First Commonwealth Advisors

Loyd Johnson,
Chief Investment Officer

Monthly Review

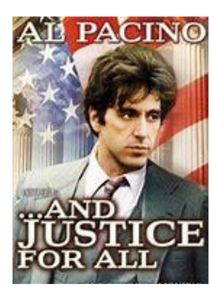
August: "There's Something Really Wrong Here"

Asset Class	Index	August	3 Month	YTD	1 Year	3 Year	5 Year
US Large Cap	S&P 500 Index	-1.58	6.87	18.34	2.92	12.70	10.11
US Mid Cap	Russell Mid Cap Index	-2.90	5.17	19.19	0.02	9.50	7.41
US Small Cap	Russell 2000 Index	-4.94	2.37	11.85	-12.89	7.89	6.41
Int'l Developed	MSCI EAFE (Europe, Australia, Far East)Index	-2.59	1.88	9.66	-3.26	5.91	1.89
Int'l Dev. Small Cap	MSCI Developed Market Small Cap Index	-2.47	0.95	8.99	-9.16	5.99	4.26
Emerging Markets	MSCI Emerging Markets Index	-4.88	-0.17	3.90	-4.36	5.76	0.38
US Inv Grade Taxables	Bloomberg Barclays US Aggregate Bond Index	2.59	4.11	9.10	10.17	3.09	3.35
US Inv Grade PA Munis	Bloomberg Barclays PA Municipal Bond	1.75	3.01	8.30	9.55	3.73	4.18
US Inv Grade Nat'l Munis	Bloomberg Barclays National Municipal Bond	1.58	2.77	7.61	8.72	3.30	3.85
High Yield Bonds	Bloomberg Barclays US Corporate High Yield Index	0.40	3.27	11.00	6.56	6.17	4.85
Bank Loans	S&P/LSTA Leveraged Loan TR	-0.27	0.77	6.30	3.33	4.66	3.76
Emerging Market Bonds	JPMorgan Emerging Market Bond Index (USD)	0.55	4.80	12.49	13.11	4.08	4.66
US Real Estate	Wilshire US REIT TR USD	3.34	6.46	23.78	12.03	5.48	8.26
Int'l Real Estate	Wilshire Ex-US REIT TR USD	0.82	2.96	13.25	6.42	5.33	3.73
Commodities	S&P GSCI Commodity Index	-5.62	-1.65	6.74	-14.52	2.33	-13.14
Cash Equivalents	Merrill Lynch 3 Month Treasury Bill	0.21	0.61	1.63	2.36	1.50	0.95

A Look Back

This was a line from one of my favorite Al Pacino movies, *And Justice for All*. Pacino played Arthur Kirkland, a wide-eyed, idealized defense attorney trying to make his way in a somewhat perverse judicial system. The film was released in 1979, and as a 16 year-old high schooler, it made a distinct impression. In the same way that Arthur thought things were out of whack, several market indicators seem so too recently. Large cap Domestic stocks continue to lead the way in the equity classification, with the S&P 500 down -1.58% in August. Even with the negative month, the much-followed index is up over 18% YTD. Given the headlines regarding tariffs and the slowing global economies of late, it sure doesn't feel like it, does it? Smaller-Cap stocks and International Equities continued to lag in the month, and in the case of Emerging Markets, trail by over 14% so far this year. You typically do not see that kind of divergence over an eight month period. Conversely, Fixed Income securities performed very well in August. The bell weather Bloomberg Barclays Agg was up **2.59%** in just one month, and is now up **9.1%** in 2019. For perspective, the 20 year annualized return for the Agg is around 5%. Another, seemingly "wrong" occurrence during the month was the much talked about inversion of yield curve. Specifically, many economists and market strategists refer to the relationship between the 2 and 10 year Treasury. Typically, like most traditional fixed income securities, buyers demand a higher yield for longer dated securities to compensate them for increased risk of the longer time frame. In August, buyers, seeking the safety of longer-dated U.S. debt, pushed the yield of the 10 year Treasury below 1.5%, and below the yield of the 2 year Treasury…creating the inverted yield curve. So, what is the importance? This inversion of the 2/10 year yield has preceded every recession in the U.S. since the 1960's. However, it doesn't tell us much about the timing. In fact, the median span from inversion to recession historically was 17 months—with a range of 10 to 24 months.

A Look Ahead



The look ahead is always difficult, and even more so now. In addition to the yield curve inversion, we saw something happen for the first time ever. The yield on the 30 year U.S. treasury fell below 2%. Part of the reason is that even at these historically low levels, they represent a better yield than much of the developed world. Japan's 30 year yield stands at .13% currently, and Germany's is at -.03%! As we've discussed in past writings, economies here and around the world are slowing down. Manufacturing numbers are coming in, as the tariff war between the U.S. and China drags on and companies are delaying capital spending because of the uncertainty. However, the most recent retail sales number surprised to the upside in July with a robust reading of .7% month-over-month. We expect increased volatility to remain in the markets for the foreseeable future, as we look for some of the current wrongs to get right…and Al won't have to say, "You're out of order, this whole market is out of order!"