July 2019

2nd Quarter Commentary

by Jonathan M. Hechscker

As we move into the third quarter and share our review of the first six months of the year, we want to take a moment to thank you for partnering with Pennsylvania Trust.

As a firm, we are thrilled with the performance of our investment and wealth advisors as we now manage and administer over $4.3 billion in assets (including $137 million in new assets in 2019) on behalf of a client base that is more diversified than ever. From our core family wealth clients to a growing number of institutional and nonprofit clients, we now offer more financial solutions than ever before. Our three internal equity strategies (Growth, Equity Income and Multi-Cap Value) continue to produce great risk-adjusted returns while our fixed income strategies continue to provide both ballast and an income stream that is greater than the market.

Our asset allocation strategies have also been expanded and offer portfolio diversification across the risk spectrum. In addition, our growing Socially Responsible Investing (SRI) platform now offers three diversified mandates that blend multiple responsible investment strategies to create portfolios with goals to meet the sustainability of the present without compromising the needs of future generations.

The second quarter was a small-scale version of the previous three quarters. Much like the third quarter of last year, April began with equity markets moving into record territory. A breakdown of trade talks spooked the market in May, which then resulted in a moderate pullback. In June, the central banks stepped in globally. Confronted by weaker economic data, trade concerns with China and Mexico and stubbornly low inflation, the Federal Reserve (the Fed) and the European Central Bank (ECB) indicated that aid is available in the form of further monetary stimulus. In the end, the bad economic news was good news for markets as we retested record highs by quarter end.

While markets rotated from bullish to bearish and back to bullish, the bond market remained strong. An early quarter move higher in rates was reversed as dovish comments from central banks and lower global interest rates allowed yields to decline, continuing the bullish price trend that began in the fourth quarter of 2018.

The current U.S. economic expansion turned ten years old this spring, and we believe still has room to continue. The main reason being, unlike prior expansions, low inflation has kept the pace of growth modest. While the latest reading reflected a robust 3.2% growth rate, the average GDP growth over the past ten years has been 2.1%. We believe that with inflation around 2%, longer-term Treasury rates around 2% and GDP around 2%, prices and productivity should remain balanced and prolong the cycle. In the end, bull markets do not die of old age; they normally get killed by the Fed due to an excess of overspending, overleverage or overconfidence, all of which are not currently prevalent.

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While the next recession is likely to be a few years away, some economic signals are noteworthy. The yield curve from the 3-month T-bill to 10-year Treasury note inverted in May, but the more widely recognized 2-year to 10-year segment of the yield curve is still positively sloped with yields of 1.75% to 2.00% respectively. An inverted yield curve has preceded the last seven recessions by an average of 14 months. In addition, manufacturing has weakened around the world, with a notable decline in the U.S. business surveys and continued weak-

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ness in China, Japan and Europe. While some of this can be directly linked to the ongoing trade disputes, the risk is that continued weakness in the manufacturing sector could lead to job cuts and falling consumer confidence. Lastly, we remain concerned by the rising level of global debt now yielding a negative rate. While this phenomenon has been a catalyst for gold's resurgence, the magnitude of this move (among other concerns) may limit the ability of central banks to address future recessions.

Lost in the headlines is the fact that all markets are off to a great start this year. Midway through the year, the U.S. market is enjoying its best start to the year since 1997. The NASDAQ Composite, S&P 500 and the Dow Jones Industrial Average are up 21.3%, 18.5% and 15.4% respectively. The two main international stock indices, MSCI EAFE, and the MSCI Emerging Markets trailed the U.S. markets but still posted 14.5% and 10.7% year-to-date increases. Bonds, stocks and gold do not always move in tandem, but they have this year. The Barclays Aggregate Bond index is up 6.1% year-to-date. High yield bonds are also performing well, showing gains of 9.9% this year, while gold is up 13.0%.

More recently, sectors that are most sensitive to the economic cycle (i.e., cyclicals) generally performed well. Financials, materials and technology were the best performing sectors during the second quarter while more defensive sectors such as staples, utilities and real estate posted more modest gains. The worst performing sectors were healthcare, which remains challenged by potential legislation changes to pricing and the energy sector, which was hurt by slowing global demand.

The current investment environment provides an occasion to reiterate investment observations:

- U.S. markets remain in a secular bull market, which has continued to reward long-term investors who benefit from staying invested over time.
- Headlines remain a distraction that should generally be downplayed. Emotions should be suppressed as long-term objectives, and risk tolerance should guide your investment decisions.
- Market corrections, like those experienced in December and May, are normal. These corrections ultimately are opportunities to buy risk assets at lower prices.
- In markets where security selection is as important as market risk, the idiosyncratic risks of concentrated positions should be addressed.

We believe 2019 should continue to be a good year for investors, albeit with expected volatility, as the markets still trade at reasonable valuations and the economy and earnings are still growing (though more slowly). We will be closely monitoring events as they develop but remind you, our clients, that patience is a virtue. We urge you to focus on long-term goals and not let tomorrow's headlines shake your confidence or derail your financial plan.

Again, we would like to thank you for your relationship and interest in following our thoughts. We wish everyone a happy Summer and encourage you to contact your portfolio manager with any investment questions, concerns, or perspectives as 2019 unfolds.

You may reach us at 610-975-4300, or
email info@penntrust.com.