THE BOSTON FAMILY OFFICE

Investment Update

Third Quarter 2019

The stock indices that we regularly report on here continue to all be up handsomely since the beginning of the year, thanks to the sell-off that closed out 2018, but are roughly flat on a year-over-year basis (small-cap companies being the exception). In this past quarter, the S&P 500 continued its momentum from June and drifted upwards to all-time highs in July. August was a different story; the index slid quickly at the outset and then spent the remainder of the month bouncing around but remaining down 5%. There were fourteen days in the quarter when the S&P 500 moved more than 1% and eleven of those days occurred in August. Global bond yields also fell, with the 10-year Treasury yield bottoming out near 1.45% late in the month after having held steadily near 2% during July. This was close to an all-time low but came during a freefall in interest rates worldwide. Stocks and bond yields rebounded for most of September, only fading back slightly towards the very end with the various indices all finishing close to where they began the quarter. We want to note the large one-year returns in the bond indices below lest you think they are typos. These sorts of returns are not the norm, but certainly possible and the primary reason why we typically avoid longer-term bonds despite the higher income they typically provide. They are much more affected by changes in interest rates than shorter-term bonds, and it is also possible to lose this much on paper from time to time.

Equity Markets (Total Return)	3Q19	1-Year
Dow Jones Industrials	1.8%	4.2%
S&P 500	1.7%	4.3%
S&P Mid-Cap	-0.1%	-2.5%
S&P Small-Cap	-0.2%	-9.3%
MSCI All-Country World	0.1%	1.9%
MSCI Foreign Developed Markets	-1.1%	-1.3%
MSCI Foreign Emerging Markets	-4.1%	-1.6%
US Bond Markets	**3Q19**	**1-Year**
Barclays US Govt/Credit Intermediate	1.4%	8.2%
Barclays US Govt/Credit Long	6.6%	21.9%
BAML Municipal Intermediate	0.8%	6.5%

Several notable new developments presented themselves for investors' consideration in the third quarter including unrest in Hong Kong, attacks on Saudi Arabia's oil infrastructure, and Democrats in the House pursuing impeachment of the President. One might think that list would be in order of increasingly negative response in the stock market, but it was quite the opposite.

The possibility of impeachment proceedings has been discussed since Trump was sworn in, with actual action just waiting for the evidence in a particular case to be worth the political gamble of pursuing it. Given the unlikelihood that the Senate will convict and remove Trump from office, the market has shrugged the topic off to date. The attacks in Saudi Arabia took half of the country's oil production capacity and 5% of global capacity off-line and were a stark reminder of the vulnerability of critical infrastructure everywhere. Despite dire predictions from the 24-hour news cycle, the interruption has proved temporary and the stock market effects were primarily felt within the energy sector. It turns out that the protests in Hong Kong over a controversial proposed extradition regulation had the most profound effect on the stock

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market, largely leading to the aforementioned weakness in August. The world watched closely as citizens pushed back against this assertion of control by mainland China, fearing that a violent crackdown might ensue as it did in Tiananmen Square thirty years ago. The assumption was that such a response by Chinese authorities would lead to the US retaliating with significant economic sanctions, potentially triggering a global recession.

In contrast to these developments, the handicapping of recession risks is not a new investor pastime. In fact, it has had a consistent and prominent spot on the list of top things investors have fretted about since 2009. Stocks might be driven down by mounting weak data points, but often rebound once it appears likely that the Fed will act with more urgency to support the economy. Stronger data points are usually initially met with some enthusiasm, only to eventually be followed by disappointment that the Fed might be less supportive. And so the cycle repeats itself.

At this time a year ago, stock market investors found themselves in a similar position to where we are today with good returns year to date before a nearly 20% selloff ensued, so it is tempting to ask if history might repeat itself with another challenging fourth quarter? At neither time could the economy be described as teetering on the brink of recession based on available data, but last year the Fed seemed to be missing the signs of slowing that were on display, and forecasted several interest rate hikes for 2019. This disconnect was largely responsible for starting the selloff, whereas this year the Fed has reversed course already reducing rates twice, and continues to signal it is ready and willing to lower rates further.

When it comes to making investment decisions, we try to not focus too much on the question of whether there might be a recession within the next 12 months, because sooner or later one will happen and that one will certainly not be the last. Rather, we ask ourselves whether stocks are likely to appreciate more than other asset classes over the next ten years. We think the answer is yes. While it might be temporarily satisfying to have sold stocks ahead of a recession-related selloff, it is important that clients hold an appropriate amount of cash or shorter-term fixed income instruments that have a more predictable future value, regardless of how optimistic or pessimistic you are about what is to come. With this cushion in place, one should feel less compelled to try to hedge the risk of a possible recession with stock sales, avoiding the difficult task of getting the timing right and the potentially substantial opportunity cost over the longer term.