Navigating Financial Markets amid *Mixed Signals* from Consumers, Corporations, and the U.S. Government

Volatility returned to the markets in the late summer months as intensified trade developments between the U.S. and China took center stage in the market narrative, along with revived concerns surrounding slowing global growth.

The trade war between the U.S. and China has now been ongoing for nearly two years, and economists and investors are beginning to see the latent impacts on global growth expectations, as businesses around the world have generally reduced business investment in the midst of uncertainty stemming from the trade backdrop. Manufacturing activity—both here in the U.S. and abroad—has been the major casualty thus far in the trade war, with U.S. manufacturing gauges falling into contractionary territory in the third quarter.

Despite the slowing activity across the manufacturing sector, consumers have remained a steady engine for the U.S. economy, as evidenced by strong consumer spending levels and relatively resilient consumer confidence levels. Amid the heightened uncertainties caused by the U.S.-China trade saga, the Federal Reserve has implemented three interest rate cuts so far, labeling the activity as "mid-cycle policy adjustments" in response to increased downside risks (as opposed to a sustained monetary easing cycle). However, the Fed has indicated that further rate cuts would hinge on a significant change in the current economic outlook.

As we approach 2020, a year we expect to be volatile given the growing list of unresolved geopolitical issues and the impending presidential election, we continue to lean on our investment philosophy. Our long-term approach to investment opportunities, in addition to our focus on quality management teams with efficient business practices, is more imperative than ever in the market environment we anticipate. As we monitor the general themes below—both broadly as they relate to the business cycle and in more detail as they relate to individual investments—we look forward to uncovering possible investment opportunities in the months ahead that are in alignment with our investment principles.

Earnings

Corporate earnings growth estimates for 2019 are generally lower than actual earnings growth reported in 2018, both domestically and abroad. In the near term, earnings levels are likely to continue to moderate from the double-digit growth levels seen in 2018.

Valuations

U.S. stocks and emerging markets stocks are currently trading at forward price-to-earnings multiples that are above their respective long-term averages. European stocks and Japanese stocks are trading at discounts to their long-term average valuations. »

Consumer Confidence

Overall, consumer confidence levels remain elevated compared to historical averages but have shown some volatility over the last few months, most recently coming in below expectations in September.

Business Confidence

Business confidence levels remain near historic highs but have recently shown signs of weakening, led by declining expectations regarding the future of the economy and declining perceptions that now is a good time for businesses to expand.

Monetary Policy

The Federal Reserve has lowered rates three times so far this year, describing the cuts as "mid-cycle adjustments" rather than a prolonged easing cycle. The Fed has also been providing liquidity to short-term funding markets (i.e., repo markets).

Fiscal Policy

The growing federal government budget deficit continues to add to the national debt burden and long-term sustainability concerns. Policymakers recently passed the Bipartisan Budget Act of 2019, which increased discretionary spending limits and suspended the debt limit.

Credit Conditions

Trade uncertainties and growth concerns have weighed on investors' appetite for risk assets, yet risk spreads on corporate bonds remain low. In addition, lending standards have not significantly tightened, and capital markets remain accessible.

Volatility

In recent months, we have seen an uptick in volatility given uncertainty regarding trade and slowing global growth concerns. We expect volatility to remain elevated as both stories continue to develop and as we approach the 2020 presidential election season. ■