AUGUSTINE
ASSET MANAGEMENT

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July 2019

MARKET SUMMARY

Equities

MSCI AC World	523.4
Price / Earnings	17.5x
Dividend Yield	2.5%
S&P 500	2,942
Price / Earnings	19.3x
Dividend Yield	1.9%

US Treasury

2 Year Yield	1.8%
10 Year Yield	2.0%
30 Year Yield	2.5%

US Corporate Spreads

Investment Grade	1.3%
High Yield	4.6%

Equity Volatility

CBOE SPX Volatility	15.1

US Economic Figures

GDP Growth 1Q19	3.1%
Unemployment	3.7%
Inflation (core)	2.1%
Fed Funds Rate (mid)	2.4%
3 Month LIBOR	2.4%

Commodities

Oil (Brent)	$66.55
Natural Gas	$2.31
Copper ($/lb.)	$2.71
Gold ($/oz.)	$1,410

Foreign Exchange

Euro	$/€	1.14
Japanese Yen	¥/$	108
Chinese Yuan	元/$	6.87

Market summary data as of:
June 30, 2019

When Doves Cry

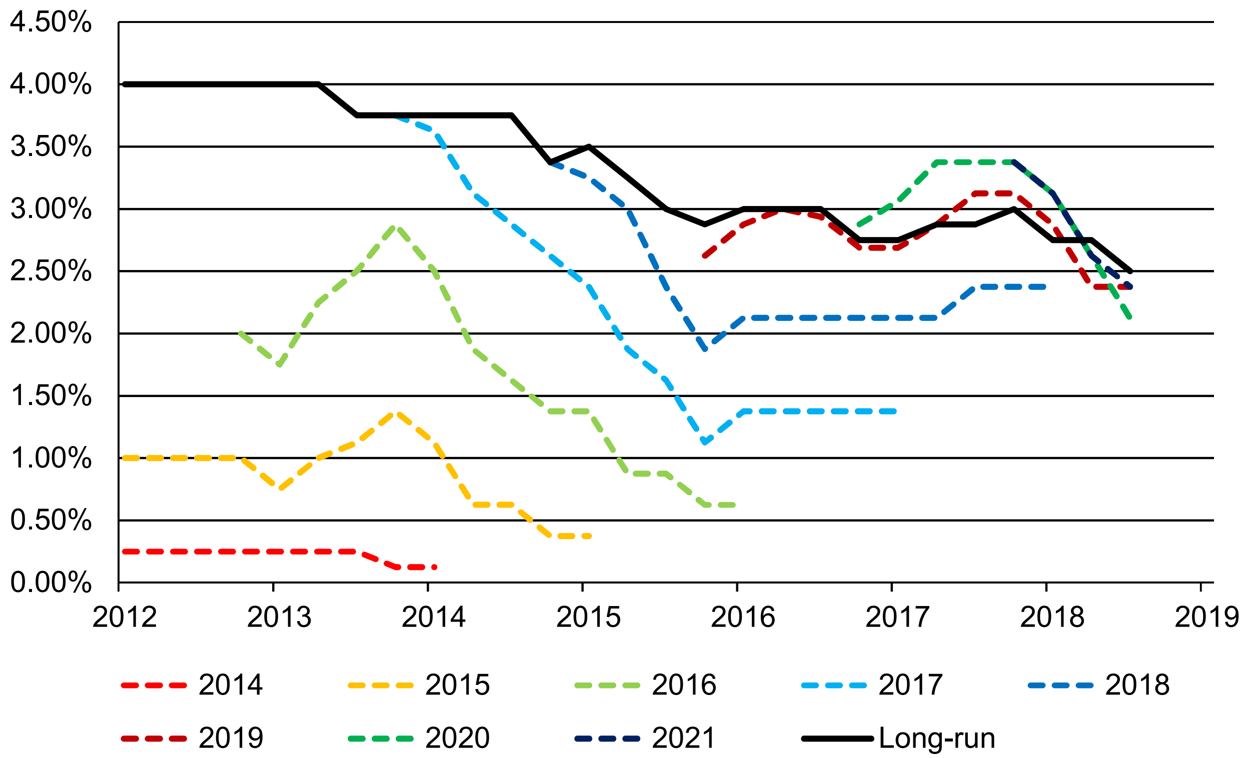
The great American founding father, Benjamin Franklin, is well known for wisdom expressed with simplicity and often humor. One of our favorites is the axiomatic “an ounce of prevention is worth a pound of cure”. Franklin was also an early proponent of expansionary monetary policy in colonial Pennsylvania, noting that “a plentiful currency will occasion interest to be low..and…will tend to enliven trade exceedingly”.

Capital markets around the world and across the major asset classes rose during the June quarter as central banks channeled Franklin’s view by continuing a recent dovish shift toward renewed policy easing.

Our April letter *Hair of the Dog* chronicled the Fed’s shift from tightening to a “patient” stance holding rates steady and announcing no further reductions to its balance sheet. A fresh round of subsidized loans from the European Central Bank made the move globally united.

Citing low inflation and risks to the economy from disputed trade policies, central banks are now eying the proverbial ounce of prevention as a possible step to provide fresh stimulus and lengthen the record-long economic expansion. The Fed appears no longer "patient" and intent on reducing interest rates as soon as this month, and the ECB has suggested it will cut its already-negative policy rate or restart its bond-buying stimulus program. As seen in Exhibit 1, which shows the historical evolution of Fed rate projections, the turn from tightening to patient to renewed easing has been completed in a quick six months.

Exhibit 1: Federal Reserve "Dot Plot" Median Year-End Fed Funds Rate Forecast



Prices of financial assets have risen as investors cheered the monetary underwriting of risk. The quick turn in central bank stance, however, raises the question of why the sudden change of policy, described as too loose and "a far way from neutral" last autumn but now as too tight and in need of easing.

The explanation supportive of prices for riskier financial assets has the Fed acting on an abundance of caution and perhaps in response to politically-motivated presidential hectoring of the FOMC and its chairman in demand for lower rates. In that scenario, rate cuts are of the nice-to-have rather than the need-to-have variety, are not countering imminent recession, and simply produce a higher present value of future earning whose outlook is undiminished.

Easier policy can also be explained less auspiciously as needed to soften the blow of a quickly deteriorating economic outlook. Such lower rates would portend lower stock prices and wider corporate bond spreads as lower earnings and lower valuation multiples produce a cyclical bear market.

Which view is correct? Equity markets are pricing in the optimistic scenario, interest rate markets reflect the pessimistic stance, while economic data suggest a centrist view. As seen in Exhibit 2, global equities have rallied in response to central bank policy, nearly reclaiming the record high of last year, as rates throughout the bond market have fallen precipitously. Meanwhile, Exhibit 3 shows the fundamental picture as slowing but not at risk of near-term recession.

Exhibit 2: Equity Markets Glass Full & Interest Rate Markets Glass Empty

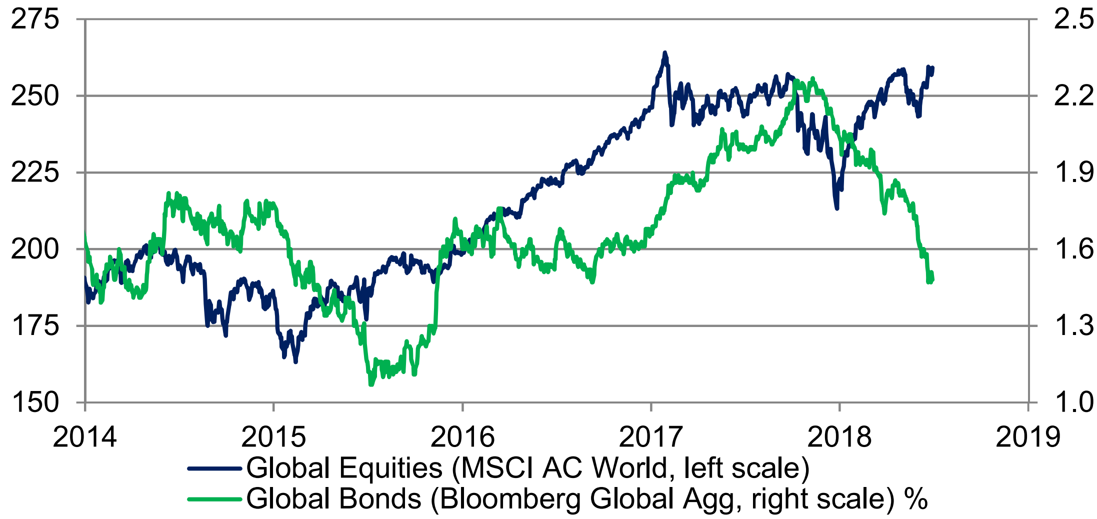
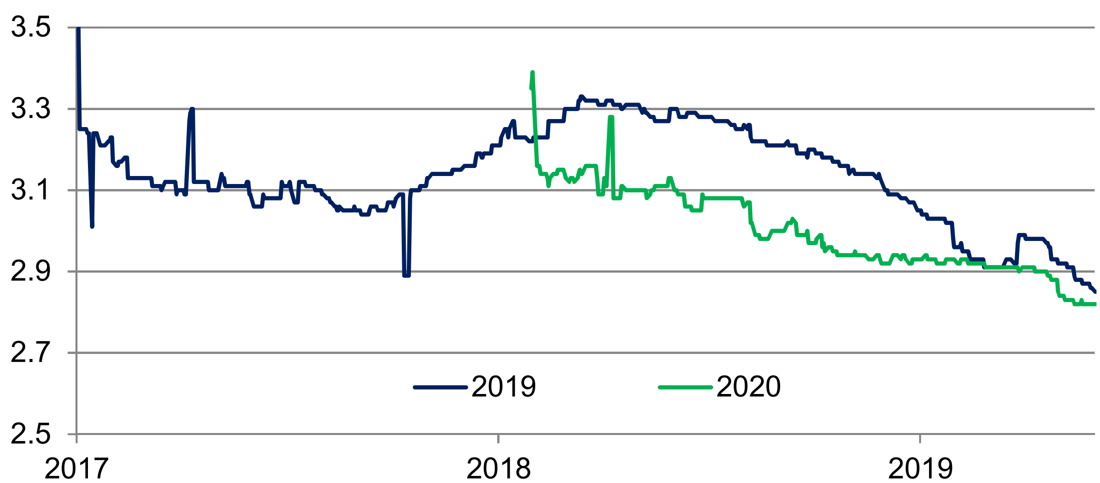


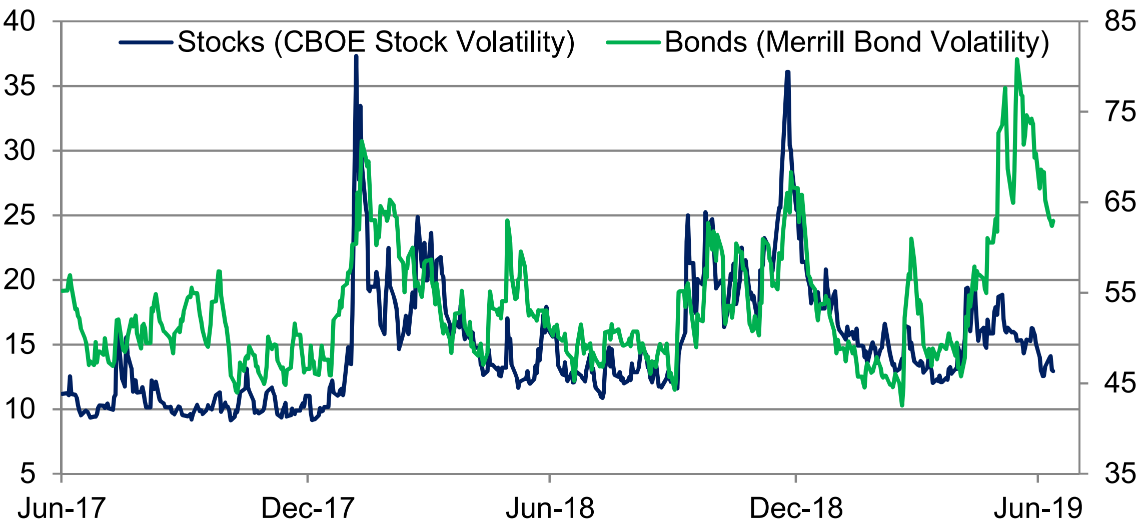
Exhibit 3: Slowing But Not Pre-Recessionary Consensus Global Growth Outlook %



While risk to the economic cycle has risen in recent months, we have yet to witness signs that suggest mounting recessionary forces. Leading indicators published by the Conference Board domestically and the Organization for Economic Cooperation and Development globally corroborate the slowing but still growing scenario, as does a robust labor market that has low unemployment, low initial unemployment claims, and hourly wages rising faster than inflation.

Based on the slower but still positive signals for the economy and earnings, we see the ebullience in equity markets as potentially overestimating the extent to which monetary support will be applied and the dramatically lower interest rates in bond markets as possibly underestimating the current growth dynamic. Volatility measures appear to confirm this view, with equity market volatility showing signs of complacency and bond market volatility showing signs of stress (see Exhibit 4). Lower rates may prove to be either temporary or indicative of a growth problem such that they serve as a warning sign for stocks rather than a justification for higher valuations.

Exhibit 4: Divergence in Stock & Bond Market Risk Measures



As such, we see equity holdings focused on companies with relatively higher return on invested capital and lower earnings variability as appropriate in the current late-cycle, high optimism environment and favor short and medium term bond holdings that capture well-vetted credit premia in lieu of lengthy maturities in a market offering scant term premia.

Furthermore, we see hedges to loose monetary policy, such as gold, as increasing in value in a time when central banks appear unable to return to historically normal policies and more interested in driving inflation higher.

As noted since disputes between the US and its major trading partners began last year, we see uncertainty around trade policy as the major risk to the outlook. The inevitable protracted nature of negotiations is taking a toll on corporate sentiment and willingness to commit to capital investment. A drawn out escalation of tariffs could affect sentiment enough to tilt the outlook closer to recession and would warrant a more defensive posture in asset allocation and within stock and bond portfolios. We will monitor these developments closely.

Exhibit 5: Trade Policy Uncertainty at New High…

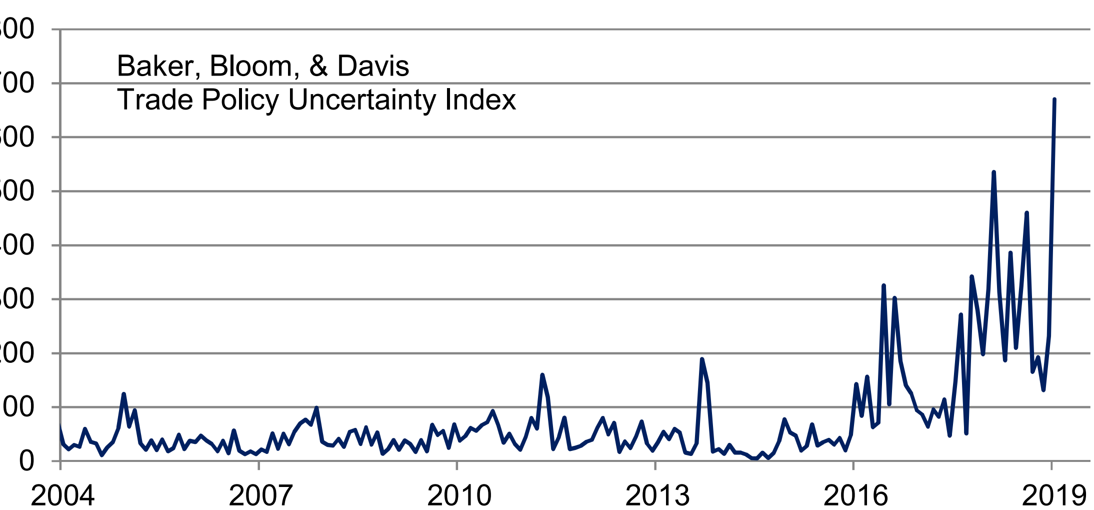
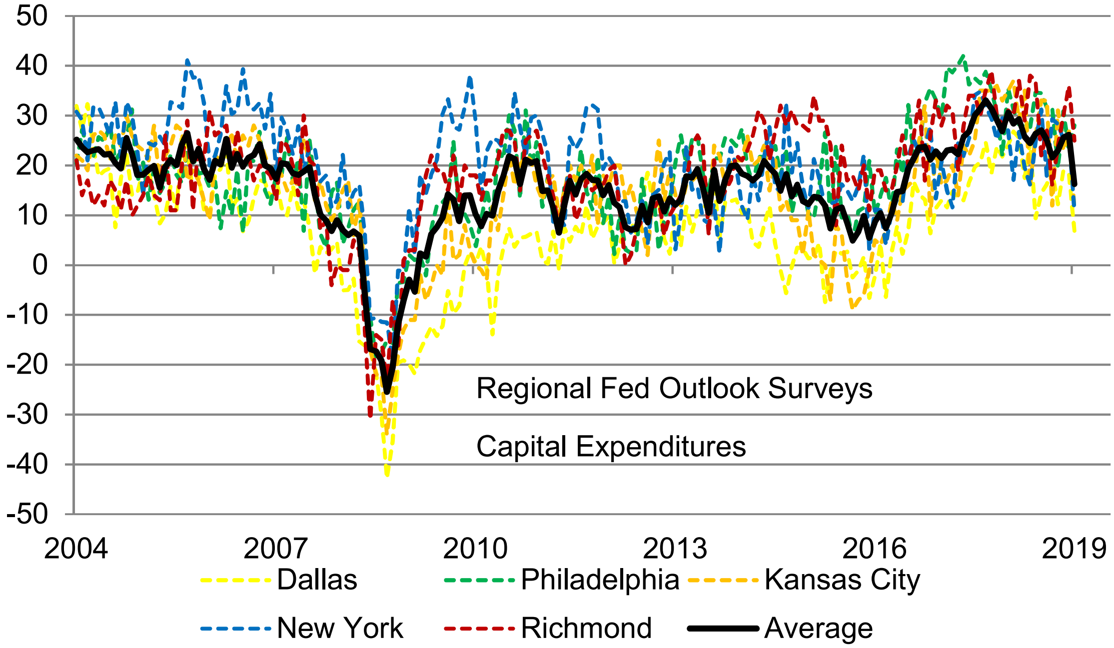


Exhibit 7: …Negatively Affecting Capital Spending Plans



We appreciate your trust in our management of your capital and would welcome further discussion of our outlook and the strategy reflected in your portfolio. Please contact us with any questions. We welcome your call or email.

Best regards!

Jeffrey E. Bernardo CFA

Gregory M. Estes CFA

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Chart 1: S&P 500 Index

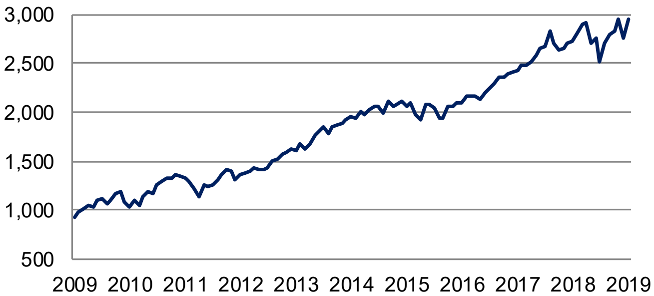

Chart 6: US Unemployment Rate %

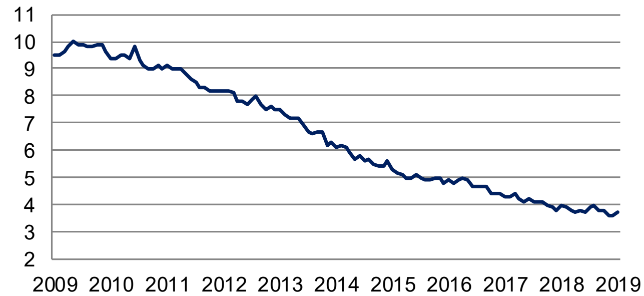

Chart 2: US Treasury 10 Year Yield %

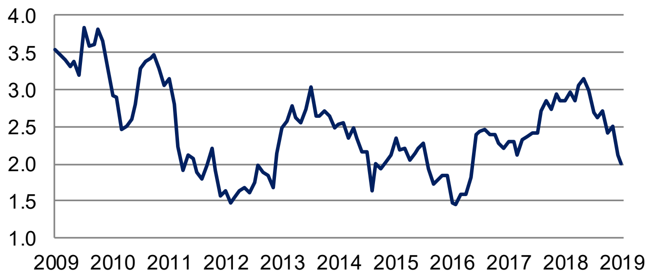

Chart 7: US Consumer Confidence Index

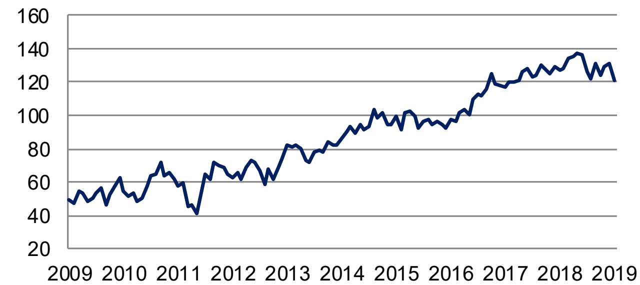

Chart 3: US Annualized GDP Growth %

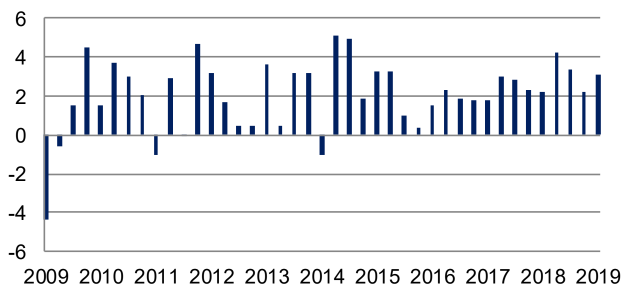

Chart 8: US Retail Sales Growth %

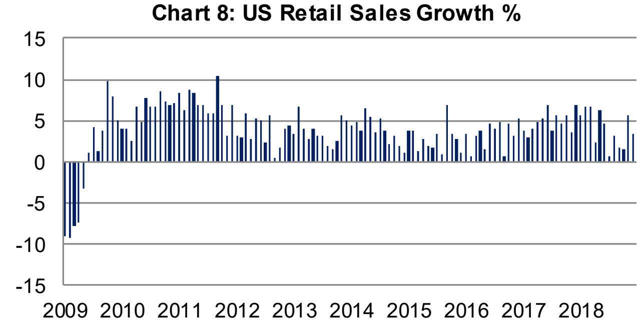

Chart 4: US Core Consumer Price Index %

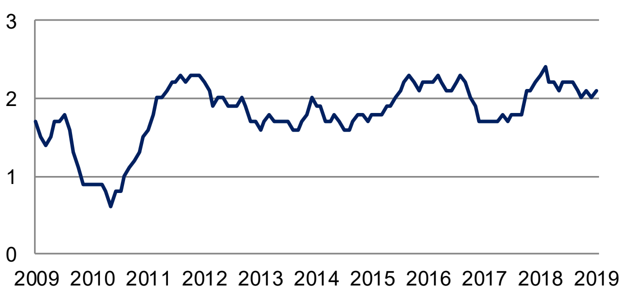

Chart 9: US ISM Manufacturing Index

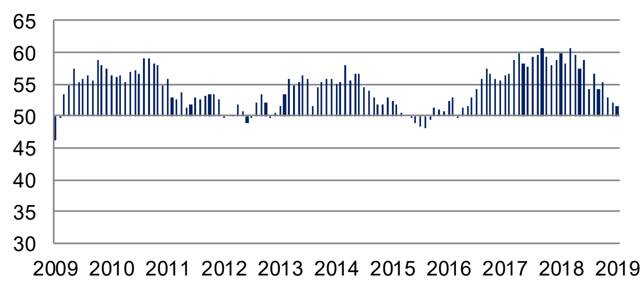

Chart 5: Trade-Weighted US Dollar Index

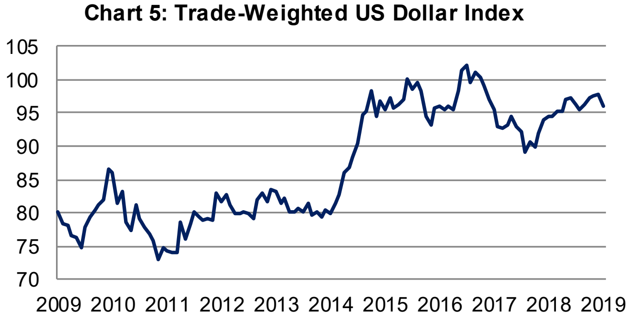

Chart 10: Conference Board Leading Index