



MIDWEST CAPITAL
ADVISORS™

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To Our Clients and Friends:

We are pleased to bring you our report for the second quarter of 2019.

Equities continued their remarkable run in the second quarter¹. The S&P 500 index's returns, which reached an all-time high, were the best since 1997, and June's 7.2% return was the best June performance since 1938². European stocks' return of 14% was their best first-half performance since 1998³. Bonds also did well in the quarter, with the Bloomberg Barclays U.S. Aggregate Bond Index returning 6.11% for the year⁴.

Stocks have paused or retreated periodically on their way to current levels and continue to do so even on seemingly small news, rumors or tweets. This is not surprising since the S&P 500 index is up in the first *six months* of the year by an amount almost twice as great as its average *annual* return since inception (~10%), and the S&P 500 index has returned full year gains of 18%+ only 29 times since 1930. If the stocks returned 0% for the rest of 2019, it would be a great year, which has some pundits saying the markets have no place to go except down. And, while many point to the fact that the third quarter typically is not

as strong as other quarters, this is not a given⁵. While reversion to the mean is a valid statistical concept, it alone does not mean the market is going to falter in the second half. Its ability to sustain its climb is far more dependent on the various headwinds and uncertainties it faces. Let's take a look at a few of these.

The Economy This month the current U.S. economic expansion enters a record 11th year. The U.S. economy showed signs of slowing in the first half of 2019 due primarily to the fading impact of the 2017 tax cuts and the broader slowdown in the global economy, which is due in part to trade tensions⁶. However, none of the cyclical sectors (e.g., autos, housing, business investment spending or inventories) appear to be over-extended, nor does there appear to be any particularly concerning areas of financial excess⁷. Furthermore, the Fed appears to have finished raising rates for the foreseeable future, and its next move is likely to be a cut⁸ (more on this below).

Today's jobs report far exceeded expectations. The Labor Department announced 224,000⁹ new non-farm jobs were added in June¹⁰, whereas the market was expecting only 165,000. Not surprisingly,

¹ The S&P 500 index was up 18.5% and the MSCI World ex-USA index gained 15.11%, both including dividends. Source: Dimensional Fund Advisors.

² Source: CNBC.

³ Source: Bloomberg

⁴ Not only that, U.S. corporate investment grade bonds returned 9.7% in the first six months of the year, a record. Source: Bloomberg

⁵ In fact, as we observed in our Q3 2018 letter, the S&P 500 had its best quarter in five years in the third quarter of 2018.

⁶ Source: J.P. Morgan.

⁷ Id. Or, in the words of J.P. Morgan's Chief Strategist, David Kelly: "Without a boom it's hard to generate a bust."

⁸ The *timing* of any cut, however, is crucial to the equity markets as they seem to have already priced in a cut. If that does not happen (the next Fed meeting is July 30-31), markets could retreat in disappointment.

⁹ Source: Bureau of Labor Statistics.

¹⁰ This came on the heels of a tepid gain of only 72,000 jobs in May.

the market was at least confused by (and at worst worried about) the huge number. Why? The market has priced in a Fed rate cut and such a robust job number could mean the economy is doing just fine without a rate cut. Most experts, however, see employment as only one of many factors that the Fed is watching (inflation, trade and earnings being a few of the others – more on this below) and believe that, by itself, a stellar jobs report is not inconsistent with a possible rate cut¹¹. Interestingly, even with employers having a difficult time in attracting and retaining workers, they have become adept at holding the line on wage inflation¹², which suggests that higher wage inflation may not materialize.

Trade July 6 will mark the one-year anniversary of China's imposition of tariffs on U.S. farm goods. This has cost American soybean growers their biggest customer and, while prices have recovered much of their losses, some of this is due to record rains that disrupted planting. While this is only one example, it is widespread and affects the livelihood of not only a great number of Americans, but large geographic areas (essentially most of America's heartland) as well¹³. A resumption of trade talks is the scenario that seems to have emerged from the June G20 meetings in Japan. But, the statements that came from that meeting suggesting no additional tariffs are just comments and speculation, and there is precedent for both President Trump and President Xi posturing and re-posturing¹⁴, something that is not good for markets, which seek relative certainty. China's economy has recently shown signs of slowing,

however, which may make the Chinese more likely to agree to a trade deal.

Interest Rates While the Federal Reserve did not cut interest rates at its June meeting it did say it is considering doing so at its July meeting. Despite the robust jobs report, persistently low inflation,¹⁵ decelerating U.S. economic growth, rising trade tensions and global economic weakness all point toward the Fed taking a relatively dovish stance on interest rates.

Earnings U.S. companies will report second-quarter earnings later this month, which will provide investors with a clearer picture of the health of the economy¹⁶. Earnings growth has been ebbing since peaking in the third quarter of 2018¹⁷. Ironically, equities finished 2018 in the red, primarily due to fears of slowing earnings growth, whereas in the midst of those expectations are coming to pass, U.S. stock market benchmarks hit all-time highs this past week.

As the foregoing illustrates, directions of the markets and interest rates are going to be most affected, if not determined, by, a variety of factors, none of which are known or can be predicted with any degree of certainty. This can produce volatility, which sometimes can be significant. The best way to navigate these uncertain outcomes is to have a financial and investment plan that not only maximizes the chances of reaching your financial goals, but also gives you the confidence to stick with it through difficult times. It is relatively easy to stay the course

¹¹ The Labor Department's long history of making revisions (sometimes significant) to jobs estimates in later months is also well known and is likely to discount the impact of the June report somewhat.

¹² From May 2018 to May 2019, wages for production and non-supervisory workers climbed a healthy, but still relatively modest, 3.4%, not that much higher than inflation at the consumer level. Source: J.P. Morgan.

¹³ In a sobering prediction, the USDA projects that U.S. soy exports won't reach pre-tariff levels until 2027.

¹⁴ Readers may recall this behavior following the G20 Summit in Buenos Aires in December.

¹⁵ In May, the Personal Consumption Expenditure (or PCE) price index, the Fed's preferred inflation measure, was up only 1.6% year over year, 20% below the Fed's target of 2%.

¹⁶ According to CNBC, 77% of companies have issued pre-announcements saying profits will be disappointing.

¹⁷ According to Ned Davis Research, profits reached a high of \$2.321 trillion in the third quarter of 2018 and fell to \$2.252 trillion in the first quarter of 2019, a drop of approximately 3%.

in years with above-average returns but periods of disappointing results can test investors' faith in the equity markets. Regular readers know we always remind our clients that successful financial outcomes require a good plan and disciplined adherence to that plan¹⁸. An asset allocation that aligns with personal risk tolerances and investment goals is also valuable. By thoughtfully considering these and other issues, investors may be better prepared to stay focused on their long-term goals during different market environments. We are here to help you with not only the design, implementation and execution of a financial plan, but also the intestinal fortitude to reach the finish line.



Did you know that Midwest Capital Advisors has a presence on social media? Follow us on [LinkedIn](#) and [Facebook](#) for both informative and fun updates.

¹⁸ Legendary investor Warren Buffett puts it this way: “The best way to measure your investing success is not by whether you’re beating the market but by whether you’ve put in place a financial

plan and a behavioral discipline that are likely to get you where you want to go.”