DT INVESTMENT PARTNERS, LLC

Q3 2019
FINANCIAL MARKETS COMMENTARY

"Be Cautious, Not Fearful"

DT INVESTMENT PARTNERS

RISK-BASED ASSETS PERFORMANCE SUMMARY

- The stock market continued to climb the wall of worry in the third quarter as an escalating U.S.-China trade war, a slowing U.S. economy, an inverted yield curve, stalled profit growth, and political strife that led to an impeachment inquiry were not enough to keep stock prices from grinding higher. The S&P 500 is currently hovering near all-time highs reached on July 29th as the stock index enters the fourth quarter with its biggest YTD gain (20.5%) in 22 years.

- Stocks surged in July as the Fed cut interest rates for the first time since December 2008. The risk markets fell in August over fears of a U.S. recession and an escalating trade war with China. September saw a rebound in stocks thanks to a second Fed interest rate cut and signs of a firming U.S. housing market.

- U.S. Large Cap stocks eked out gains for the third quarter while U.S. Mid Cap, U.S. Small Cap, International Developed and Emerging Markets all declined (See page 5). The more defensive U.S. Large Cap sectors that offer higher relative dividend yields such as Utilities, Real Estate, and Consumer Staples led the way higher for the quarter as investors rotated away from the more growth-oriented, cyclical sectors such as Energy, Materials, and Technology.

- Emerging Market stocks struggled the most during the quarter as the effects of the trade war with the U.S. began to filter through the Chinese economy. In addition, a strong U.S. dollar that reached its highest level in the past two years and weak economic growth in Europe also negatively impacted emerging market economies.

- For the second consecutive quarter, Gold was the top-performing risk-based asset class thanks to growing uncertainty and fears regarding the U.S. tariff war with China, the potential for armed conflict with Iran, the British exit from the European Union, slowing global economic growth, and U.S. presidential impeachment proceedings (See page 5). As a safe-haven asset class, Gold performs well during times of high uncertainty and turmoil.

BOND PERFORMANCE SUMMARY

- U.S. Government bonds posted their fourth consecutive quarterly gain. Global investors continued to buy U.S. government debt in a flight-to-quality move due to fears of slowing economic growth and rising geopolitical risks combined with some of the highest relative government bond yields in the developed world.

- After bond prices staged a large rally in August due to growing anxiety about the health of the world economy and rising trade tensions between China and the U.S., prices fell/yields rose in early September as investors grew somewhat less concerned about the U.S. economy and more optimistic about the potential for improvement in U.S.-China trade relations.

- All fixed income sectors generated positive returns during the quarter. Investment Grade Corporate bonds once again led the way as investors sought higher relative yields in a very low interest rate environment (See page 5).

- Municipal bonds performed well during the quarter, largely following the broader Treasury bond rally in August and further supported by record demand for tax-exempt securities. Supply of new bonds rose higher than expected in September which slightly hampered prices.

CONTRIBUTORS & DETRACTORS TO PERFORMANCE

- Performance contributors versus the Global Stock/Intermediate Maturity U.S. Bond blended benchmark index during the quarter included our overweight allocation to fixed income and our underweight allocation to risk-based assets. In addition, our overweight allocations to U.S. Large Cap stocks and Investment Grade Corporate bonds, and our outside-of-benchmark allocation to Gold contributed to performance.

- Detractors to performance versus the Global Stock/Intermediate Maturity U.S. Bond blended benchmark index included our underweight allocation to U.S. Treasury Notes and our overweight allocation to Mortgage-Backed Securities.

GLOBAL MARKETS & ECONOMY

- Stocks rallied for most of July thanks to investors' expectation for the start of monetary policy easing, which officially occurred at the Fed's July 31st meeting. The Fed cut interest rates by a quarter percentage point for the first time since December 2008. Chairman Powell characterized the move as more of a mid-cycle adjustment to policy rather than the beginning of a prolonged period of rate cuts. Stocks initially cheered the move and then sold off in disappointment. The very next day President Trump escalated the trade war with China and stocks continued to fall while bond prices rose.

- Then in early August, China reported the weakest growth in industrial output since 2002 while Germany's economy shrank as exports slumped and Euro area production plunged the most in more than three years as the overall expansion cooled. U.S. and U.K. bond markets sent their biggest recession warnings since the global financial crisis as the spread between 10-year maturity and 2-year maturity government bonds fell below zero.

- September brought stronger than expected housing market data and U.S. hiring while consumer spending remained solid. The Fed once again cut interest rates by a quarter percentage point to help protect the U.S. economy from weak international economic growth and a very high level of trade policy uncertainty. Such uncertainty can lead to lower business investment, weaker consumer confidence, and declining business/consumer spending.

- As the final month to the quarter came to a close, House Speaker Pelosi announced an impeachment inquiry of President Trump. It is very difficult to assess the financial market impact from the impeachment proceedings in Washington D.C. Only three U.S. Presidents have ever faced impeachment and financial market reaction was mixed. If the President were impeached by the House of Representatives, it is very unlikely that the Republican-controlled Senate would convict him. Unfortunately for the U.S. economy, the impeachment proceedings significantly diminish the likelihood that any fiscal stimulus programs will be enacted before the 2020 election.

- As we enter the fourth quarter, the four keys to financial market performance that we identified back in January remain our primary focus. They include Fed interest rate policy, U.S.–China trade policy, Chinese economic growth, and U.S. dollar strength/weakness.

- U.S. and Chinese officials are scheduled to meet in Washington D.C. in early October for high level trade talks. With less than a year to go before the 2020 presidential campaign kicks off, President Trump needs to prove to the American public that he can actually negotiate a trade deal. In the meantime, uncertainty facing the stock market and business spending remains. The longer this high level of uncertainty lingers, the greater the negative impact to the global economy and possibly the President's re-election chances.

- As for Fed interest rate policy, although Fed officials appear to be divided about their next move, we believe an additional rate cut in October appears more likely than not. Global manufacturing data continues to weaken, most likely due to the lagged effects from higher tariffs and uncertainty over future trade policy which is negatively impacting corporate spending and business investment. ***We still believe that deflation is a greater risk than inflation and the Fed would be justified in cutting rates for a third time this year.***

- Although Chinese policymakers have begun increasing both monetary and fiscal policy stimulus, economic growth improvement is still missing. A resolution in the trade war with the U.S. is most likely needed before the world's second largest economy fully rebounds.

- The U.S. dollar strengthened to a two year high during the third quarter as U.S. economic data releases mostly came in stronger than expected, while Eurozone economic data was weaker than forecast. The annual rate of inflation in the Eurozone fell to its lowest level in almost three years during September. Investors believe the European Central Bank will have to be more aggressive than the Fed to counteract an economic slowdown. The U.S. dollar will not likely weaken until economic growth outside the U.S. begins to pick up.

PORTFOLIO STRATEGY & OUTLOOK

- S&P 500 corporate earnings have declined for the past two quarters and third quarter earnings are estimated to fall by 3.8%. If -3.8% is the actual decline for the quarter, it will mark the first time the index has reported three straight quarters of year-over-year earnings declines since Q4 2015 through Q2 2016. ***In order for earnings to rebound, there will need to be an easing in the trade war and further interest rate cuts by the Fed combined with a rebound in Chinese economic growth and a weaker U.S. dollar.*** In the meantime, stocks are likely to trade sideways to lower until such catalysts materialize.

- As for the dreaded R word which is frequently being mentioned in the media, recessions rarely happen when monetary policy is expansionary. Stock bear markets and recessions usually overlap. In other words, stocks rarely enter a bear market without a recession. However, the longer that trade tensions and tariff policies persist between the world's two largest economies, the more likely that global manufacturing will continue to weaken and U.S. agriculture, employment, and the price of oil could all suffer. Therefore, a contraction in the U.S. economy cannot be completely ruled out.

- We are hopeful that the U.S. and China will come to the realization that trade wars are not good, no one wins, and a deal will be reached very soon. Although, it may take a stock market riot and pre-election year polls in the U.S. to drive this point home.

- Nothing up to this point has changed our outlook from the start of the year. Therefore, we have not made any recent, significant tactical adjustments to portfolios. We continue to expect low nominal economic growth, low inflation, and no recession over the next year. Financial conditions remain supportive, the Fed is accommodative, bank balance sheets are sturdy, there are no identifiable imbalances such as financial asset or housing bubbles, and the rate of unemployment is historically low.

- In terms of specific risk-based asset classes, International Developed and Emerging Market stocks look more attractive than U.S. stocks based upon cheaper relative valuations. The slowdown in global economic growth has already been reflected in current pricing. If a trade deal is reached and global growth accelerates later this year, the Fed continues reducing interest rates, and the U.S. dollar weakens, international and emerging markets stocks could greatly benefit. We'll continue to be neutral on both asset classes until a trade resolution is reached between China and the U.S.

- As for bonds, much of the economic weakness, geopolitical risks, and trade uncertainty have already been reflected in U.S. Treasury prices. Rates in many countries are already at or near zero and the U.S. bond market is currently pricing in 3 more interest rate cuts by year end 2020. Although not unquestionably attractive at current yield levels, bonds still provide a stable source of income and act as a low-risk diversifier in balanced, asset allocation portfolios. We continue to favor U.S. Investment Grade Corporate bonds and Mortgage-Backed Securities over Government bonds. In the Municipal bond market, we expect demand for bonds to outpace supply of bonds for the remainder of the year keeping prices strong.

- If the Fed once again shows a reluctance to ease monetary policy like it did in the fourth quarter of last year, then we would reduce exposure to risk. Conversely, if the Fed and global central banks get more aggressive in easing policy, then we'd likely raise exposure to risk. If the U.S. and China were able to reach a conclusive trade deal, then we would increase our exposure to risk-based assets and reduce bonds and cash. Such an agreement could lead to a rebound in global business capital spending and a recovery in manufacturing. In the meantime, we will remain cautious, not fearful, with an underweight allocation to risk-based assets and an overweight allocation to bonds and cash.

Andrew Zimmerman, Chief Investment Strategist

ASSET CLASS TOTAL RATE OF RETURN PERFORMANCE SUMMARY AS OF 9/30/2019

Stock Indices	Asset Class	QTD Return	YTD Return	1 Year Return
MSCI AC World Daily TR N	Global Equities	-0.03%	16.20%	1.38%
S&P 500 INDEX	U.S. Large Cap Equities	1.70%	20.55%	4.25%
S&P 400 MIDCAP INDEX	U.S. Mid Cap Equities	-0.09%	17.86%	-2.51%
RUSSELL 2000 INDEX	U.S. Small Cap Equities	-2.41%	14.15%	-8.92%
MSCI EAFE	International Developed Market Equities	-1.00%	13.39%	-0.75%
MSCI EM	Emerging Market Equities	-4.16%	6.14%	-1.69%
FTSE E/N All Eqty ReitTR	Real Estate (REITs)	7.73%	28.49%	20.70%
U.S. Large Cap Sector Stock Indices				
S&P 500 ENERGY INDEX	U.S. Large Cap Equities - Energy Sector	-6.30%	6.00%	-19.21%
S&P 500 HEALTH CARE IDX	U.S. Large Cap Equities - Health Care Sector	-2.25%	5.64%	-3.57%
S&P 500 CONS DISCRET IDX	U.S. Large Cap Equities - Consumer Discretionary Sector	0.51%	22.46%	2.36%
S&P 500 CONS STAPLES IDX	U.S. Large Cap Equities - Consumer Staples Sector	6.11%	23.28%	16.85%
S&P 500 INFO TECH INDEX	U.S. Large Cap Equities - Information Technology Sector	3.34%	31.37%	8.60%
S&P 500 UTILITIES INDEX	U.S. Large Cap Equities - Utilities Sector	9.33%	25.40%	27.10%
S&P 500 INDUSTRIALS IDX	U.S. Large Cap Equities - Industrials Sector	0.99%	22.58%	1.35%
S&P 500 COMM SVC	U.S. Large Cap Equities - Telecom Sector	2.22%	21.74%	5.69%
S&P 500 MATERIALS INDEX	U.S. Large Cap Equities - Materials Sector	-0.12%	17.11%	2.70%
S&P 500 FINANCIALS INDEX	U.S. Large Cap Equities - Financials Sector	2.01%	19.60%	3.91%
S&P 500 REAL ESTATE IDX	U.S. Large Cap Equities - Real Estate Sector	7.71%	29.71%	24.74%
Commodities Indices				
ISHARES GOLD TRUST	Gold	4.44%	14.73%	23.36%
S&P GSCI Tot Return Indx	Broad Commodities	-4.18%	8.61%	-16.31%
Bond Indices				
U.S. Aggregate	Core Bonds	2.27%	8.52%	10.30%
Intermediate	Intermediate Government & Corporate Bonds	1.37%	6.41%	8.17%
U.S. Corporate High Yiel	High Yield Debt	1.33%	11.41%	6.36%
U.S. Treasury	U.S. Treasuries	2.40%	7.71%	10.48%
U.S. TIPS	U.S. TIPs	1.35%	7.58%	7.13%
U.S. Agency	U.S. Government Agencies	1.74%	5.98%	7.99%
U.S. MBS	Mortgage-Backed Securities	1.37%	5.60%	7.80%
Corporate	Corporate Debt	3.05%	13.20%	13.00%
Municipal Bond Index	Municipal Debt	1.58%	6.75%	8.55%

Notes: The DT Investment Partners' Commentary and Outlook discusses general developments, financial events in the news and broad investment principles. It is provided for information purposes only. The material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Investments in various asset classes entail different investment risks. For example, small cap stocks tend to be more volatile than large or mid-cap stocks. International and emerging markets stocks have exposure to currency fluctuations, foreign taxes, political instability and the possibility for illiquid markets. Fixed income investments involve interest rate and credit risks among others. Real estate investing includes risks such as declines in value of real estate, changing economic conditions, tax laws or property taxes. Commodities' investing is highly volatile and subject to changing economic conditions and the vagaries of speculators among other risks. One cannot invest directly in an index. Past performance does not guarantee future results.