CURBSTONE FINANCIAL MANAGEMENT CORPORATION

From the Curb

Letter to Clients

Quarter Ending June 30, 2019

Historical market volatility returned in the second quarter of this year. As uncertainty rose, stock markets declined as evidenced by the S&P 500's pull back of 6% in the month of May. Investors' concern is with U.S.-China trade relations, the state of the U.S. and global economies and Federal Reserve interest rate policy.

In sharp contrast to the quiet, steady gains of the first quarter, stock market performance in the second quarter was a rollercoaster. The S&P 500 logged a 4% gain in April thanks to solid first quarter corporate earnings reports, reducing fears that earnings growth had peaked in 2018. Additionally, data showed that inflation was running well below the Fed's target, fueling investors' expectations for a Fed interest rate cut in either June or July. With bullish sentiments in place, the S&P 500 ended April near new all-time highs.

The euphoria didn't last long. The decline started in the first week of May following the collapse of U.S.-China trade negotiations, as President Trump took to his Twitter account and announced that he would be raising tariffs from 10% to 25% on $200 billion in Chinese goods. He further threatened to levy additional tariffs on the remaining $325 billion worth of Chinese products imported into the United States if trade negotiators did not return to the table. The news caught investors by surprise, as reports previously implied that a trade deal was close to being finalized. Stocks dropped sharply in reaction.

Further escalating the trade conflict was the decision by the U.S. Commerce Department to add the Chinese telecom company Huawei to its "Entity List," which would effectively ban U.S. companies from doing business with the telecom giant. That development further pressured stocks. Then, Federal Reserve Chairman Jerome Powell sewed doubts about the future of interest rate cuts when he described low inflation as "transitory." The markets took this to mean that the Fed was not as open to an interest rate cut as had been anticipated. That combination of factors weighed on markets throughout May and the S&P 500 fell to its lowest levels since early March.

The stock market was able to find support and rebound strongly in June as progress was made across the two main sources of concern, U.S.-China trade and future Fed interest rate policy. First, at the June 19th meeting, the Federal Reserve reversed course from May and signaled an interest rate cut is likely in 2019, perhaps as early as July. That shift helped to validate market hopes of lower interest rates in the near future, causing stocks to rebound strongly. Second, President Trump and Chinese President Xi Jinping met at the recently held G20 meeting resulting in a trade "truce" of no new tariffs, while trade negotiations resume.

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The ups and downs of the quarter and the first half of 2019 ultimately rewarded investors with positive performance across the board as tracked by the following major indices:

	Q2 Return	YTD Return
S&P 500	4.30%	18.54%
DJ Industrial Average	3.21%	15.40%
MSCI EAFE NR USD (Foreign Developed)	3.68%	14.03%
BBgBarc US Agg Bond	3.08%	6.11%

While markets were impressively resilient in the second quarter, we face macroeconomic uncertainty on multiple fronts as we move into the second half of 2019. First, the U.S.-China trade situation remains delicate and uncertain. Until there is a final agreement on a new trade pact, the lack of clarity will act as a headwind on economic growth and likely create temporary periods of volatility like we experienced in the second quarter.

Looking at the global economy, growth metrics underwhelmed in the second quarter. However, the impact on global stocks was muted by rising market expectations of more stimulus from global central banks, including the Fed. We believe any further deterioration in global and U.S economic indicators will give investors a reason to reduce the risk in their portfolios by lowering their exposure to stocks. Additionally, there are several unsettled geopolitical situations that must be monitored, including Brexit (the deadline is October 31st), North Korea (relations are still unsettled despite the recent Trump/Kim meeting) and Iran (the chances of a U.S.-Iran military conflict are as high as they've been in years).

Finally, while the Federal Reserve has signaled it will begin to reduce interest rates in the coming months, their decision-making remains very fluid. Should the Fed hold interest rates at their current levels, investors may decide to sell stocks sensing that valuations are rich.

It remains unclear how, or when, these events will be resolved, and what those implications will be for markets. As 2019 has thus far demonstrated, uncertainty is not, by itself, enough to offset the strong price performance we've seen in markets as measured by major indices. Instead, these and other market reservations require an intent focus on economic data, corporate fundamentals and political news. Put more generally, markets always faced murky futures; but, over the long term, it is core economic and corporate fundamentals that drive market returns—not the latest sensational headlines.

We understand that volatility, whether related to trade disputes or concerns about Federal Reserve policy, can be unnerving, even if it is historically typical. We continue to believe that our disciplined approach to investing and broadly diversified portfolios will serve you well. We will work diligently to ensure that the management of your portfolio aligns with your financial position, risk tolerance and investment time horizon.

We enjoy working with you and we appreciate your business. After reviewing the enclosed quarterly reports, please let us know if you would like to schedule a meeting to discuss the management of your accounts. Otherwise, please feel free to reach out via a phone call.