Market Perspective

Q32019

All data and information as of June 30, 2019
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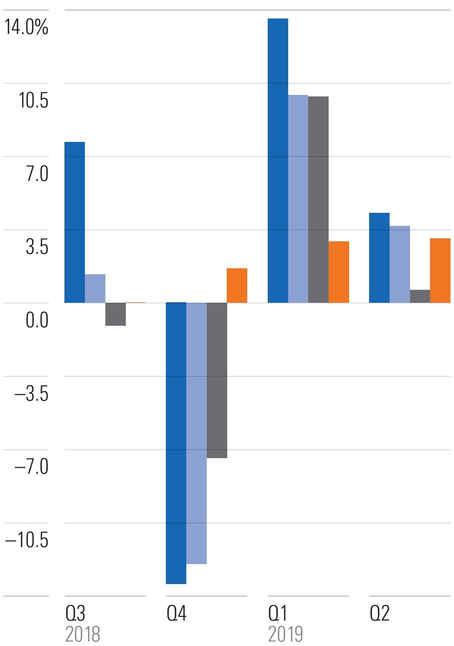
Quarterly Index Returns



Returns %	Q1 2018	Q2 2018	Q3 2018	Q4 2018
U.S. Stocks S&P 500	7.71	-13.52	13.65	4.30
International Stocks MSCI EAFE	1.35	-12.54	9.98	3.68
Emerging Markets MSCI Emerging Mkts	-1.09	-7.46	9.91	0.61
Bonds BBgBarc U.S. Agg.	0.02	1.64	2.94	3.08

Where Are Markets Headed?

Advisors ask us this question often, and we're sure they are asked the same question by their clients. Of course, the answer is, "No one knows where markets are headed—if someone did, they would quit work and invest every penny in the market they knew would rise the most!" We all know this question doesn't have a true answer, but that knowledge doesn't seem to stop us from asking it. And it doesn't stop some asset managers from answering it.

I'll warn you, it can be a dangerous question to ask—not so much in the asking but in what one does with the answer. That answer can come from a reputable source, like an asset manager or financial advisor, but often it comes from oneself. Think carefully—have you ever developed an opinion (maybe a hunch?) on where the markets are headed, even if you never shared it with anyone?

I expect most people have. Now I want you to think about how you arrived at your conclusion. What information fed into your decision? Again, I expect that for most of us, the quality and amount of information isn't as compelling when we face it squarely. The feeling of uncertainty about the future and the fear of loss can be powerful motivators whose influence we seldom recognize. Trade war tweets, new tariffs on Mexico, just about anything related to North Korea—these things can spook investors. Maybe you own a stock or a fund that you're tired of seeing underperform—or maybe it's hit a high and you're afraid it will fall before you can lock in gains. These feelings are natural, but the desire to avoid the pain of losing money can cause people to bail out of investments, missing out on potential future gains.

Tune Out the Noise

You may have heard this a million times—often the best move for investors to make is doing nothing. If left to compound over the long term, most major asset classes like stocks and bonds have a history of paying investors well. Over the short-term, however, it's anybody's guess. So how can you avoid those feelings that give you the urge to sell and seek safety?

It can help to avoid checking your investment balance and daily performance. Historical daily returns show many ups and downs, despite a typically upward trend over time. If you look at your investments every day, you're more likely to see more loss days, which may lead you to trade out of investments. This can be costly, not only in trade fees but in potential gains lost.

We also like to tune out the noise. For example, we don't have cable news running all day in our offices, nor do we hold a morning meeting, like many asset managers do, to review data that came in overnight.

Our Valuation-Driven Approach

We don't know what will happen to markets in the next three months, or even the next three years. However, we study asset class fundamentals and their market prices. This is valuation—comparing the quality of an asset, defined as the level and durability of its cash flows, with its price. Would you pay the same price for a chicken who laid an egg a week as for a one that laid an egg a day? If you were to go to the market (where they sold chickens, of course) and these two chickens were the same price, say $10, which would you buy? Further, if last week you sold an egg-a-day chicken for $20, would you be tempted to buy the $10 egg-a-day chicken today and take it back to the market next week to try to sell at a profit? We would. The best chickens aren't the ones that lay the most eggs, but those that have the lowest price per egg laid.

This is valuation-based investing. We don't know what the market will do tomorrow, and we might not even be able to explain why the market might be offering $10 egg-a-day chickens. But we strongly believe that if we buy a healthy one, we'll be able to sell it for a profit later.

So Where Are Markets Headed?

We still don't know. But as investors we do need to get some sense of what the future might look like. In a recent interview, the famed value investor Howard Marks said, "the future is never fixed or knowable … so, at best, the future is merely a probability distribution. All you can do is get the odds on your side."

At Morningstar Investment Management, our way of trying to get the odds on our side starts with valuation. For example, our investment research leads us to believe that U.S. stocks are overpriced, which means that investors should expect lower returns from them over the next decade or so than they may have returned over the past decade. Whether and how trade wars, interest rate moves, or any other unpredictable events might affect risk and return is something we can factor in only in an imprecise way.

Our approach leads us to build multi-asset portfolios that aim to limit exposure to investments we expect to have weaker returns going forward and instead own those we think may perform better.

We believe this approach will benefit you in two related ways. First, we expect our portfolios to provide a smoother ride to your investing destination, whatever it may be, assuming you've worked with a financial advisor to select the right portfolio to suit your needs. Second, because of that smoother ride, we hope to make it easier for you to avoid the noise—to instead focus on things you can control, like your savings rate, while ignoring the markets, which you can't control.

As always, we thank you for your consideration.

Opinions expressed are those of Morningstar Investment Management LLC and are as of December 31, 2018; such opinions are subject to change without notice.

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S&P 500 Index—An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. The S&P 500 is a market value weighted index.

MSCI EAFE Index (Europe, Australasia, Far East)—A free float-adjusted market capitalization index designed to measure the equity market performance of developed markets, excluding the U.S. & Canada.

Bloomberg Barclays U.S. Aggregate Index—A market value weighted performance benchmark for investment-grade fixed-rate debt issues, including government, corporate, asset-backed, and mortgage-backed securities, with maturities of at least one year.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.