Before the Bell

Morning Market Brief

October 21, 2019

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MONDAY MORNING MARKET STRATEGY: ***David M. Joy, Chief Market Strategist***

The search for direction in U.S. stocks remains elusive. For more than three months, the S&P 500 has drifted, unable to see enough progress on trade to mount a rally, but finding enough support from easing monetary policy and the strong consumer to prevent a serious downturn. The index closed last week at 2986, up 0.5 percent, only slightly more than one percent below its all-time high. But as far back as July 3rd, it was trading at 2996. Since then, it has traded in a range between 3225, its all-time high, and a low of 2840 on August 5th., hardly dramatic stuff.

But that headline price action belies the underlying volatility that was better captured by the VIX. At the beginning of the period on July 3rd, the VIX traded at 12.6. But on August 5th, it doubled to a high of 24.6, the same day the S&P hit 2840. Throughout the period, the VIX averaged 16.2, close to its long-term average, but with a noticeably wide range around that average.

Investors have had a lot to digest in the past three months. The Fed has lowered rates twice, and the ECB has restarted its own stimulus program. All the while, the global economy has slowed. And there has been a lot of talk, but little progress, on trade. But that has been enough to keep investors at the table, afraid of missing out on what could be a powerful rally if a meaningful deal is struck. Unfortunately, at least so far, they have been repeatedly left at the altar.

For a while last week, it looked like we were witnessing simultaneous breakthroughs on both U.S.-China trade and Brexit. But once again, at least so far, it has proven to be a triumph of hope over experience. As it turns out, the Chinese had very different ideas from president Trump about the details of the so-called phase one agreement. And Prime Minister Johnson has run into the political realities of getting the newly agreed deal with the EU through parliament. In the meantime, the tariffs remain in place, along with the debilitating uncertainty for business.

While all this was happening, third quarter earnings season was in full swing. According to FactSet, about fifteen percent of the S&P 500 has reported so far, with the blended earning growth rate for the quarter projected to be -4.7 percent, the same projection as last week. Some better than anticipated results in the healthcare and financials sectors was offset by worse than expected results in energy. This week will see fully 25 percent of the index report. Among the notables are Amazon, Microsoft, McDonald's, and Caterpillar.

Last week's economic data provided more evidence of the headwind created by trade uncertainty. China reported year-over-year growth of just 6.0 percent, its slowest pace in 27 years. It is widely expected to report a rate below 6.0 percent in the fourth quarter. In the U.S., manufacturing production and retail sales were decidedly soft, and leading indicators fell for the second straight month. That weakness was offset to some extent by a strong home builders report. This week will see durable goods orders and new and existing home sales.

Notations:

- For further information on any of the topics mentioned, please contact your Financial Advisor.
- Unless specifically stated otherwise, comments contained in this document should not be construed as an investment opinion or recommendation of any securities mentioned. Charts depicted are from FactSet unless otherwise noted.

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But the slowing outlook for the global economy was highlighted by the IMF's lowered forecast for global GDP, for both 2019 and 2020, now projected to total 3.0 and 3.4 percent respectively. The IMF estimated the drag from trade will trim growth by 0.8 percent by 2020, partially offset by a 0.5 percent boost from monetary stimulus.

MORNING MARKET COMMENTARY: ***Anthony M. Saglimbene, Global Market Strategist***

- ***Quick Take***: U.S. futures are pointing to a higher open; European markets are trading higher; Asia ended flat-to-higher overnight; West Texas Intermediate (WTI) oil trading at $53.71; 10-year U.S. Treasury yield at 1.78%.

- ***QCMD – Stuck In The Middle Of Opportunity & Risk:*** The world's capital markets have been struggling with a protracted period of policy uncertainty and may now find themselves at an inflection point. For almost two years, the MSCI All-Country World index of global equities has treaded water, currently sitting virtually unchanged since the start of 2018. Trying to make sense of Brexit, a confrontational U.S. trade policy, and divergent central bank policies has left investors and equity markets in limbo and pushed bond yields to levels once considered unimaginable.
- Economic growth has slowed. But recently, we have seen progress on Brexit as well as a tentative thaw in U.S./China trade war tensions, offering some hope that policy uncertainty may begin to recede, and economic/investment decision making can return to normal.
- **Below is a snapshot view of how we see the current investing environment as the last quarter of 2019 presses forward:**

  - **THE MACRO ENVIRONMENT*:*** Seasonal tailwinds point to a solid fourth quarter finish, noted by the market's resiliency and strong returns in 2019. But the landscape is growing less certain, and clouds are forming on the horizon.
  - **THE FUNDAMENTALS:** Stocks and bonds continue to face several hurdles on the macro-economic front, which could carry over into 2020. To some extent, asset prices are beholden to trade developments and central bank policies. Particularly, against a backdrop of slowing global economic and profit growth.
  - **THE PORTFOLIO:** Maintain a home bias, stay diversified, and focus on high-quality investments.

- Here at home, performance across the S&P 500 sectors this year is bunched in the middle, with cyclical and defensive sectors both performing well. In our view, this argues for diversification across industries and likely a greater focus on the companies one is allocating to across each industry. As we have highlighted all year, investors should allocate to high-quality companies with more predictable profit trends, competitive advantages, and solid balance sheets. A willingness to hold these companies through both up and down markets could also play a critical role in determining investment success over the intermediate-term.
- Lastly, on the fixed income side, we recommend investors exit aggressive bond investments backed by risky companies. We recommend income investors engage the market available today, to be sure income investments adequately term-out income generation. Avoid floating rate investments and invest out the curve to avoid potentially reinvesting in lower yields should the Fed continue to cut rates.
- **For more detail on our asset allocation recommendations and the Global Asset Allocation Committee's market outlook through the rest of the year, please refer to the latest edition of the *Quarterly Capital Market Digest (QCMD)* report.**

- ***Asia-Pacific:*** Asian equities finished flat-to-higher on Monday. Over the weekend, Chinese Vice Premier Liu He said the U.S. and China had made substantial progress in several areas of trade, and each side is working with each other to address its concerns on a deal. The Vice Premier also said China would boost investment in core technologies to accelerate economic restructuring as well as reiterated Beijing would increase IP protections, according to *FactSet*. The comments could help increase positive market sentiment for a 'signed' phase one deal next month. However, investors would be wise not to read too much into this weekend's comments out of Beijing and focus more on the actions that follow over the coming weeks.
- ***Europe:*** Markets across the region are trading in the green at mid-day. Those of us hoping Saturday's Brexit vote in the UK would finally start to put to rest the uncertainty over Europe's ongoing divorce saga were disappointed by the result. UK Prime Minister Boris Johnson was unable to secure a meaningful vote on his Brexit plan in the House of Commons over the weekend, as members of parliament (MPs) instead backed an amendment to withhold support

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until it has passed into law. Mr. Johnson was then forced to ask the European Union (EU) for a Brexit extension but made it clear he still intends to pull Britain out of the EU with or without a deal.

- It is not clear if the EU will grant the UK an Article 50 extension, though we believe Brussels would do so if it avoided a no-deal Brexit at the end of the month. Although the UK government is preparing for a no-deal Brexit, Mr. Johnson intends to ask MPs to approve his Brexit deal today. Based on a few reports, Mr. Johnson may have the votes to pass his deal through as early as Tuesday following debates in the Commons. As we have commented on for the last several weeks, the drama over Brexit is likely to extend right up to the October 31st deadline.
- Outside of Brexit, the other highlight of the week in Europe will come from the European Central Bank (ECB) meeting on Thursday. ECB President Mario Draghi will proceed over his last policy meeting on Thursday and before former IMF Chief Christine Lagarde assumes the leadership role at the end of the month. Following the ECB's latest round of easing measures at its September meeting, which showed several members divided on its actions, the central bank is widely expected to keep policy on hold. At its last meeting, Mr. Draghi pushed lower the ECB's deposit rate as well as restarted asset purchases — against the wishes of some senior ECB officials. Following Thursday's ECB decision, Mr. Draghi is expected to focus his last press conference on the need for increased fiscal measures to help lift the Eurozone's economy.
- ***U.S.:*** Equity futures are pointing to a positive open this morning. What's the focus for U.S. markets this week? Earnings, earnings, earnings. While the background macro noise on trade and growth certainly won't go away this week, investors will have a chance to drown out some of the drumbeats with corporate fundamentals.
- Per *FactSet*, over 25% of S&P 500 companies report their profit results this week, including 12 Dow 30 components. Thus far, 15% of S&P 500 companies have reported their third quarter results, leaving the blended Q3'19 earnings per share (EPS) growth rate down 4.7% y/y on revenue growth of +2.6%. In aggregate, companies are reporting EPS growth 2.6% above analyst estimates, which is solid, but below the five-year average beat rate. However, 85% of S&P 500 companies are surpassing their EPS estimates as a whole, which is above the five-year average.
- Analysts and companies substantially lowered the hurdle rate for third quarter earnings, particularly as y/y profit margin comparisons will be very tough. In the third quarter of 2018, S&P 500 profit margins peaked at +12.0%, which could represent a cycle high. Rising input costs, trade frictions, and slowing global growth could all weigh on Q3'19 profit metrics, making y/y comparisons more difficult — hence the analyst and corporate conservatism across earnings expectations.
- Per *The Wall Street Journal,* UAW leaders may have a tough time convincing GM rank-and-file members the new labor agreement struck with the automaker last week has their best interests at heart. Although UAW workers would see increased wages, improved job security for temporary workers, and a record signing bonus — GM would still close three now-idled U.S. plants with no commitment to relocate production from Mexico. Importantly, the pro-longed GM strike could start to have a more meaningful effect on economic data in the Midwest, as the ongoing strike affects more businesses and auto suppliers reliant on GM work.
- Outside of earnings barrage this week, investors will get updates on September existing home sales (Tuesday), September new home sales (Thursday), and a preliminary look on October U of M consumer sentiment (Friday).

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WORLD CAPITAL MARKETS *(all data as of approximately 8:00 AM ET)*

Americas	% chg.	% YTD	Value
S&P 500	-0.39%	21.05%	2,986.2
Dow Jones	-0.95%	16.99%	26,770.2
NASDAQ	-0.83%	22.96%	8,089.5
Russell 2000	-0.41%	15.11%	1,535.5
Brazil Bovespa	-0.27%	19.16%	104,728.9
S&P/TSX Comp. (Canada)	-0.30%	17.14%	16,377.1
Mexico IPC	-0.69%	5.97%	43,178.6

Europe (Intra-day)	% chg.	%YTD	Value
DJSTOXX 50 (Europe)	0.48%	23.91%	3,596.5
FTSE 100 (U.K.)	0.16%	10.64%	7,162.3
DAX Index (Germany)	0.76%	20.56%	12,730.2
CAC 40 (France)	0.21%	23.05%	5,648.2
FTSE MIB (Italy)	0.48%	22.40%	22,428.3
IBEX 35 (Spain)	0.58%	13.26%	9,383.5
Russia TI	0.27%	23.54%	4,838.0

Asia/Pacific (Last Night)	% chg.	%YTD	Value
Nikkei 225 (Japan)	0.25%	14.80%	22,548.9
HK Hang Seng (H. Kong)	0.02%	6.99%	26,725.7
Korea Kospi 100	0.20%	1.62%	2,064.8
Singapore STI	0.80%	5.97%	3,139.2
Shanghai Comp. (China)	0.05%	20.74%	2,939.6
Bombay Sensex (India)	Closed	10.07%	39,298.4
S&P/ASX 200 (Australia)	0.04%	23.26%	6,652.5

Global	% chg.	% YTD	Value
MSCI All-Country World Idx	-0.32%	17.85%	525.3

Developed International	% chg.	%YTD	Value
MSCI EAFE	-0.11%	15.31%	1,920.1

Emerging International	% chg.	%YTD	Value
MSCI Emerging Mkts	-0.42%	8.70%	1,024.0

Note: International market returns shown on a local currency basis. Equity index data is total return, inclusive of dividends.

S&P 500 Sectors	% chg.	% YTD	Value
Consumer Discretionary	-0.32%	23.96%	958.8
Consumer Staples	0.19%	22.28%	623.4
Energy	-0.54%	2.07%	420.7
Financials	0.23%	20.00%	466.5
Real Estate	0.98%	31.59%	247.0
Health Care	-0.34%	7.58%	1,061.6
Industrials	-0.87%	21.44%	648.4
Materials	-0.10%	15.82%	360.6
Technology	-0.91%	32.05%	1,419.8
Communication Services	-0.87%	24.44%	170.5
Utilities	0.36%	23.66%	323.9

Equity Income Indices	% chg.	% YTD	Value
JPM Alerian MLP Index	0.70%	-0.39%	22.2
FTSE NAREIT Comp.	0.85%	30.31%	21,626.2
DJ US Select Dividend	0.33%	17.10%	2,178.6
DJ Global Select Dividend	0.99%	9.01%	225.4
S&P Div. Aristocrats	0.21%	20.71%	2,893.5

Bond Indices	% chg.	% YTD	Value
Barclays US Agg. Bond	0.05%	8.34%	2,217.2
Barclays HY Bond	0.01%	11.65%	2,131.8

Commodities Futures & Spot (Intra-day)	% chg.	% YTD	Value
CRB Raw Industrials	-0.16%	-8.59%	439.2
NYMEX WTI Crude (p/bbl.)	-0.56%	17.77%	53.5
ICE Brent Crude (p/bbl.)	-0.74%	9.63%	59.0
NYMEX Nat Gas (mmBtu)	-0.65%	-21.60%	2.3
Spot Gold (troy oz.)	0.01%	16.20%	1,490.3
Spot Silver (troy oz.)	0.85%	14.24%	17.7
LME Copper (per ton)	1.26%	-2.76%	5,784.8
LME Aluminum (per ton)	0.59%	-6.88%	1,734.5
CBOT Corn (cents p/bushel)	0.38%	-1.26%	392.5
CBOT Wheat (cents p/bushel)	0.23%	-1.66%	533.5

Foreign Exchange (Intra-day)	% chg.	% YTD	Value
Euro (€/$)	0.0%	-2.6%	1.12
British Pound (£/$)	0.1%	1.9%	1.30
Japanese Yen ($/¥)	-0.09%	1.05%	108.55
Australian Dollar (A$/$)	0.32%	-2.43%	0.69
Canadian Dollar ($/C$)	0.2%	4.1%	1.31
Swiss Franc ($/CHF)	0.0%	-0.3%	0.99

Data/Price Source: Bloomberg; Equity Index data is total return, inclusive of dividends where applicable.

Ameriprise Global Asset Allocation Committee

U.S. Equity Sector - Tactical View

Sector	S&P 500 Index Weight	GAAC Tactical View	GAAC Tactical Overlay	GAAC Recommended Weight
1) **Communication Services**	10.5%	Underweight	- 2.0%	8.5%
2) **Consumer Discretionary**	10.0%	Overweight	+2.0%	12.0%
3) **Consumer Staples**	7.4%	Equalweight	-	7.4%
4) **Energy**	4.6%	Equalweight	-	4.6%
5) **Financials**	13.1%	Underweight	- 2.0%	11.1%
6) **Health Care**	13.9%	Equalweight	-	13.9%
7) **Industrials**	9.3%	Equalweight	-	9.3%
8) **Information Technology**	21.8%	Overweight	+2.0%	23.8%
9) **Materials**	2.7%	Equalweight	-	2.7%
10) **Real Estate**	3.2%	Overweight	+1.0%	4.2%
11) **Utilities**	3.5%	Underweight	- 1.0%	2.5%

Index weighting represents relative weightings based on the regional market capitalization balance of the MSCI All-Country World Index; may not add due to rounding. The GAAC Tactical Overlay, as well as Recommended Tactical Weights, is derived from the Ameriprise Global Asset Allocation Committee (GAAC).Views are expressed relative to the Index and are provided to represent investment conviction in each region. Tactical Allocations are designed to augment Index returns over a 6-12 month time horizon. Index weights as of 9/20/19. Numbers may not add due to rounding.

Ameriprise Global Asset Allocation Committee

Global Equity Region - Tactical View

Region	MSCI All-Country World Index Weight	GAAC Tactical View	GAAC Tactical Overlay	GAAC Recommended Weight
1) **United States**	55.6%	Overweight	+7.3%	62.9%
2) **Canada**	3.1%	Equalweight	-	3.1%
3) **United Kingdom**	4.8%	Underweight	- 2.0%	2.8%
4) **Europe ex U.K.**	14.5%	Underweight	- 2.0%	12.5%
5) **Latin America**	1.4%	Equalweight	-	1.4%
6) **Asia-Pacific ex Japan**	12.0%	Equalweight	-	12.0%
7) **Japan**	7.3%	Underweight	- 2.0%	5.3%
8) **Middle East / Africa**	1.3%	Underweight	- 1.3%	-

Index weighting represents relative weightings based on the regional market capitalization balance of the MSCI All-Country World Index; may not add due to rounding. The GAAC Tactical Overlay, as well as Recommended Tactical Weights, is derived from the Ameriprise Global Asset Allocation Committee (GAAC).Views are expressed relative to the Index and are provided to represent investment conviction in each region. Tactical Allocations are designed to augment Index returns over a 6-12 month time horizon. Index weights as of 9/20/19. Numbers may not add due to rounding.

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THE WEEK AHEAD: *Russell T. Price, CFA, Chief Economist*

- **Corporate earnings ramp up.** This week, 126 companies, or about 25% of the S&P 500 Index is scheduled to report their third quarter results, including 12 of the 30 constituents making-up the Dow Jones Industrial Average. This is scheduled to be the second-heaviest week of the earnings season in terms of actual reports but given some of the names on the docket it could be the most influential in terms of market impact.
- Through last Friday, just 76 (or 15%) of S&P 500 companies had reported. **Earnings per share (EPS) for S&P 500 companies are still expected to be down 4.9% year-over-year, but sales growth expectations have come down to just +2.7% from a quarter-ending estimate of +3.3%. (All numbers cited are sourced from FactSet.)**
- The decline in sales growth expectations are somewhat concerning, but as has been the case for overall financial estimates for the quarter, much of the weakness is due to just two sectors, Energy and Materials. The Energy sector is forecast to see sales decline 8.8% versus year-ago levels while sales in the Materials sector are forecast to be down a whopping 13.4%. In both cases, the declines are largely due to weaker commodity prices amid the broader global economic slowdown.
- We also note that, while EPS results for Q3 have been coming in modestly ahead of estimates, forecasts for Q4 have been coming down notably as have estimates for 2021. Estimates for the pending quarter do almost always decline during any given reporting season but the $0.50 decline thus far registered appears notable this early in the release season as is the $0.92 drop in forecasts for 2021. (All numbers since September 30th)
- **Housing and manufacturing dominate the economic calendar this week.** The release schedule begins with some of both on Tuesday with Existing Home Sales and the Richmond Fed's regional Manufacturing Index. Existing Home Sales for the month of September are expected to be flat to slightly lower. Mortgage rates have certainly been conducive of home sales over recent months, but the existing home market remains constrained by availability. At the end of August, the months supply of inventory remains very low at just 4.1 months versus a historical norm during periods in which supply and demand are considered "balanced" of about 6.0 months. Our estimate of 5.49 million units (on an annualized basis) would represent a year-over-year gain of 6% and median home sales prices have been averaging gains of about +4% to 5%.
- New Home Sales on Thursday, however, have a better ability to show growth as builders are slowly improving overall market availability. This week's report on sales for the month of September, however, are expected to be down modestly after sales jumped a strong 7.1% in August. Even if sales decline by the 2% we are forecasting, it would still represent a pace of sales growth that would be about 15% higher than year-ago levels.
- Thursday's report on New Orders for Durable Goods is also expected to show a modest decline. This report is always one of the most volatile we see each month and it could be even more volatile this month given the potential influence of the labor strike at General Motors. Dealers could certainly order more vehicles during the period but if they are not receiving delivery of orders already placed due to the strike, would they? Not likely, but its very difficult to judge given the very limited track record of such periods. Overall, total new orders are forecast to be down about 1% in the month which would equate to a drop of about 4% versus the year-ago month. New orders for business equipment will again be closely monitored given that business spending has stalled over the last year due to lower export demand and the uncertainly of trade rules, but we note that the category has stabilized and even shown some modest gains of late. Through August, new orders for non-defense capital goods, the commonly used proxy for business investment spending, was up 2.4% on a 3-month annualized basis.

October 21	22	23	24	25
Trade - Japan	**Existing Home Sales**	*GDP - S. Korea*	**Initial Jobless Claims**	**U. of M. Cons. Sentiment**
	Richmond Fed Mfg. Index		**Durable Goods Orders**	*Jobseekers - France*
	Retail Sales - Canada		**Markit Prelim. PMI**	*Retail Sales - Mexico*
	Employment - Mexico		**New Home Sales**	
			Kansas City Fed. Mfg.	
			Monetary Policy - Euro Zone	
			Unemployment - Spain	

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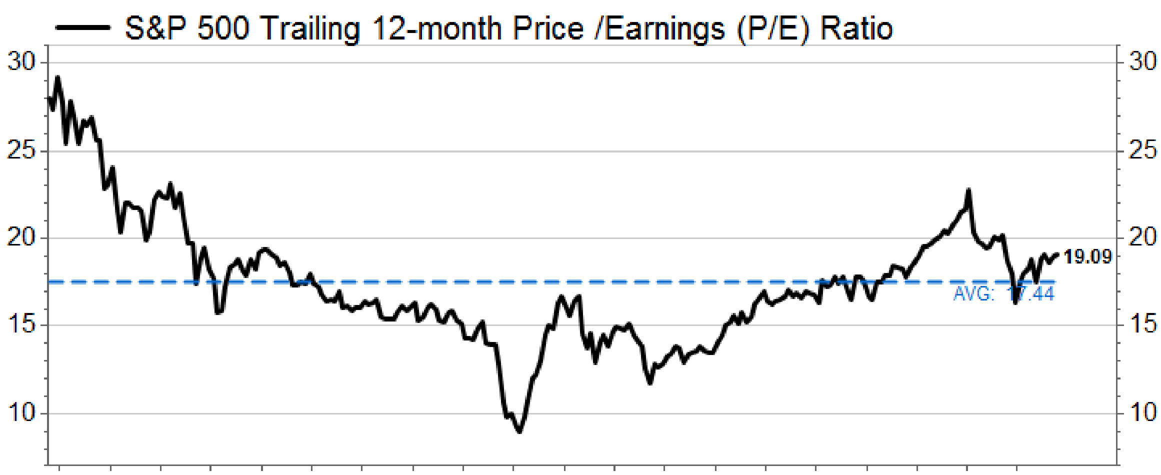
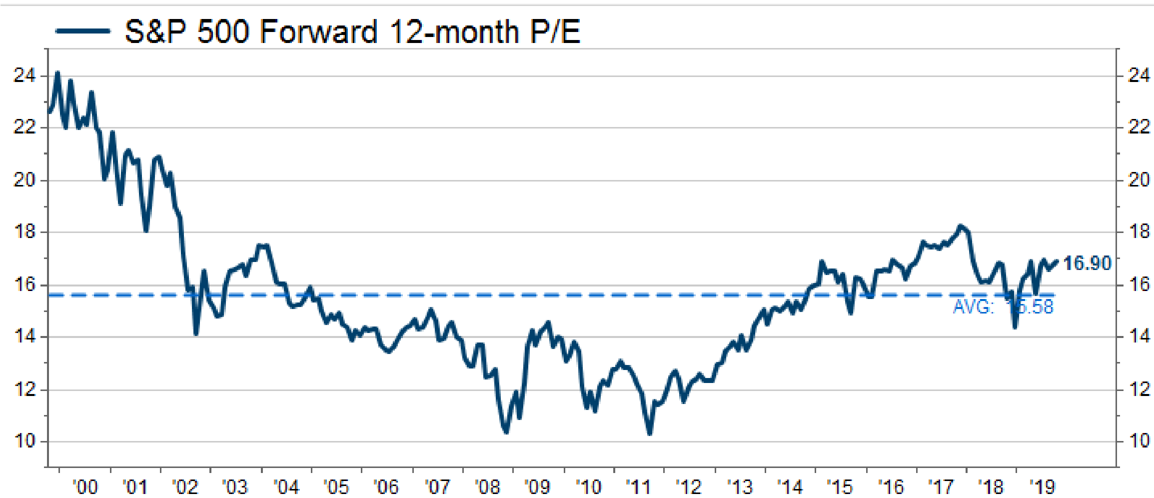
Where Market Fundamentals Stand Heading into The Week:

S&P 500 Trailing and Forward P/E valuations: *Source: FactSet*
Please note: Although we try to maintain consistency as much as possible, Price to Earnings (P/E) ratios may differ modestly from once source to another. Most notably, P/E numbers can often show their most notable differences during an earnings release season as some sources may still use the last full 'actual' earnings number (for instance, currently Q4 trailing 12-month earnings per share) while others use earnings per share that are updated for Q1 using a combination of actual and estimated earnings per share. The calculation of earnings (operating earnings versus 'as reported' or GAAP) also often differs modestly from one data source to another due to the proprietary use of calculation methodologies. The "average" shown in the charts below represent averages for the period shown.





Consensus Earnings Estimates: *Source: FactSet*

S&P 500 Earnings Estimates	2014	2015	2016	2017				2018				2019				2020
10/21/2019	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Est.	Est.	Est.
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Quarterly $$ amount				$30.87	$32.80	$33.54	$36.29	$38.71	$41.13	$42.87	$41.32	$38.80	$41.47	$41.03	$42.22	
change over last week														$0.12	-$0.21	-$0.70
yr/yr				13.9%	10.7%	6.7%	15.9%	25.4%	25.4%	27.8%	13.9%	0.2%	0.8%	-4.3%	2.2%	
qtr/qtr				-1%	6%	2%	8%	7%	6%	4%	-4%	-6%	7%	-1%	3%	
Trailing 4 quarters $$	$119.02	$118.67	$119.64	$123.25	$126.42	$128.53	$133.50	$141.34	$149.67	$159.00	$164.03	$164.12	$164.46	$162.62	$163.52	$180.27
yr/yr	6.8%	-0.3%	0.8%				11.6%				22.9%				-0.3%	10.2%
Implied P/E based on a S&P 500 level of: **2986**												18.2	18.2	18.4	18.3	16.6

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BY THE NUMBERS: ECONOMIC ACTUALS AND FORECAST:

Current Projections:

	Actual 2014	Actual 2015	Actual 2016	Actual 2017	Actual 2018	Est. 2019	Est. 2020	Quarterly Actual Q1-2019	Quarterly Actual Q2-2019	Quarterly Est. Q3-2019	Quarterly Est. Q4-2019
Real GDP (YOY)	2.5%	2.9%	1.6%	2.4%	2.9%	2.2%	2.1%	3.1%	2.0%	1.8%	2.2%
Unemployment Rate	5.6%	5.0%	4.7%	4.1%	3.9%	3.6%	3.5%	3.8%	3.7%	3.5%	3.6%
CPI (YoY)	1.6%	0.1%	1.3%	2.1%	2.4%	1.8%	2.1%	1.6%	1.8%	1.8%	1.9%
Core PCE (YoY)	1.6%	1.3%	1.7%	1.6%	1.9%	1.8%	1.9%	1.6%	1.5%	1.7%	1.8%

Sources: Historical data via FactSet. Estimates (Est.) via American Enterprise Investment Services, Inc.

YoY = Year-over-year, Unemployment numbers are period ending. GDP: Gross Domestic Product; CPI: Consumer Price Index

PCE: Personal Consumption Expenditures Price Index. Core excludes food and energy

Last Updated: October 7, 2019

ECONOMIC NEWS OUT TODAY:

Economic Releases for Monday, October 21, 2019. All times Eastern. Consensus estimates via Bloomberg.

None scheduled

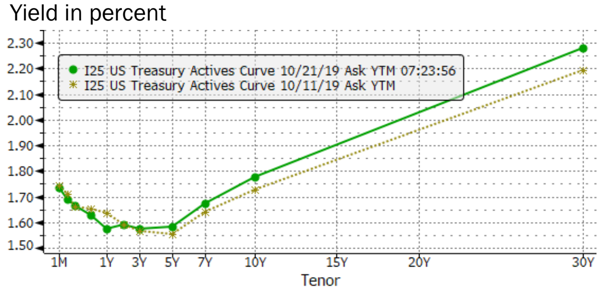
FIXED INCOME NEWS & VIEWS: *Brian M. Erickson, CFA, Fixed Income Research & Strategy*

Treasury Yields Rise; Spreads Diverge

- Treasury prices settled lower this morning, sending 10-year Treasury yields two basis points higher to 1.78%, the highest level since September 19.
- Credit spreads diverged last week, with spreads on the Bloomberg Barclays U.S. Investment Grade Corporate index narrowing three basis points on the week to +112 basis points. Meanwhile, spreads on the Bloomberg Barclays U.S. High Yield Index widened in four consecutive trading sessions last week to +383 basis points after positive market sentiment faded through the week yet ended 7 basis points tighter relative to Friday October 11 due to the strong rally over the interceding weekend and on Columbus Day when U.S. bond markets were closed.

U.S. Treasury Yield Curves – June 30 and Today

Yield in percent



Source: Bloomberg L.P.

Treasury Yields Spreads – 10s/2s & 10s/3-mo Positive

Spread in basis points

We Expect the Fed to Cut by a Quarter of a Percent Next Week; ECB Policy Meeting This Week

- Looking ahead: The Fed is scheduled to hold its seventh policy meeting of 2020 wrapping up next week with a policy decision and the press conference with Fed Chairman Jerome Powell. We anticipate the Fed elects to cut the fed funds target rate by a quarter point to 1.50-1.75%, its third quarter point cut this year. With one meeting remaining this year in December, we anticipate the Fed likely holds steady for a few meetings to allow the mid-cycle adjustment to pass through the market into more favorable borrowing conditions. In addition, beyond three cuts the Fed's rate adjustment may take on the appearance of more than a mid-cycle adjustment and stir deeper concerns that a

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recession may be around the corner in 2020 requiring the Fed to continue lowering rates in anticipation that the end of the cycle is near.

- As a result of Fed rate change, we anticipate yields on the short-end of the Treasury curve to trend lower into a likely cut. In addition, the Fed previously announced the reopening of T-bill purchases aimed at improving liquidity in repo markets and to shore up the market context for the fed funds target range. Beyond solving the repo market that arose at the end of the third quarter, we believe additional bill purchases will not have the same impact as quantitative easing, which was aimed at lowering long-term yields through purchases of long-term assets. Further, while Fed
- Later this week, the European Central Bank is scheduled to hold its second to last policy meeting of 2019 and the last meeting for Mario Draghi before his term ends. Former head of the IMF Christine Lagarde will take over the ECB President at the end of the month. We see the set up for the policy meeting Thursday and his final press conference as filling in more details around how new asset purchases announced in September logistically function. Left unanswered were how much the ECB planned to purchase and how central bankers saw holdings limits rising as purchases grew toward central banks within the Union owning nearly half the outstanding debt for several nations. A Bloomberg article this morning also suggested ECB policy likely remains unchanged even with the anticipation that the bank's forecasts are likely adjusted lower once again in December. In our view, the ECB may be reaching the limits of what some central bankers are willing to do, requiring either a hand-off to fiscal support to reverse slowing growth, or to place the fate back into the hands of market forces.
- Should the ECB cease asset purchases, we would anticipate sovereign debt yields across Europe to gravitate higher as prospects for future monetary support come into question, with greater dispersion among core and peripheral sovereign Eurozone debt yields. Should ECB policy retreat as a buyer, we believe yields would rise to price in 1) declining technical demand, and 2) higher yields due to the risk of a further slowdown. Similar to how anticipation of ECB policy pulled global yields lower through the summer in anticipation of renewed monetary stimulus, we could see some reversal with yields moving higher. This is simply one dynamic in play. We would also anticipate potentially greater demand for true safe haven assets including Treasury yields, as well as Norway and Swiss sovereign debt, if the ECB no longer maintains the will to spur Eurozone growth.
- At a high level, we see friction within the ECB adding uncertainty to bond markets until a Christine Lagarde can establish a new direction that conforms to the political limitations. In other words, future plans for the ECB are simply one new dimension for bond markets to consider. When one door closes, others can open.

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