WEALTH MANAGEMENT 360
FARMERS TRUST COMPANY

Market Update and Outlook for Fourth Quarter 2019

Company Profile

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options.

We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well.

Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

Market Recap and Outlook Third Quarter 2019

MARKET SCORECARD as of 09/30/2019	TOTAL RETURN IN USD	
	Q3	2019 TR YTD
DOW JONES IND AVG	1.83%	17.51%
S&P 500	1.70%	20.55%
NASDAQ	0.18%	21.56%
MSCI EAFE EQUITY (GROSS)	-1.00%	13.35%
RUSSELL 2000 INDEX	-2.40%	14.18%
MSCI EMERGING MARKET EQUITY (GROSS)	-4.11%	6.22%
BARCLAYS INTERM. TREASURY	1.18%	5.22%
BARCLAYS INTERM. GOVT/CREDIT	1.37%	6.41%
BARCLAYS 5 YEAR MUNI INDEX	0.54%	4.37%
BARCLAYS HIGH YIELD CORP INDEX	1.33%	11.41%
ishares S&P GSCI COMMODITY TR INDEX	-4.18%	8.61%

Note: All returns include invested cash flows expressed in U.S. dollar terms

Market Recap

Equities survived a somewhat rocky third quarter with the widely followed S&P 500 index of large U.S. stocks managing to eke out a total return of roughly 2%, closing out Q3 at 2,976.74. That puts the index up nearly 20% thus far in 2019, which has been a welcome recovery from the sharp drop stocks experienced at the end of last year. Small company stocks have lagged (as measured by the Russell 2000 Index) and are up 14.18% over the same time frame. Although volatility returned in the summer months, domestic equity markets have shown impressive resiliency and climbed a "wall of worry" by defying many market skeptics calling for a more pronounced decline in asset values. The U.S./China trade dispute continues to garner headlines, but the Federal Reserve (the Fed) and monetary policy has been the key catalyst for the resurgence in the equity markets thus far in 2019. The Fed has cut their benchmark interest rate twice this year, and will likely cut at least once more before year end. Lower interest rates are generally a tailwind for equities, and the markets have responded favorably to the direction of the current Fed interest rate policy. On the fixed income front, the benchmark 10-year U.S. Treasury note is currently yielding approximately 1.6%, which is roughly the same level as three years ago. While interest rates may have stagnated over the last several years, it has been a bumpy ride recently as the same 10-year U.S. Treasury yielded roughly 3.25% this time last year. High yield bonds have had an excellent 2019 with a total return of 11.41% year-to-date. Financial markets around the rest of the globe continue to struggle, as developed foreign stocks (measured by the MSCI EAFE index) continue to lag the U.S. equity markets and are up 13.35% year-to-date. Emerging markets have slumped recently, yet have still returned 6.22% through the first three quarters of 2019. In the United States, large capitalization growth stocks have experienced the best gains thus far in 2019 (+22%); the Information Technology sector has led the way with a 30% gain. Real Estate is the next best performing sector this year, up 29% through September, followed by Utility stocks which returned 25% over the same time frame. The worst performing sectors in the S&P 500 this year have been Healthcare (+5%) and Energy (+7%). As measured by the S&P GSCI index, commodities have returned 8.61% through three quarters this year.

Key Points

- The Fed is likely to cut its benchmark interest rate (Fed Funds) again in October in an effort to keep the economic expansion going
- A more stimulative Fed will likely cause inflation to begin to accelerate in late 2019 and into 2020
- Economic growth, along with corporate profit growth, continues to slow
- Equity market volatility is likely to remain elevated for the foreseeable future

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Investment Outlook

Economic growth in the United States (as measured by Real GDP) is likely to continue to moderate over the last several months of 2019. Corporate profits have followed a similar trajectory, softening year-over-year. In fact, it is going to be a horse race to see whether or not the S&P 500 index will be able to produce positive earnings growth for the quarter ended September 30th (results will be reported throughout the next several weeks). Estimates are for somewhat stronger profit growth in the fourth quarter, but at a much lower rate than was experienced last year. The gradual deceleration of both economic growth and corporate profitability has led the Fed to cut their benchmark interest rate in hopes of stimulating the economy (any by proxy corporate profitability). Unfortunately, a by-product of a lower interest rate policy (and associated accelerated growth) may be inflationary pressures. Inflation has not been a problem so far in 2019, but further rate reductions are likely to create the additional demand from businesses and consumers that leads to inflation. We continue to find value-oriented equities attractive over "growth" stocks, and continue to overweight defensive sectors of the S&P 500 (Utilities and Real Estate) which generally offer relative downside protection. Our outlook changing to include the risk of accelerating inflationary pressures has also led us to an overweight position in the Energy sector.

Global Macroeconomic Review and Outlook

Real GDP growth for the United States was 2.0% for the 2nd Quarter of 2019, which was much lower than the growth rate in 2nd Quarter of 2018 (3.5%). Again, growth remains positive, just not quite as impressive as last year. The median forecast for 3rd quarter (2019) Real GDP is 2.1%, well below the 3rd Quarter 2018 reading of 2.9%. Corporate profit data has continued to soften throughout 2019. A slowdown from the artificially inflated 2018 corporate earnings (due to tax legislation changes in late 2017) was expected, yet earnings revisions going forward have continued to trend lower. In addition to slowing earnings estimates from corporations, sales data has shown a similar deceleration in 2019. Recent manufacturing data suggests that we are at or near a contractionary phase in the U.S., putting us on par with the rest of the developed world. On the bright side, the U3 unemployment rate in the United States is at a generational low at 3.5%, and inflation continues to be in check (for now) with the Consumer Price Index (CPI) reflecting a moderate rate of 1.7% year-over-year. The Fed's dual mandate of low unemployment and stable prices is currently being met on both fronts.

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