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Atlas BROWN
FAMILY WEALTH MANAGEMENT

3rd Quarter 2019

As we enter the final three months of the decade, with folks gearing up for the holiday season, there is a lot for investors to be thankful for. The broad market, as measured by the S&P 500, is up 20.6% year to date, the largest year to date return in over two decades. Interest rates are at historic lows, unemployment is at an all-time level, and the economy is in its 123rd month of expansion, the longest ever. However, if you pay attention to most of the headlines you would think we are in much worse shape than we are. Concerns around global trade and currency issues, along with the partisan political climate has investors concerned. We will touch on these issues in the paragraphs below along with giving you a few of the highlights in the quarter. For now we will jump right into the 3rd quarter returns for the major assets classes. Equities were mostly positive in the quarter with large and mid-caps up 1.7%, 0.5% with small caps declining in the quarter down -2.4%. Outside the U.S., developed international declined -1.0% during the quarter with emerging markets notching negative performance of -5.0%. Fixed income investors were up 2.3% during the quarter with the ten year rate ending the quarter at 1.68%. Turning to alternatives, real estate was up 5.9% in the quarter with both commodities and MLP's down -4.2% and -6.9% respectively.

Economy

As we mentioned above, the economy is now in its 123rd month of expansion, the longest on record. We have written at length on this in the past so won't rehash our thoughts on that here. However, it's worth stating again that just because this recovery is the longest in history doesn't necessarily mean it has to end soon. Expansions don't die of old age, although much like this author they get slower, and that's what the economy is experiencing now. And just like when you ride a bicycle very slowly it makes it easier to topple over, this economy could easily fall into a recession, but doesn't have to. As you know from our commentaries in the past we don't try to time markets and call recessions, and feel that effort there is futile. What we focus on and what we encourage investors to focus on, is making sure that their allocation to risk assets matches their long term risk tolerance and return objectives, and that they should maintain that allocation. We are not burying our heads in the sand, and will admit that while we don't know when we will see a recession, one is coming. However, instead of trying to determine when it will come, we strive to find quality investments in the current environment and will be ready to take advantage if we see buying opportunities that come with a recession. As we mentioned above, a lot of the discussion this past quarter (and the year frankly) has been around trade and most recently the potential impeachment of the president. We will let others write about the political landscape, and will admit we are no expert on global trade. What we will say is that investors will have to tolerate elevated volatility due to these issue in the months ahead, and should prepare themselves.

Equities

The late artist Prince had a hit song called "1999" with the lyrics "We are going to party like its 1999". We are thinking about performing the song with "1997" in place of "1999" given that we haven't seen performance like this in the equity markets since the year 1997 (due to song licensing issues we are unable to make the above changes, you have been spared). We have been surprised with the strength of equity markets, especially given the trade and political headwinds. With the S&P 500 set to achieve earnings growth a bit less than 3% in 2019, a 20.6% return year to date through the 3rd quarter is surprising. However, what we underestimated was the markets multiple expansion back to historic averages from the depressed levels at the end of 2018. The S&P 500 ended 2018 at 14.4 times forward earnings, but currently stands at 16.8 times (above the historic average of 16.2). That is roughly a 17% increase in just multiple expansion. Tack on another 2% in dividends and you can see how we got to the strong performance this year. Now as we are writing this we have seen the market sell off a bit, but outside of a continued large pullback, 2019 should be a good year for investors. The biggest question is where do we go from here? With continued uncertainty around trade and the aforementioned political environment, we still feel that returns moving forward will be less than we have been accustomed to. We expect equity returns to be closer to the mid-single digits than the high single digits, but continue to feel that equity returns will be above those for bonds.

Fixed Income

"The Fed continues on the path of tightening, most recently raising the fed funds target to 2.25% on the upper end"

We wrote the above statement exactly one year ago, my how things have changed. The fed actually had one more rate hike at the end of last year putting the upper bound at 2.5%, and with two rate cuts in 2019 that now stands at 2.0%. The central bank cut rates for the first time since the Great Recession in late July, then followed that up in mid-September, likening the moves to taking out insurance. They were meant to give the economy a little bit of extra padding in case risks on the horizon turned into realities. While some recent data does suggest that things are slowing including the most recent PMI data, consumer spending is still showing some strength. The markets do expect one more rate cut this year, and possibly another one or two next year. The last several years have been difficult for those looking to generate an income yield on their fixed income investments, with historical low rates. This has been the tail wind that has driven risk assets higher as investors seek yield. We don't see much change to this environment moving forward as we don't see rates moving much higher in the near term.

Alternatives

You have heard us express our thoughts on the advantages of utilizing alternatives in overall portfolio allocations to both enhance returns and reduce risk, so we won't bore you with more of the same comments on how non-correlated alternatives can add a significant amount of value to one's allocation. (You see what I did there?) We do think moving forward alternatives such as longevity assets, music royalties, and solar infrastructure will continue to produce positive returns with little volatility. We would welcome the opportunity to discuss these with you in detail and how they might be a fit for you.

As always we could have written more, but will show mercy and end this commentary here. However, if you have any questions or concerns regarding anything touched upon above or other issues not addressed, please don't hesitate to reach out. As always, we would like to thank you for the trust and confidence you place in us. We look forward to speaking with you in the coming weeks.

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