STOCKS DIVED WHILE ALTERNATIVES THRIVED

Global equities notched their worst month of the summer amidst heightened volatility

- After touching its all-time high on July 26, the selloff that began in the last week of July accelerated into August, pushing the S&P 500 lower for six consecutive days, by a total of 6%.
- In the midst of the selloff, President Trump announced on August 1 that the U.S. would be imposing 10% tariffs on an additional $300 billion of Chinese imports.
- For the entirety of the month the S&P 500 vacillated in a 3% range, rising and falling with each new piece of trade-related news. After being down more than 4% MTD in each of the first three weeks, the index finally finished the month 1.6% lower.
- Equities outside the U.S. offered no haven either as both developed and emerging markets declined, exacerbated by a strengthening U.S. dollar.
- As bad as it was for large cap stocks, small- and mid-caps fared even worse, falling nearly 3x as much and exhibiting higher volatility.
  - Interest rate-sensitive utilities and real estate led all sectors as interest rates fell to their lowest levels since 2016.
  - Down 8.7%, the energy sector was the laggard as the price of oil fell for the fourth straight month, touching its lowest level since January.
- Across the major market segments, volatility was higher in August than it was in July, but especially in the U.S. The VIX averaged 19 in August, 30% higher than its average in June and July.
- As stock prices fell, bond prices climbed, putting downward pressure on the S&P 500's correlation to the U.S. bond market. Its correlation to international stocks also fell during the month.

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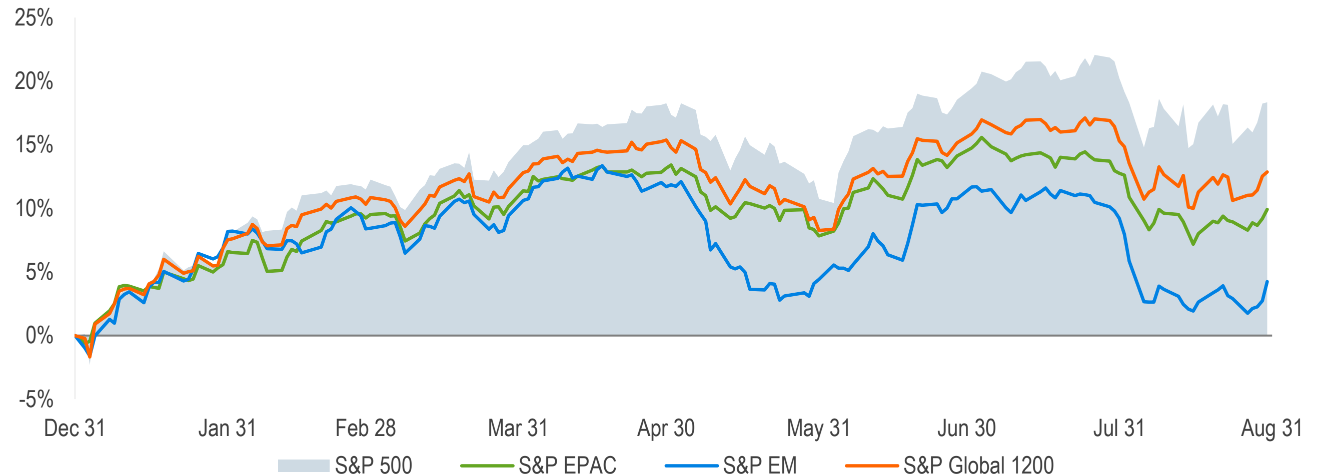

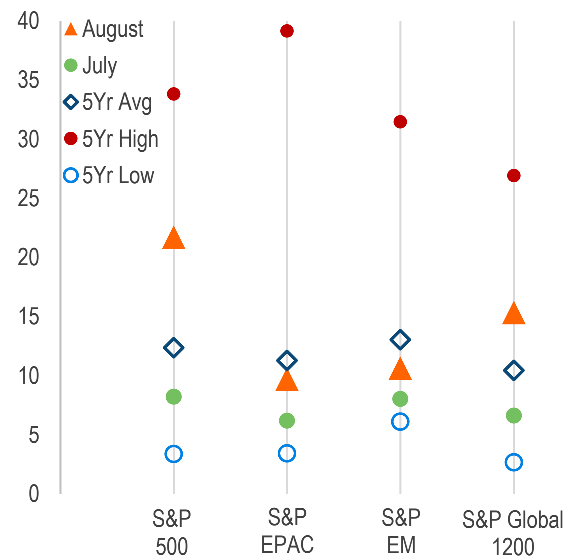

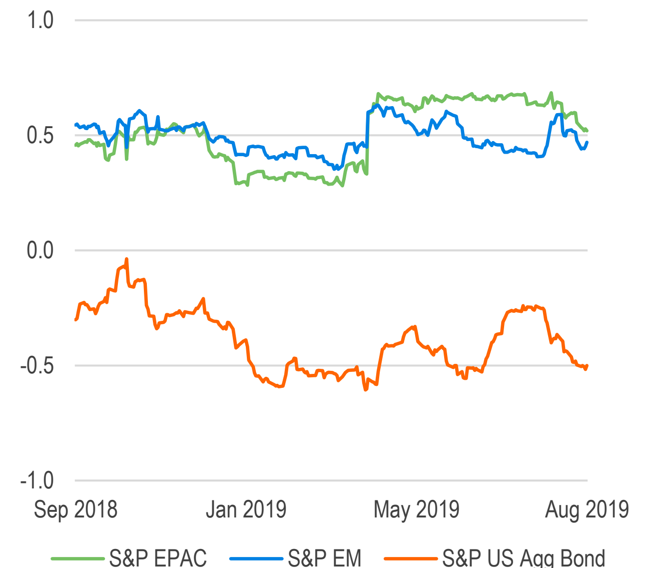

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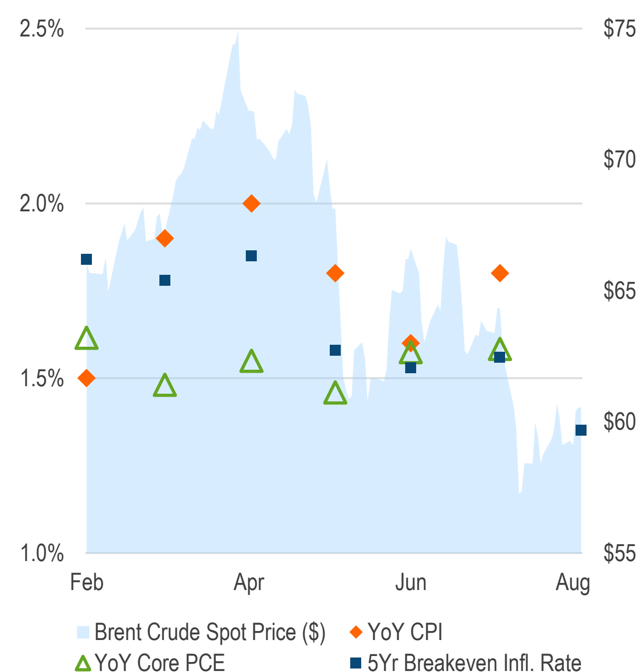
MANAGED RISK INVESTING

Managed Risk Benchmarks reduced their equity exposure in August.

- The volatility of the S&P 500 began the month below the 18% volatility threshold of the S&P 500 Managed Risk Index, but quickly moved above it early in August.
- After beginning the month at a 100% equity allocation, the Managed Risk Index reduced its equity allocation as the month wore on to a low of 67% before finishing the month at 75%.
- Volatility itself was volatile in August, so that the hedging activity resulted in a drag of about 60 bps for the MR Index relative to the S&P 500. Over the last 10 years, the average monthly return of the Managed Risk Index has exceeded the return of a 70/30* blend by 13 bps, generating an annualized excess return of 152 bps.

- The price of oil fell for the third straight month as prospects of limited demand were met with growing supply.
- The most recent CPI data came in higher than expected, pushing its year-over-year increase to 1.8%. Meanwhile, the Fed's preferred measure of inflation (PCE) was unchanged, leaving investors wondering about the number of Fed rate cuts the future might hold. The market is signaling that a cut at the FOMC meeting on 9/18 is a virtual certainty.
- As the price of oil fell, so too did inflation expectations, with five-year breakeven rates falling to their lowest level since 2016.
- While stocks fell, bonds, real estate and gold all climbed. Long-term treasuries have been one of the best-performing segments of the bond market, up more than 20% YTD. Gold and real estate have also been stellar performers, up 19% and 26%, respectively.

*Measured by the S&P 500 and the S&P US Agg Bond Index



Total Returns as of August 31, 2019

	S&P 500	S&P 500 MR	S&P 400	S&P 600	S&P EPAC	S&P EM	S&P Global 1200	S&P US AGG	Crude Oil (Brent)	US Dollar	70/30 Stock/Bond*
1 Month	-1.6%	-2.2%	-4.2%	-4.5%	-2.5%	-4.6%	-1.9%	2.2%	-5.9%	0.6%	-0.6%
3 Months	6.9%	6.1%	4.4%	3.8%	1.9%	-0.2%	4.8%	3.6%	-11.1%	0.9%	5.6%
6 Months	6.2%	5.0%	-0.7%	-4.9%	0.6%	-3.8%	3.9%	6.9%	-8.3%	2.2%	5.8%
1 Year	2.9%	0.0%	-6.4%	-15.1%	-2.7%	-3.6%	0.9%	8.8%	-21.9%	2.9%	3.5%
1M Volatility	21.7%	17.8%	23.5%	24.7%	9.7%	10.6%	15.4%	3.2%	34.5%	3.0%	15.1%

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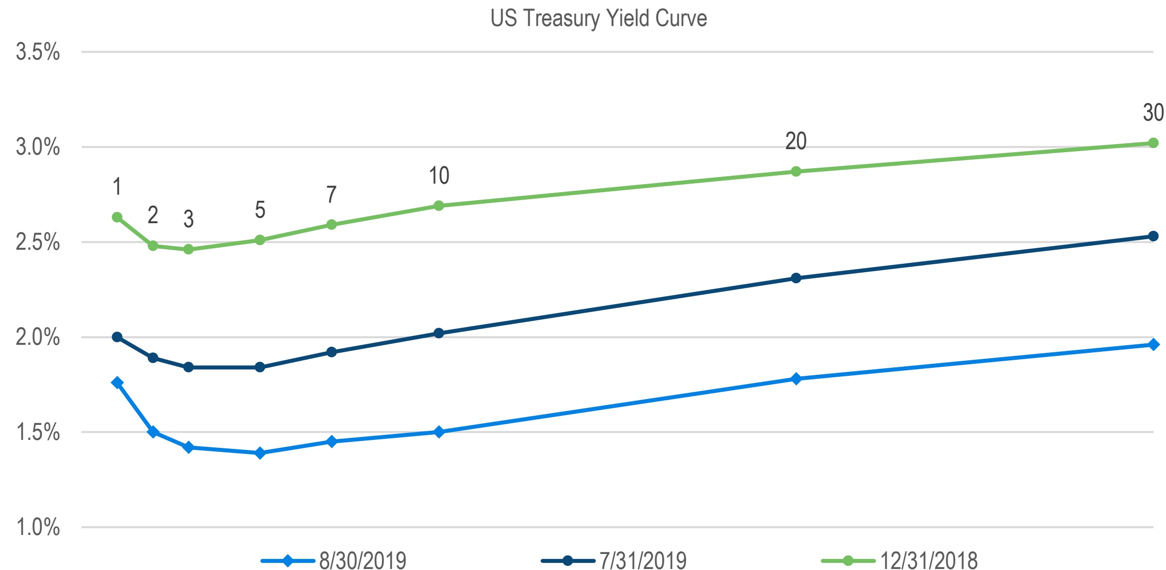
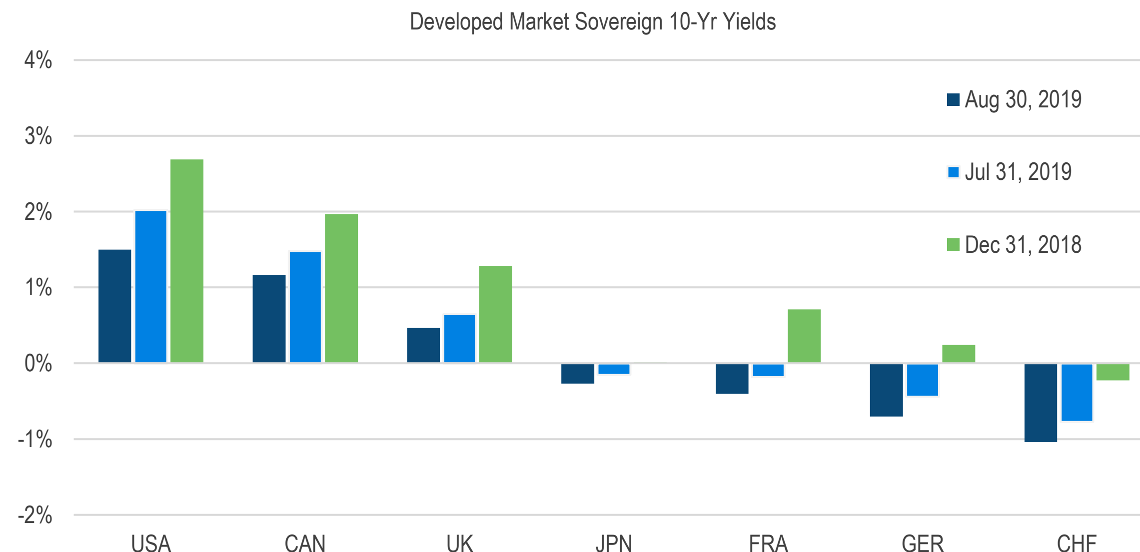
LONG-TERM RATES BREACH NEW LOWS

- In August, the yield on the 30-year Treasury not only broke below its all-time low from July 2016, it also fell below the 2% threshold to 1.95%, 30 bps below the Fed funds rate target.
- As low as that yield is, at least it's still positive. Across the Atlantic, the German government, for the first time ever, issued a 30-year bond with a negative yield. It has a zero coupon and was issued at a price of €103.61, to be redeemed at €100 in August 2050, for a yield to maturity of -0.11%. By month-end the yield had fallen to -0.18%.
- Not to be outdone, the 50-year bond the Swiss government issued five years ago was yielding -0.57% at mid-month, its 45 years to maturity notwithstanding. To be clear, this is not an inflation-linked bond.
- All else equal, as the yields of these bonds fall, the duration of the bonds increases. So in addition to getting little or negative yield, investors also are taking on massive interest-rate risk.
- If the yield on the German bond were to move simply from its August 30 yield of -0.18% to a yield of 0.0%, the price of the bond would fall approximately 6%. If the yield climbed 1% to 0.82%, the bond price would fall 26%.
- In the face of such seemingly disproportionate risk/return profiles, it's little surprise that interest in gold has increased. Over the last three months alone the price of gold has climbed 18% to more than $1500 per ounce, its highest level since early 2013.
- What is perhaps most striking about these circumstances is that it isn't unreasonable to think that yields could potentially go lower still, in light of the guidance coming out of the world's central banks for more accommodation.
- The world's economies, markets and investors continue to venture deeper into territory for which there is simply no precedent or road map. In such conditions, portfolio risk management can hardly be more relevant.





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