BERMAN CAPITAL ADVISORS

October 14, 2019

Berman Capital Advisors Q3 2019 Review and Outlook

Russ Allen, CIO

Summary Outlook

- The markets proved volatile in Q3, yet most asset classes finished higher. Bonds beat stocks this quarter, but renewed faith that the Fed would keep easing prevented stocks from giving back their strong year-to-date gains.
- A tug of war has developed in the stock market. On one hand, there is a gradual but clear weakening trend in economic growth, especially overseas. On the other, little sign of inflation along with fear of a deeper stall prompted the Fed to join a world-wide trend to provide more monetary easing.
- The trade war is a major swing factor in the market's movements today. The back and forth is head-spinning, but we think tensions will be lower, not higher, by the end of the year.
- Our analysis leads us to recommend a neutral stance, although we still feel there is little long-term value in much of the fixed income market. Despite the very long expansion, we think investors should position for slow growth and not recession.

Third Quarter in Review

To date, 2019 has seen slow but positive economic growth, but surprisingly strong investment returns. Renewed recession fears intra-quarter led to a notable rally in longer dated, high quality bonds. Negative rates in Europe and Japan were the other major factor holding down bond yields in the U.S. bond market. A friendlier Fed helped stocks continue to bounce back from the difficult fourth quarter of 2018.

Total Index Return	Q3 2019	YTD 2019
S&P 500	1.7%	20.6%
Russell 1000 Growth	1.5%	23.3%
Russell 1000 Value	1.4%	17.8%
Russell Small Cap	-2.4%	14.2%
MSCI EAFE (International)	1.8%	13.3%
MSCI Emerging Markets	-1.9%	6.2%
US Aggregate Bond	2.3%	8.5%
High Yield Bonds	1.3%	11.4%

Source: Factset Research; data through 9/30/2019

Note: Int'l market returns reported in U.S. Dollars, not local currency

While bonds outperformed stocks in the quarter, equity market returns have been excellent year-to-date. With dividends reinvested, the S&P 500 is up nearly 21% for the year, its best start since 1997. For the whole year, momentum, growth and defensive stocks have risen the most. However, in September, long-beaten down value stocks suddenly rose while former darlings severely underperformed. This trend eased off, but left market watchers wondering if it could be a precursor of better value performance going into 2020.

Several year-to-date trends persisted in the quarter, including large cap over small cap and domestic stocks over international. The flight to safety during the quarter spelled good returns for gold (up 4%), and poor returns for commodities (oil declined -8.2%).

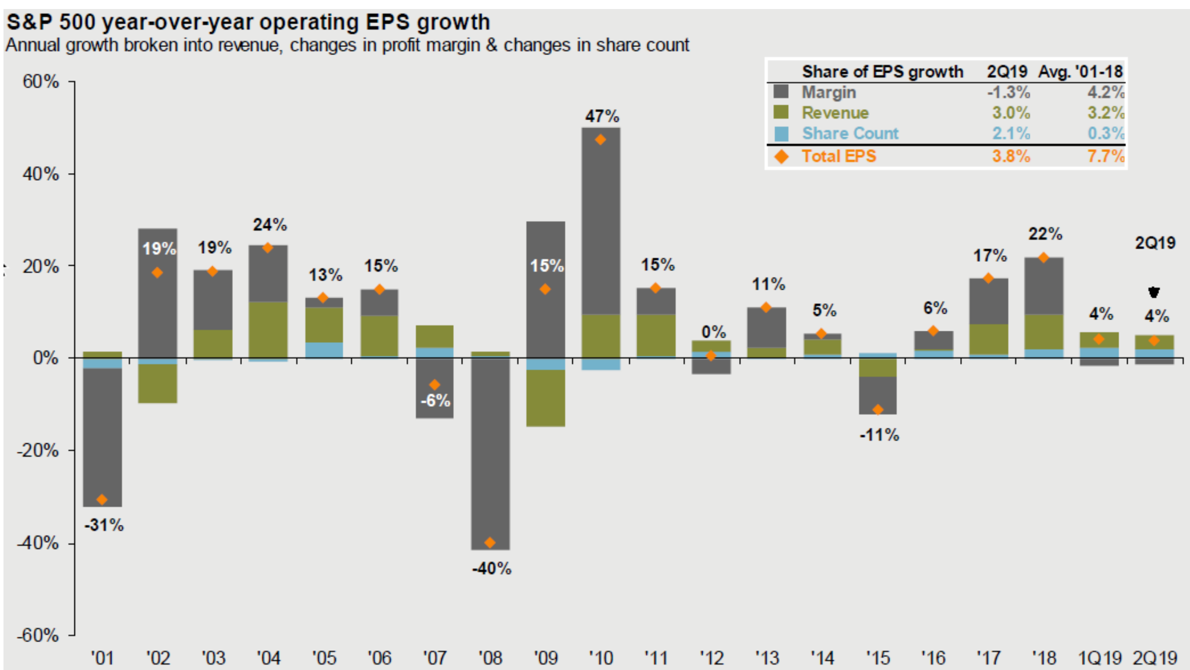
Q4 2019 Outlook

Q4 2019 Outlook

Economic Growth and Corporate Earnings

There's always lots of noise in the day to day movements of the market, but we see an O.K. setup heading into year end. While economic growth has slowed, unemployment remains close to a 50-year low. Inflation is slow and steady. While the global economy is weak, the U.S. still looks more likely to see slow growth than recession; we also think overseas manufacturing activity will improve in the next six months or so as stimulus kicks in.

For the market to stay bullish, investors will want to see evidence profits can rebound in 2020. Profit growth was historically strong in 2018, but has slowed appreciably, gaining just 4% year over year as shown in the chart below. This trend of single-digit profit growth is likely to be the trend throughout 2019. However, profit growth probably won't turn negative given still well-controlled wage costs and lower interest rates.

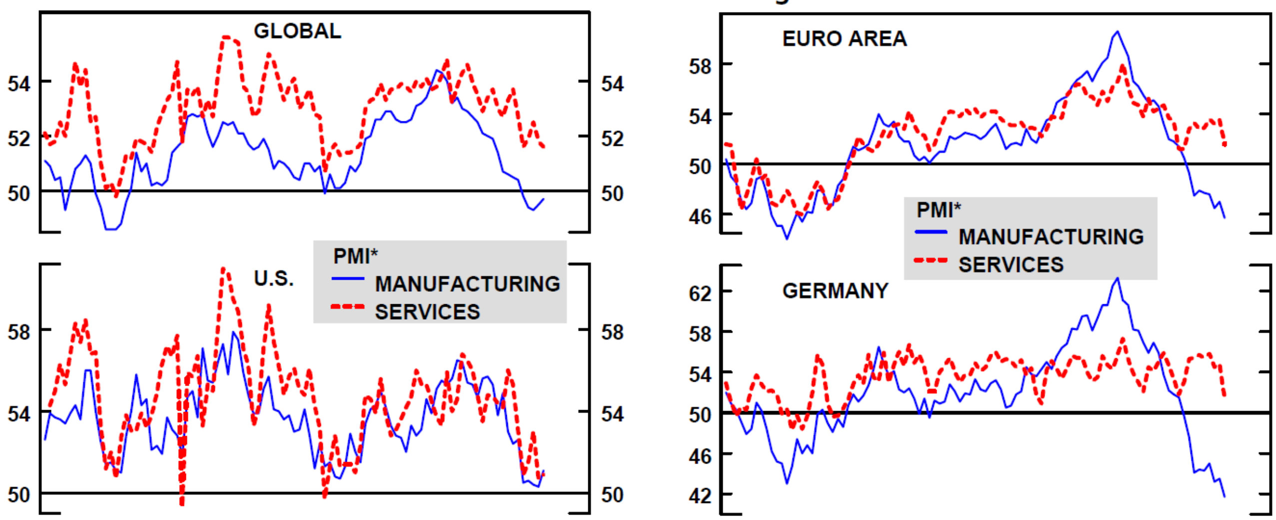


Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Much of the recent softness has come from the manufacturing sector. The question is whether this will spill over to the much larger (especially in the U.S.) services sector. There is some evidence that this is happening, but the deceleration has been limited so far. Even in Germany, with its large manufacturing base, the service sector is still slowly growing. Compared to the last major downturns in 2001 and 2008, this is a key difference. Consumers and housing are supports, not detractors, this time around.

BERMAN
CAPITAL ADVISORS

The Service Sector Has Softened Less Than Manufacturing



Source: BCA Research

The Trade War

The Trade War continues to be a major source of concern for the market, primarily due to the uncertainty it is creating. Hope has risen and fallen repeatedly, but we think the approaching 2020 election will be the catalyst that prompts a deal. It does appear that both sides have an incentive to de-escalate the trade conflict. President Trump, who has high disapproval ratings, gets much better marks from voters on his handling of the economy. A protracted trade war hurts U.S. growth and weakens his favorite measure of success, the stock market. Although better at hiding their position, China also wants to bolster growth. Trump is not an easy negotiating partner but trying to secure a trade deal with him if he is re-elected would be worse. If Elizabeth Warren is President (the betting markets think she is more likely than Biden) China could have a worse time negotiating over environmental standards and human rights as well as trade. Strategically, China has an incentive to stimulate its economy to bolster growth and gain greater leverage in the trade negotiations.

Central Bank Stimulus

QE, a.k.a. central bank bond buying, was never really gone and now is back with a vengeance. Like Pavlov's dog, markets are trained to see this as bullish, and that will likely be right this time around as well. As long as the ECB (Europe) and the BOJ (Japan) actively buy sovereign and corporate debt, borrowing rates should remain low. Euro area money growth, which historically leads GDP growth, has already picked up. Bank lending to the private sector should continue to accelerate, assisted by the ECB's efforts to mitigate the harm to banks from negative rates. In the U.S., the Federal Reserve has begun buying Treasury Bills in an effort to calm the repo market. Even if this is not exactly QE, it is sign of how normalized Fed intervention has become.

Simultaneously, fiscal stimulus is reversing from restrictive to expansionary. BCA Research expects Europe's fiscal policy impact to increase by 0.5% of GDP this year. The lagged effect of this means most of the gains to GDP growth will occur in 2020. The U.S. deficit continues to expand relentlessly, as well. Fiscal austerity does not seem to be in either Party's agenda.

Falling borrowing costs should also support Southern Europe. The Italian 10-year spread with German *Bunds* has narrowed by almost a full percentage point since mid-August. Greek 10-year bonds are now yielding less than U.S. Treasuries!

Conclusion

In the near term, progress on trade negotiations and the tug of war between economic news and stimulus hopes will move the markets. There are clear economic negatives but that these factors are generally well anticipated. We see the risk of major imbalances and outright recession as low. Yet high starting valuations will limit the returns from stocks and bonds going forward. This supports a prudently balanced, not defensive portfolio despite a long bull market in stocks and bonds.

Given muted expectations overall, we continue seek more niche investments within the alternative and fixed income space to enhance both diversification and returns, depending on the specific investments. Volatility could be a boost to high quality, experienced hedge fund managers. Private markets are crowded, but select investments offer the prospect of higher returns and at time less correlated sources of return.

Thank you again for trusting Berman Capital to be your investment advisor. We encourage you to contact your Wealth Advisor with any questions or concerns.