on Chinese telecom giant Huawei doing business in or buying supplies from the US, and again a few weeks ago when reports emerged that the White House is considering delisting Chinese companies from our stock exchanges, or even restricting investment into China. The future could easily bring more sanctions on Chinese technology companies or even financial institutions, partly as leverage in trade negotiations, partly to 'decouple' the two economies as part of what some strategists are already calling 'Cold War 2.0.' To us, this does not necessarily depend on President Trump being reelected. The shift is bipartisan: Democratic candidate Elizabeth Warren's stance towards China has been just as bellicose. It's entirely possible the 2020 election turns in part into a contest over who can sound tougher on China. If so, expect more proposals that could rattle markets in the short-term, and have a more lasting impact if actually implemented.

Brexit. Divided over how to proceed, unhappy with the terms it could get from the European Union, Britain postponed its original exit date from the European Union this spring. Now, like a college student granted a term paper extension, it has frittered away the extra time it begged for and finds itself back in the same predicament, with time again running out. The process has become so confused and complicated that even many serious observers have shrugged their shoulders and moved on. But the clock is ticking. Prime Minister Boris Johnson, who replaced Theresa May in July, declares he'd rather 'die in a ditch' than request another delay. If that's true, the United Kingdom will be out of the EU on Halloween deal or no deal.

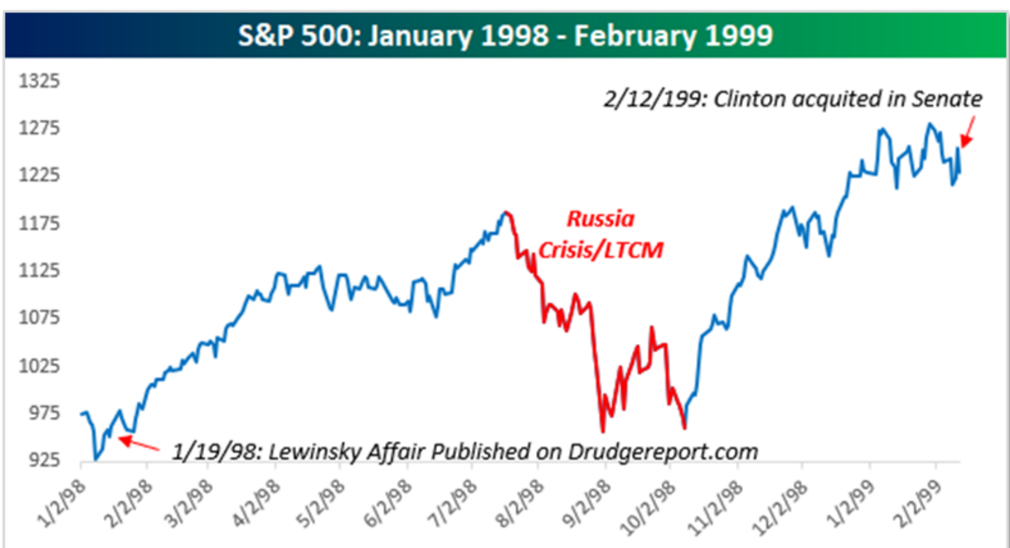
The impact on the UK economy so far has been surprisingly mild. Britain's GDP fell at an annualized rate of 0.8 percent in the second quarter, its first quarterly decline since 2012; however, the third quarter is expected to see a recovery that would avoid a recession. But small businesses in particular have been reluctant to devote precious resources to prepare for a no-deal Brexit that may or may not happen, leaving them potentially vulnerable.

A 'no deal' Brexit sounds like it allows everyone to move on, but it doesn't. Instead, Brexit is looking more and more like a saga that will go on after October 31, without a clear resolution even if Britain does leave. That's worrisome for a Europe already teetering on the edge of recession and where political legitimacy is already feeling strains.

Impeachment. The political storm in Washington, DC reached a new crescendo as whistleblower allegations concerning a presidential phone call to Ukraine prompted House Democrats to begin impeachment hearings aimed at removing President Trump from office. With polls showing the public equally divided between removing the president or not, a contentious battle is set to consume the ensuing weeks and months. President Trump warns that any attempt to remove him would crash the financial markets, and it's reasonable to look back at past impeachment episodes to ask how such a heated and high-stakes fight is likely to affect investors.

From the time the Watergate scandal first burst onto the scene in February 1973, to the day President Nixon resigned in August 1974, the Standard & Poor 500 (S&P 500) Index declined 29 percent. But Nixon's travails also coincided with a sharp deterioration in the US economy, and the stock market's big tumble came with the Arab Oil Embargo, which quadrupled oil prices. The President's job approval rating collapsed along with the economy, bottoming out around 25 percent more than a year before impeachment reached its climax. The day Nixon stepped down, the United States was in the first quarter of a recession and experiencing double-digit inflation.

In contrast, President Clinton enjoyed job approval ratings of 60 - 70 percent through most of his impeachment saga, buoyed by steady economic growth and low inflation. The S&P 500 rose 28 percent from the day the Monica Lewinsky scandal first came to light in January 1998, to the president's trial and acquittal by the Senate a year later. Their rise was briefly interrupted by a sharp 19 percent correction that coincided with the president's grand jury testimony and public confession. But the downturn was mainly driven by the Russian ruble crisis and the near collapse of the Long-Term Capital Management hedge fund, and stocks rebounded once the financial crisis had passed. At the time, Clinton's supporters explicitly pointed to good economic times and the president's popularity as reasons why the charges against him didn't merit his removal.



Our takeaway is simple. While impeachment can unnerve global markets, their overall direction is tied to the economy, and the economy's performance may be more likely to influence the political outcome than the other way around. We remain steadfast in our focus on fundamentals.

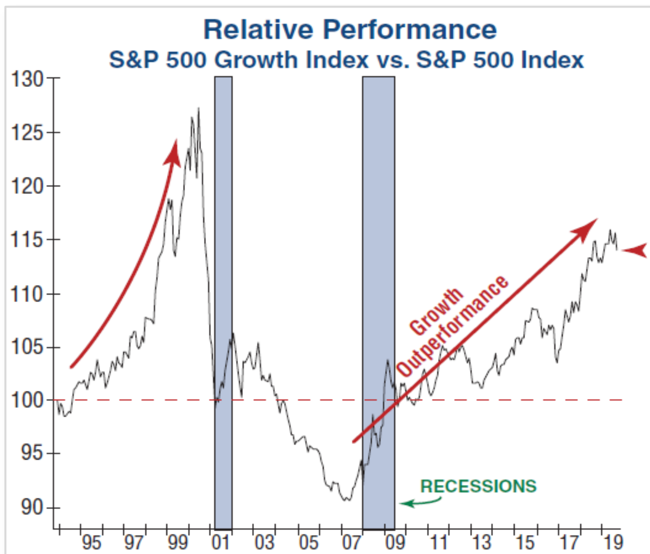
Growth Versus Value Stocks

Jamie Dimon cautions the 10-year Tresury yield could hit 5 percent. It's a higher probability than most people think – August 6, 2018

Jamie Dimon says JP Morgan is preparing for zero rates in the US – September 10, 2019

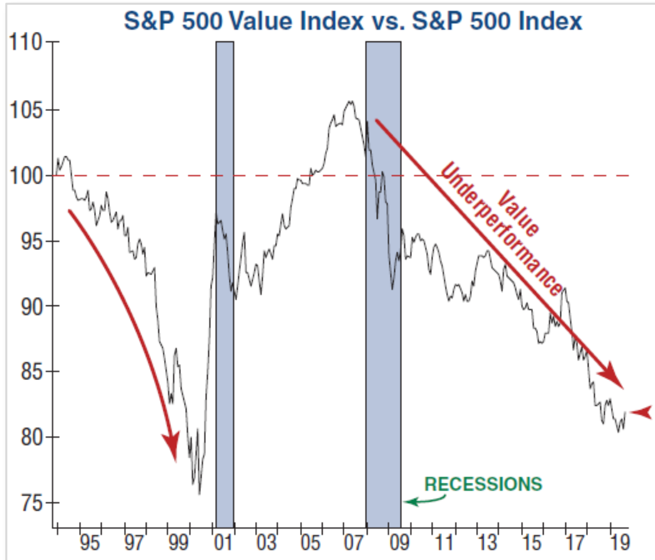
Predicting the short-term direction of interest rates is even more difficult than predicting the short-term direction of the financial markets.

One of the most dominant and consistent themes throughout this historically long bull market has been the significant outperformance of growth stocks relative to value stocks. According to our friends at InvesTech Research, we've seen this movie before, and we need to be mindful of history.



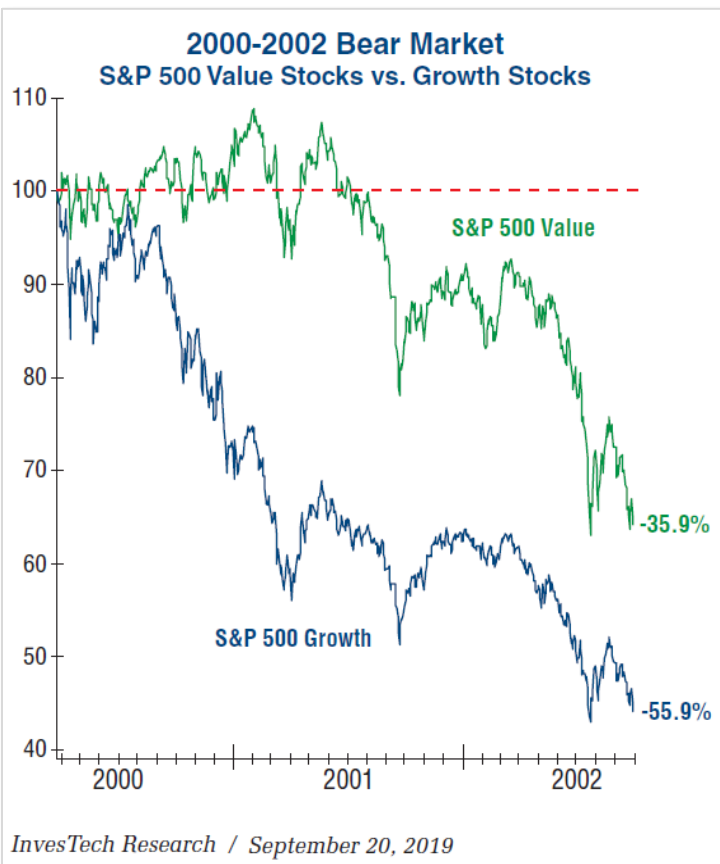
Utilizing a barrage of headline factors such as sales and earnings potential, growth stocks have the ability to outperform the overall market based on future expectations for success. Also, in a broad economic recovery, growth companies can capitalize on their competitive advantages. On the other hand, value stocks can trade below their intrinsic value as market participants overlook their relative discount and instead run after the favored high fliers. Buying stocks at a fundamental discount has been a philosophy utilized by some of the best investors of our time, including Benjamin Graham and Warren Buffett. Historically speaking, studies have shown that value stocks have generally outperformed growth stocks over the course of a full market cycle. This has largely been due to their ability to avoid the substantial losses experienced by high flying growth stocks when economic conditions take a turn for the worst.

However, this relationship can shift over shorter time frames. Two of the most extreme periods when growth has run rampant are the Tech Bubble of the 1990s and the bull market cycle of today.



From the early 1990s through the peak in March of 2000, euphoric technology stocks dominated the investment landscape, with the S&P 500 Growth Index leading the overall S&P 500 Index in outperformance, as shown in the top graph at right. Meanwhile, value stocks dramatically underperformed the S&P 500. Fast forward to the current bull market of today and you see a very similar association. Once again, many investors have focused on high flying growth stocks while value-based companies have languished far behind.

Similar to the Tech Bubble, growth stocks are priced on lofty expectations and a continuation of today's momentum. Ultimately, with history as our guide, value stocks should reemerge as market leaders, especially if stocks run headlong into a bear market.

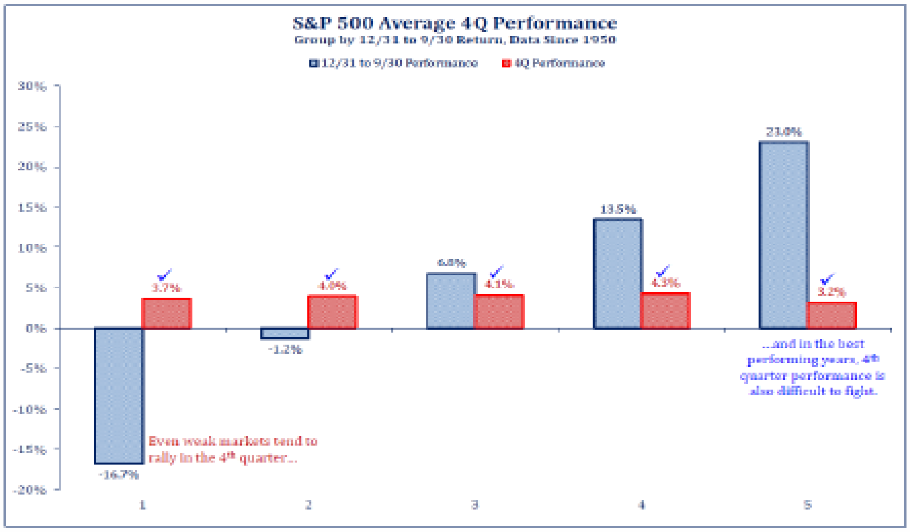


The graph at left highlights how abruptly the tables turned after the Tech Bubble peak in March of 2000. The S&P 500 Growth Index tumbled rapidly, and ultimately fell 56% over the course of the next two and a half years. In contrast, value stocks provided positive returns during the early stages of the bear market cycle, allowing investors more time to increase portfolio defenses... and in the end fell substantially less.

While each cycle is unique, the eerily similar relationship between growth and value today versus the late 1990s reminds us this is not the time to reach for excess profits or momentum growth stocks. Moreover, portfolio positioning should look to capitalize on value segments of the market that are being overlooked by investors.

A Picture Is Worth A Thousand Words

In order to provide you with a shorter read, we have included a few charts with a bullet point of explanation as to why we think the graphic is important.



Source: Strategas Research

- Regardless of how strong the stock market returns are for the first three months of the year, the fourth quarter returns gravitate toward 4 percent.

Source: Strategas Research

- This chart shows the substantial increase in negative yielding debt globally. Why anyone would pay someone to hold their money is beyond us.

No Recession Two Years Before Re-Election			Recession Two Years Before Re-Election		
President	Recession?	Re-Elected?	President	Recession?	Re-Elected?
Obama	No	Yes	Bush I	Yes	No
Bush II	No	Yes	Carter	Yes	No
Clinton	No	Yes	Ford	Yes	No
Reagan	No	Yes	Hoover	Yes	No
Nixon	No	Yes	Coolidge	Yes	Yes
LBJ	No	Yes	Taft	Yes	No
Eisenhower	No	Yes			
Truman	No	Yes			
FDR	No	Yes			
FDR	No	Yes			
FDR	No	Yes			
Wilson	No	Yes			

Source: Strategas Research

- Quoting James Carville who was President Clinton's campaign strategist, 'It's about the economy stupid.'

Concluding Thoughts

It is important to resist the urge to crouch down, despite a natural fear of heights. The markets will see ups and downs in the months and years ahead. Some of these twists and turns may even be unnerving. Despite the possibility for volatility in the short-term, the long-term upward resiliency of stocks continues to be the path of least resistance.

Recessions, and their impact on financial markets, are not created equal. The last US recession in 2008 lasted six quarters and was followed by an equally painful downturn in Europe. Starting in late 2007, the S&P 500 Index tumbled 57 percent, and took over five years to recover. The 1990–91 recession; however, played out very differently. It lasted only three quarters. The Standard & Poor 500 Index initially fell 20 percent, but even before the recession was over, seven months later, the stock market had bounced back fully. Often, the financial markets are already beginning to look through them and towards the recovery by the time the recession takes hold.

We appreciate your trust and confidence in our team. And of course, if you have any questions, please don't hesitate to contact us at (414) 257-4248 for a personal conversation. You can also visit our website for company news and reports at www.ngwealth.com.

Respectfully,

David

David A. Massart
President