

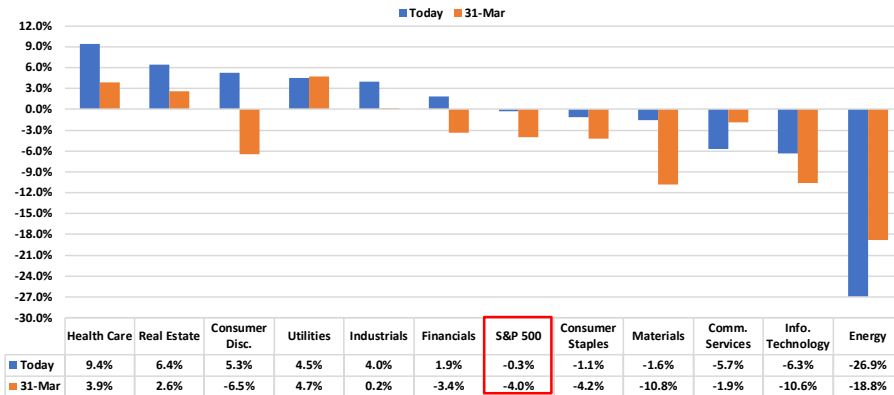
Q3 2019 LOOK AHEAD

Disclaimer

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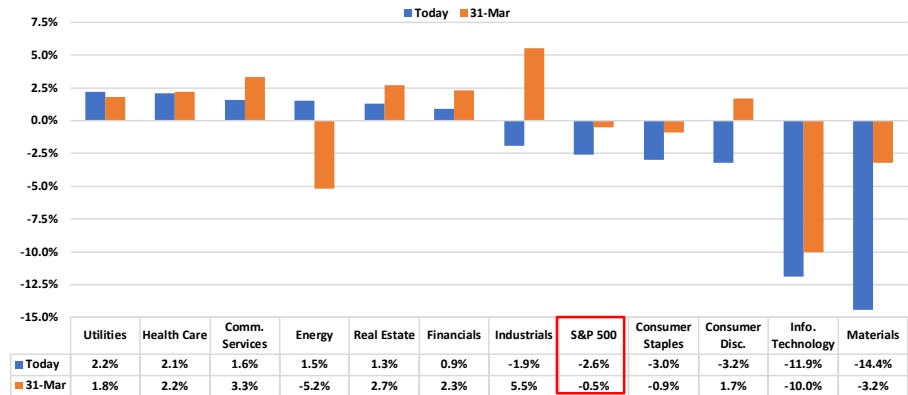
Earnings Recession Maybe

S&P 500 Earnings Growth: Q1 2019



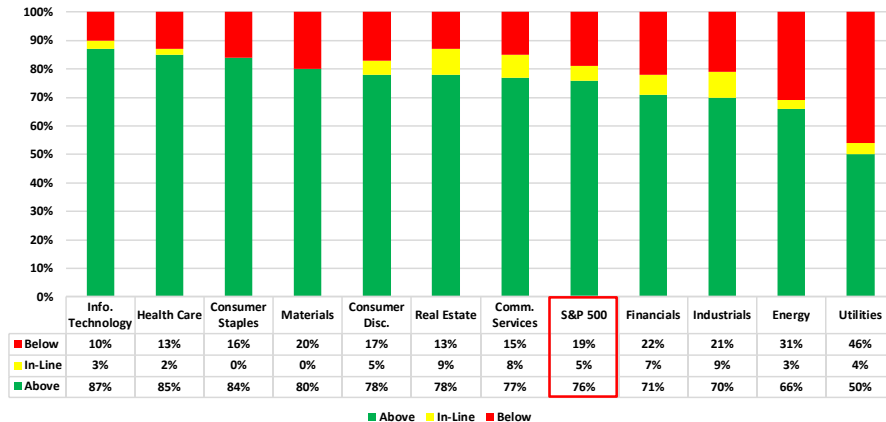
Source: FactSet as of 6/28/2019

S&P 500 Expected Earnings Growth: Q2 2019



Source: FactSet as of 6/28/2019

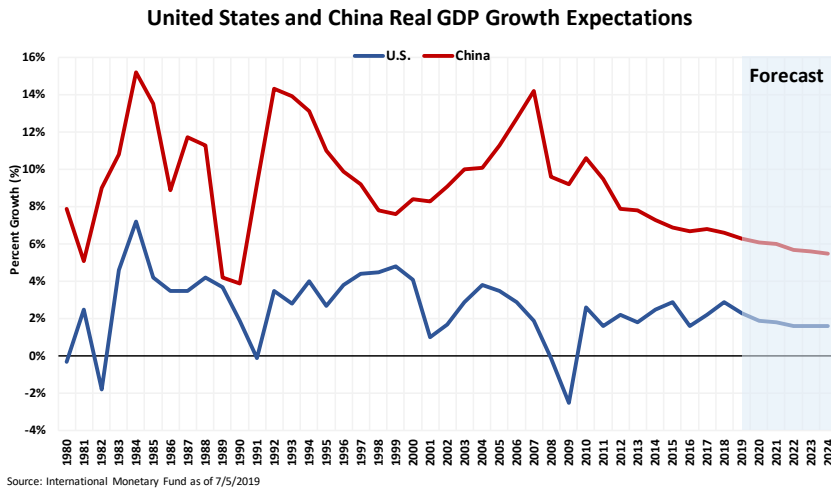
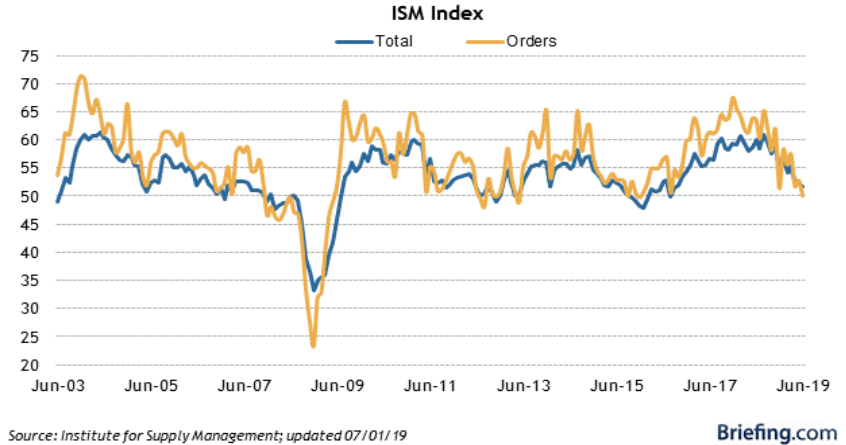
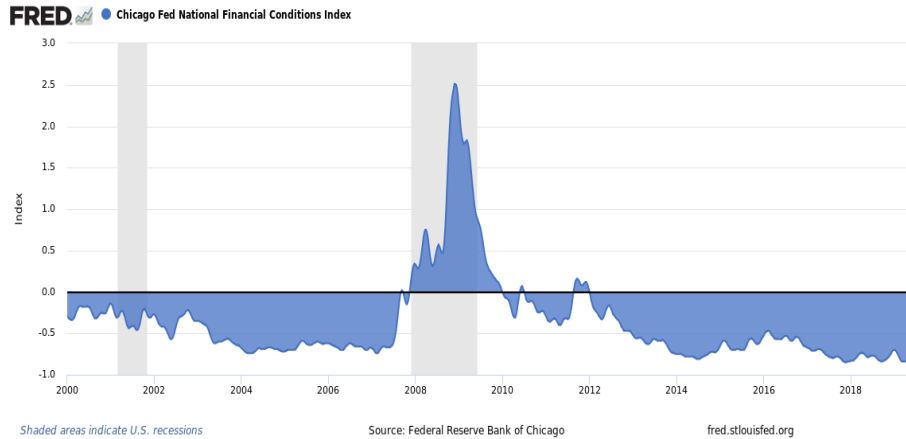
S&P 500 Earnings Scorecard: Q2 2019



Source: FactSet as of 6/28/2019

- ❑ Q2 2019 S&P 500 earnings growth is expected to be negative, which would mark the first time the index has reported two straight quarters of year-over-year declines in earnings since Q1 2016 and Q2 2016.
- ❑ Analysts have made smaller than average cuts to EPS estimates for Q2 2019 to date. On a per-share basis, estimated earnings for the second quarter have fallen by 2.5% since March 31, 2019. This decline is smaller than both the 5-year (-3.3%) and 10-year (-3.3%) averages for a quarter; however, a larger percentage of companies have lowered the bar for Q2 2019 earnings relative to recent quarters. The percentage of companies issuing negative EPS guidance is 77% (87 out of 113), which is above the 5-year average of 70%.
- ❑ We expect earnings to increase back to positive growth in the Q3 2019.

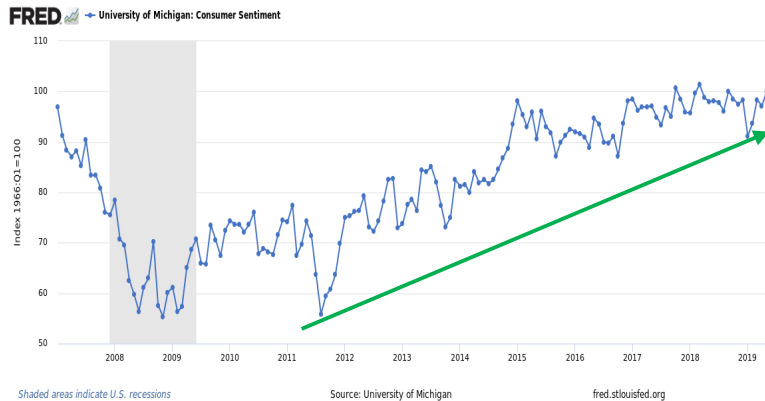
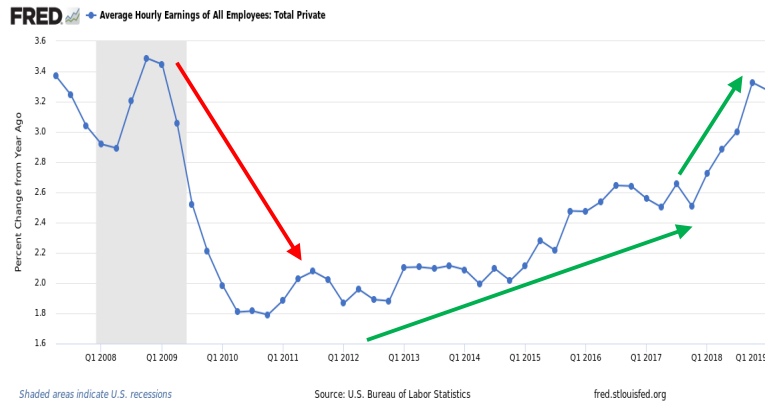
Global Macro Slowdown



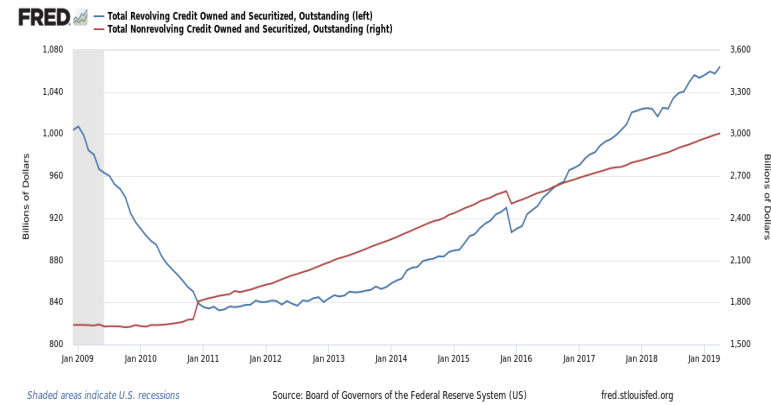
- ❑ **The Financial Conditions Index** supports a slowing U.S. economy heading into the second half of 2019 due to tighter financial conditions and a fading fiscal stimulus.
- ❑ **The ISM Manufacturing Index** for June checked in at 51.7%, down from 52.1% in May, as manufacturing activity continues to weaken. June was the third straight month in which there was a deceleration in the pace of growth. This should capture the Fed's attention as it contemplates a rate-cut decision at its July FOMC meeting.
- ❑ **Chinese economic growth is back in the cards after a sluggish 2018**, but much depends on the outcome of the ongoing trade war and the central bank's ability to inject flexibility into the economy.

U.S. Consumer Strength

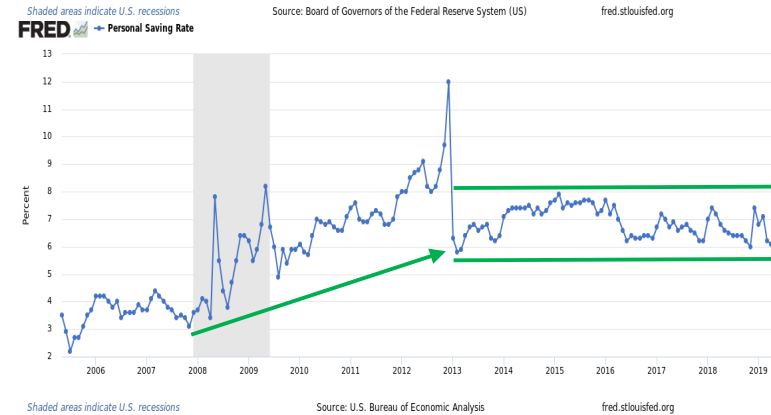
Wage
Growth:
3.28%



Consumer
Sentiment



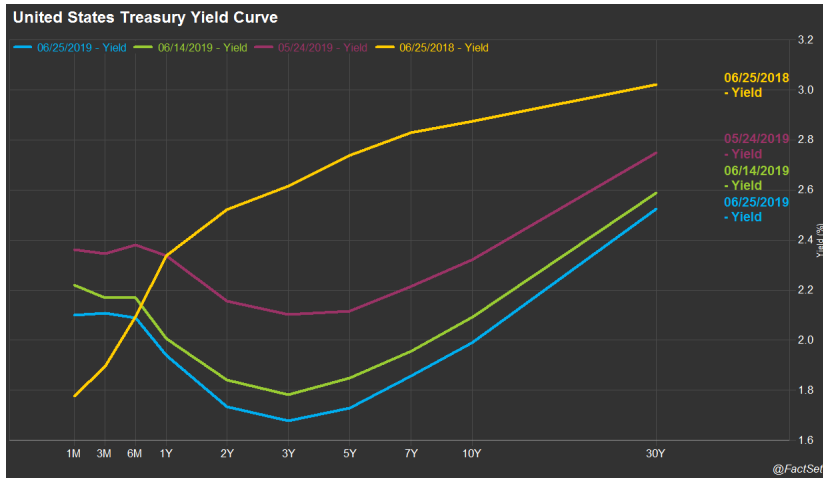
Total
Consumer
Credit
Outstanding



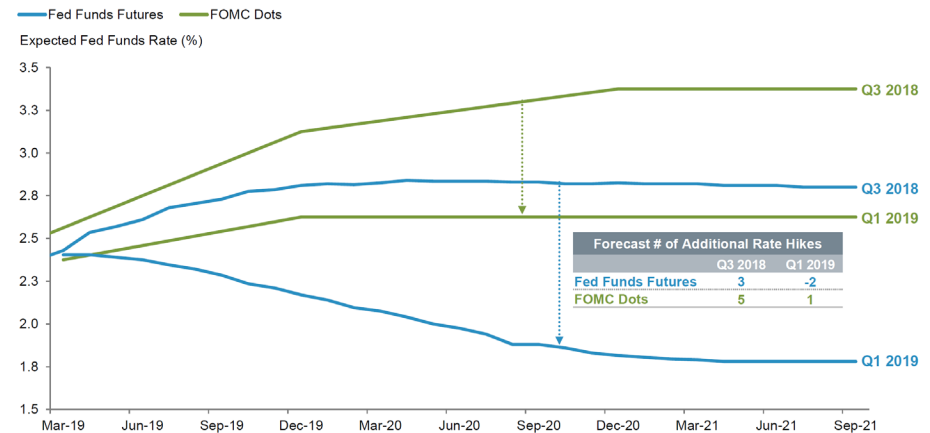
Personal
Savings
Rate remains
range bound

- ❑ **Wage growth continues to increase at a rate above 3 percent**, further supporting the consumers' appetite to spend.
- ❑ **Consumer Sentiment remains at elevated levels.** After seeing a break below trend after Q1, sentiment is once again nearing multi-year highs. We remain cautiously optimistic, with consumers likely to continue their appetite for spending.
- ❑ **After the government change in calculating the Personal Savings Rate, it shows limited declines over the past half decade**, further suggesting that the U.S. consumer has ample room to increase spending; prior to the change in calculation, the Personal Savings Rate matched the lows recorded prior to the Great Financial Crisis.

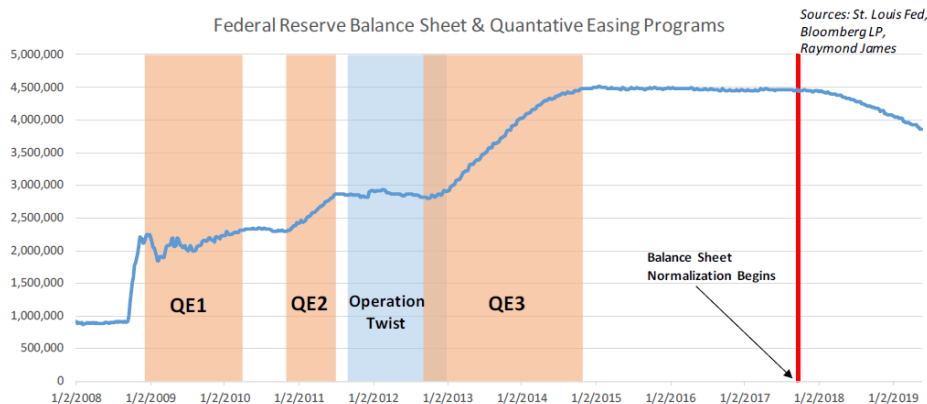
Interest Rates and Trump's Managed Trade War



FOMC vs. Market Expectations of Fed Funds Target Rate

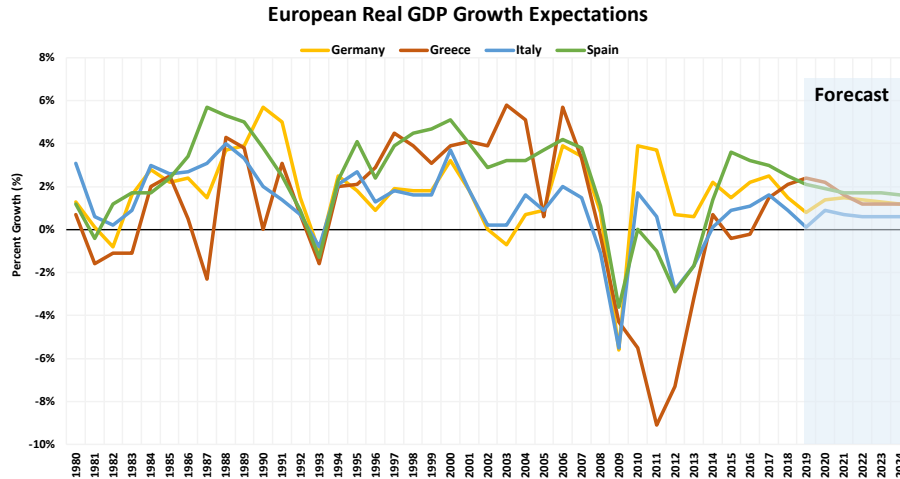


Federal Reserve Balance Sheet & Quantitative Easing Programs

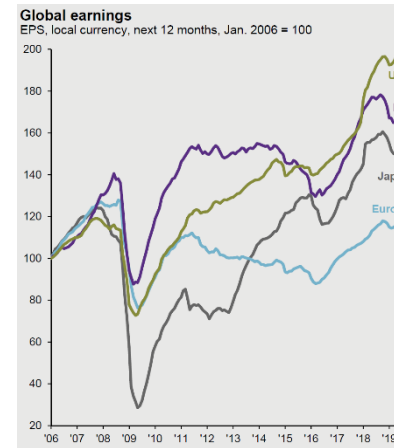


- ❑ **Market expectations are calling for lower rates**, certainly much lower than the Fed has signaled. Between market expectations and multiple trade wars, Trump will likely get what he wants – a round of monetary stimulus that will help his 2020 campaign.
- ❑ **Our expectation is for a “one and done” 50 basis point rate cut.** This anticipated rate cut combined with an economy that – overall – remains in decent shape would temper near-term recession risks and repair the short end of the inverted yield curve.

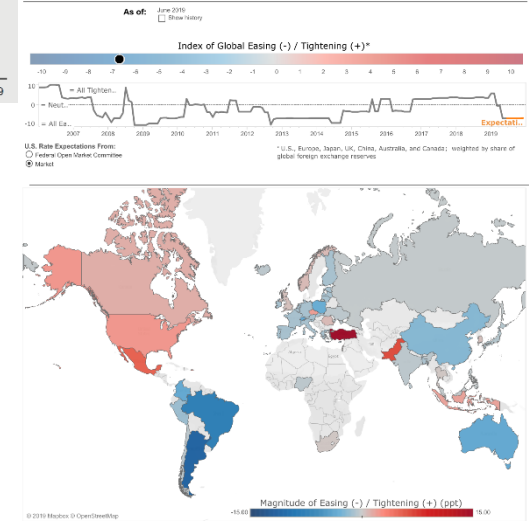
International Developed Markets



Source: International Monetary Fund as of 7/5/2019



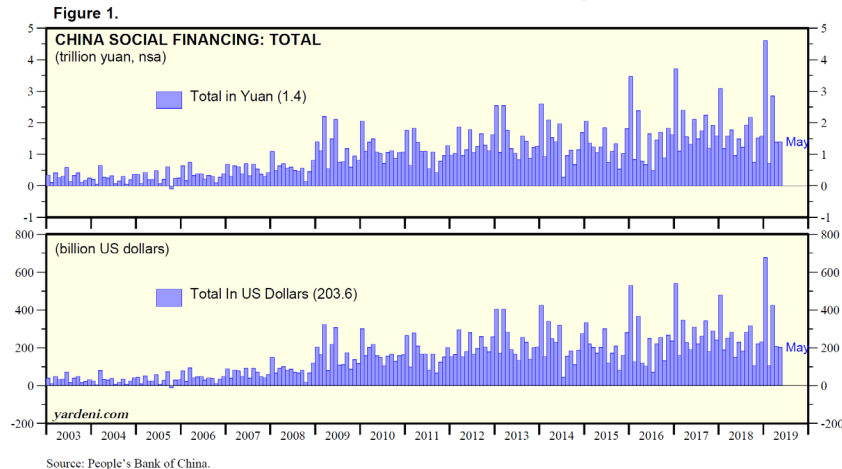
CFR Global Monetary Policy Tracker



- ❑ **Europe is poised for slow growth going forward;** southern European countries like Italy are projected to slow GDP growth to under 1.5% by 2023, and the European Central Bank is responding through continued accommodative interest rate policies
- ❑ **Brexit:** A hard landing will be disruptive to global equity markets
- ❑ **Earnings in Europe have lagged its global counterparts for much of the last decade;** heading into the late innings of the economic cycle, there is no data that supports Europe outperforming its global counterparts
- ❑ **The Trump administration is threatening to introduce new tariffs on EU products worth \$4B in a trade war escalation.** Fresh off reaching a truce in the China trade war, the U.S. Trade Representative's office released a list of products made in the EU that are being considered for additional import duties. They include scotch whiskey, ham and pork, olives, pasta, and popular cheeses.

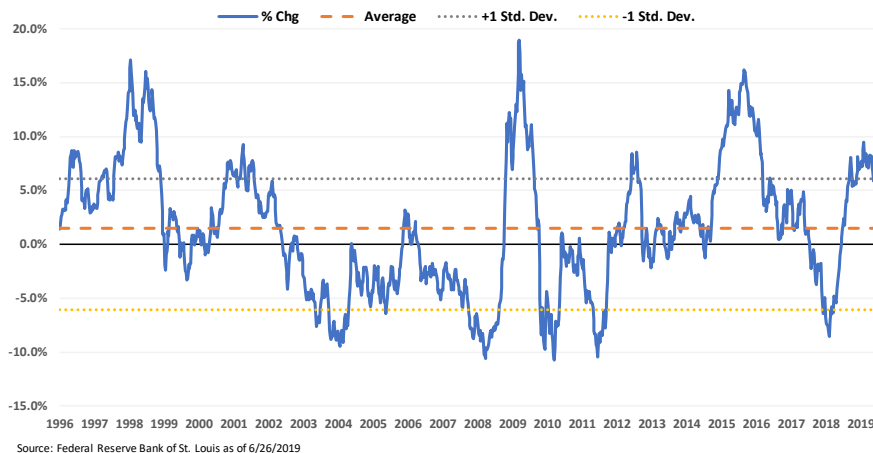
Emerging Markets (EM)

China Social Financing



- ❑ **China added to MSCI indices;** the inclusion of China A-Shares to MSCI indices should greatly increase foreign investment, in addition to bolstering corporate governance, as local companies increase the transparency of their reporting practices and adopt strategies that more firmly consider shareholders' interests.
- ❑ **China has significantly increased social financing levels,** which should calm some of the anxiety about weakening credit growth as the Chinese economy slows.

Mean Reverting the Strength of the U.S. Dollar



- ❑ **Data continues to support a weakening U.S. dollar in 2019** for two reasons:
 1. Using data going back to 1996, the strength of the U.S. dollar has reached a potential inflection point at the one standard deviation level above its mean.
 2. The Federal Reserve is no longer anticipating any additional rate hikes in 2019, further supporting the case for a weakening U.S. dollar.
- ❑ A weakening U.S. dollar will make interest payments cheaper for Emerging Market countries with dollar denominated debt.

Mean Reversion Dashboard

Style Current P/E as a % of 20-Yr Avg. P/E

	Value	Blend	Growth
Large	103.3%	106.8%	107.7%
Mid	102.4%	106.0%	107.3%
Small	88.5%	103.7%	123.3%

Regional Fwd P/E as a % of 10-Yr Avg. Fwd P/E

ACWI	EAFE Index	EM Index	United States	Germany	United Kingdom	China	Brazil	India	Russia
104.2%	97.6%	99.1%	110.5%	99.4%	97.2%	91.5%	96.1%	105.0%	78.5%

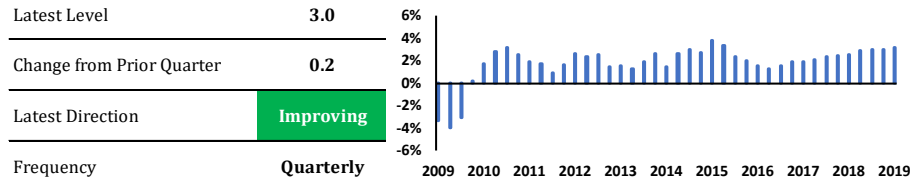
Sector Fwd P/E as a % of 20-Yr Avg. Fwd P/E

Materials	Industrials	Financials	Energy	Consumer Discretionary	Technology	Comm. Services	Real Estate	Health Care	Consumer Staples	Utilities
124.5%	99.4%	94.4%	93.1%	118.4%	95.0%	97.3%	125.3%	93.3%	114.3%	131.5%

Economic Dashboard

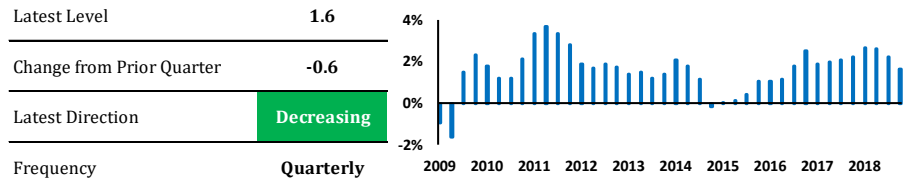
U.S. GDP Growth

As of 12/31/2018



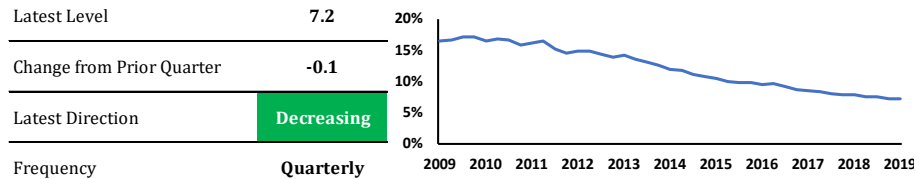
U.S. Inflation

As of 12/31/2018



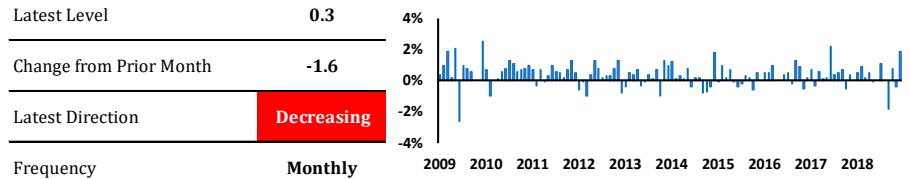
U.S. U-6 Unemployment Rate

As of 3/31/2019



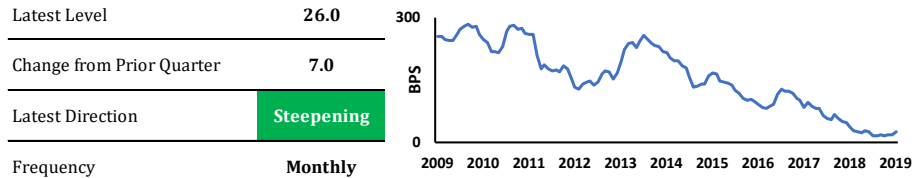
Retail Sales

As of 3/31/2019



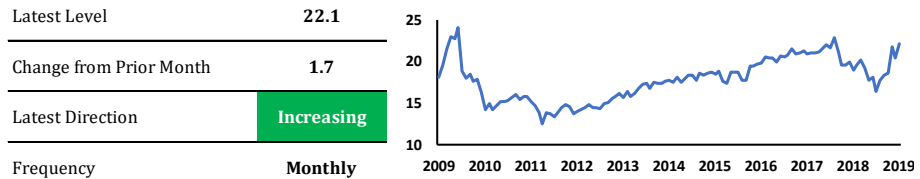
U.S. Treasury Spread 2-Yr vs. 10-Yr Spread

As of 6/30/2019



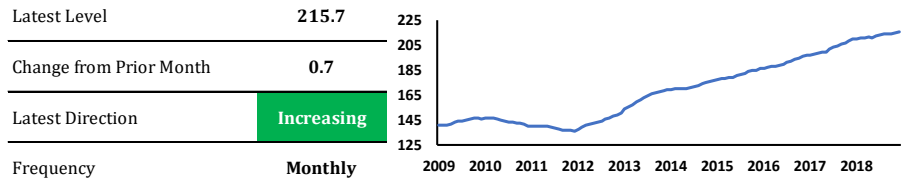
S&P 500 P/E Ratio

As of 6/30/2019



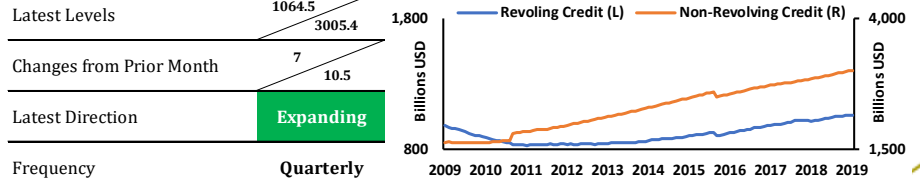
Schiller Home Value Index

As of 4/30/2019



Credit: Revolving / Non-Revoving

As of 4/30/2019



Our View and Recommendations

Our View

- ❑ Expect risk assets to start pricing in better Q3 earnings-per-share growth.
- ❑ A rally in Chinese equities should recommence as the Trade War overhang is lifted.
- ❑ Expect a “one and done” 50 basis point cut to the Federal Funds Rate.
- ❑ We expect to see the Quantitative Easing policies of the last decade being re-examined.
- ❑ Developed Markets will continue to languish, with Brexit and slowing economies being the dominant forces.
- ❑ Emerging Market economies should strengthen on better earnings and forward-looking valuations.
- ❑ Central banks around the world will continue to act as a safety net for slowing economies.
- ❑ With forward-looking returns getting smaller by the day, investors are likely to stretch for return through private equity and other U.S. growth assets.

Recommendations

- ❑ Investors should maintain a slight overweight allocation to Emerging Markets and Chinese equities.
- ❑ We recommend shortening overall bond durations in relation to benchmarks, as the short-end of the yield curve normalizes.
- ❑ U.S. Small Cap Value stocks should offer compelling mean-reverting opportunities compared to Mid and Large Cap names.
- ❑ Continue to tilt to yield as rate cuts will support the Utilities, Energy, and Telecom sectors of the economy.

THANK YOU

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