Q3 2019

Quarterly Market Review

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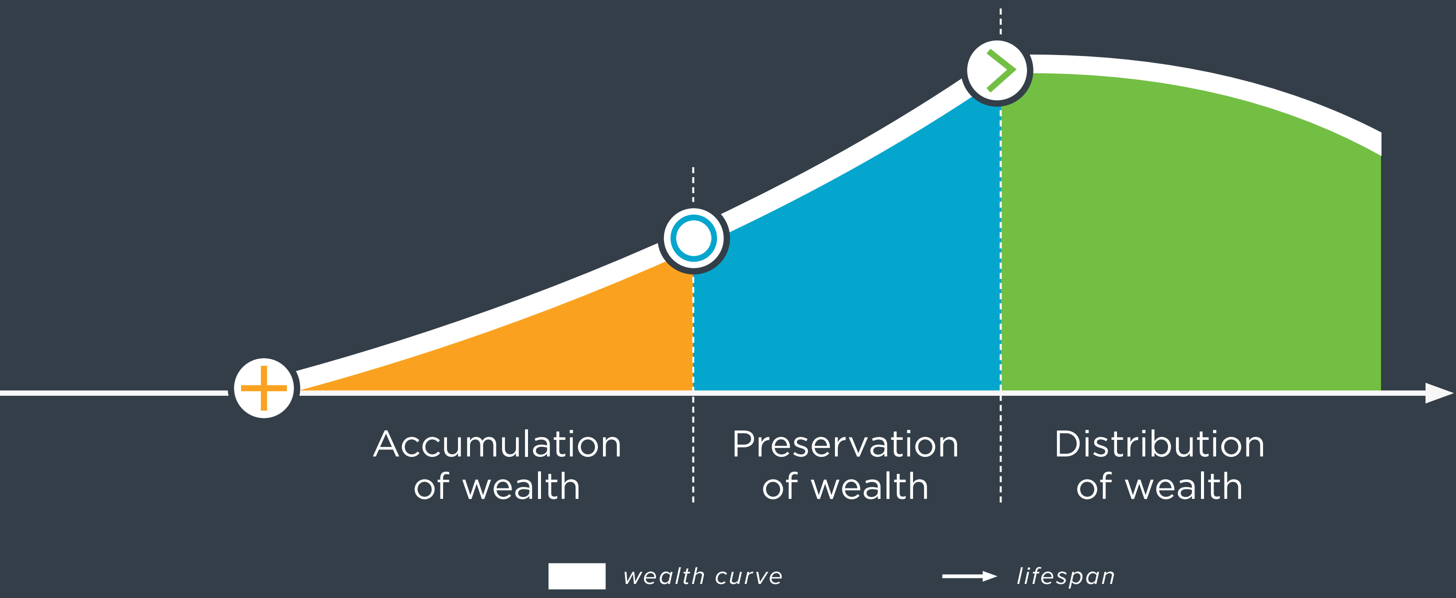
GAIN PROTECT SPEND®



What Is **Goals-Based** Investment Management?

True investment success is all about meeting the most important life goals that your clients have set out for themselves, their families and even the world at large.

That's why Horizon's approach is built on a commitment to **goals-based investment management**. A goals-based approach may help investors position their wealth to support the key financial results they seek throughout their lives. When your clients align their investments with their goals, they have the potential to achieve something that most people can only hope for: The financial security needed to live life on their terms.

All of Horizon's goals-based solutions are designed to provide a critical direct link between investment strategies and clients' key objectives. This link enables clients to address the three distinct stages of their investment journey: **Gain Protect Spend**®.

Across the investment lifecycle, these three stages demand different investment, risk mitigation and spending strategies. By offering a comprehensive suite of goals-based investment management options focused on gaining, protecting and spending wealth, Horizon achieves its primary purpose: to give investors the opportunity to successfully navigate these three key stages of their financial lives and achieve all that is truly important to them—at every step along the way.

Q3 MARKET NOTES

Inverted Yield Curve – different this time?
The yield curve inverted again in the third quarter, with the yield on 10-year U.S. Treasury bonds falling below that for the 2-year. The 3-month to 10-year curve first inverted in March of this year and the 2-year to 10-year curve then inverted in August.

Historically, a yield curve inversion has been a fairly accurate indicator that the economy was heading for a recession; prior to the last seven recessions, the yield curve has inverted (going back to the late 1960s). But these inversions all had one characteristic in common: each involved short-term rates moving up, while longer-term rates stayed more or less steady. Since the Federal Reserve has a great deal of control over the short end of the yield curve, another way of looking at this is "the Fed hiked too much."

This inversion is different, driven by a drop in long-term rates rather than an upward move in the short end of the curve (short end yields actually fell during the third quarter). This most recent yield curve inversion is not due to the "Fed hiking too much" — it is simply a result of classic supply/demand dynamics. With about $15 trillion in worldwide sovereign debt trading at negative yields, the U.S. has become a haven for investors seeking income (Figure A). While the yield on 10-year Treasuries is well below 2%, it's better than nothing, or less than nothing, in the case of some German, Swiss, and other government bonds. Investors, surveying their available options have determined that long-dated U.S. Treasuries are actually a pretty good deal — when compared with other sovereign debt — and have allocated accordingly. These flows have pushed U.S. government bond yields down on the long end of the curve while simultaneously leading to a stronger dollar.

This is something new — a global flight to the U.S. for income. Short-term rates have been coming down, too, as the Fed moves through a cycle of easing, but they remain positive as well. Consequently, this time is different in terms of market dynamics; whether it will be different in outcome remains to be seen.

There's an old joke that when you cross the street, watch the cars, not the light; nobody ever got hit by a light. Similarly, while we are keeping a close eye on the yield curve, we do not think it is the most telling metric in this cycle. We believe the focus should be on the financial health of the U.S. consumer, including spending, jobs, and household balance sheets. If the consumer stays the course, economic growth should too.

Stocks volatile, but returns subdued
Stocks were volatile in Q3, but went virtually nowhere overall. For the quarter, the S&P 500 Total Return Index was up 1.7%, the S&P Small Cap 600 Index declined by -0.2%, and international stocks declined by -1.6% (S&P Global Ex-U.S. BMI). Interest rates and trade were again the dominant themes, with defensive stocks and low volatility among the better performers. Utilities, up 9.33% (S&P 500 Utilities Sector) and Real Estate Investment Trusts (REITs), up 7.9% (Dow Jones US Real Estate Total Return Index), were the big winners for the period. Energy and healthcare underperformed, as did emerging market equities. Equities in the Latin American region were down -5.5%. Europe and Japan were relatively flat.

August was a tough month for U.S. financials and small-cap cyclical stocks, while September saw a short-lived reversal in this trend. Encouraged by positive trade developments

	Policy Rate	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr	15 Yr	20 Yr	30 Yr
Switzerland	-0.75	-0.89	-0.91	-0.92	-0.91	-0.85	-0.79	-0.59	-0.51	-0.39
Germany	-0.50	-0.68	-0.77	-0.81	-0.77	-0.74	-0.57	-0.45	-0.31	-0.07
Netherlands	-0.50	-	-0.77	-0.80	-0.70	-0.61	-0.43	-0.33	-0.11	-0.09
Austria	-0.50	-0.63	-0.71	-0.70	-0.59	-0.49	-0.33	-0.09	-0.01	0.24
France	-0.50	-0.63	-0.70	-0.73	-0.64	-0.50	-0.28	0.00	0.11	0.54
Belgium	-0.50	-0.64	-0.69	-0.70	-0.56	-0.47	-0.26	-0.02	0.20	0.54
Japan	-0.10	-0.32	-0.32	-0.35	-0.36	-0.36	-0.22	0.01	0.20	0.36
Spain	-0.50	-0.51	-0.52	-0.47	-0.30	-0.08	0.14	0.57	0.58	1.04
Portugal	-0.50	-0.43	-0.61	-0.45	-0.28	-0.05	0.16	0.54	0.73	1.07
Italy	-0.50	-0.25	-0.26	-0.12	0.21	0.49	0.82	1.37	1.56	1.91
United Kingdon	0.75	0.47	0.37	0.30	0.29	0.27	0.49	0.72	0.88	0.97
Australia	1.00	0.82	0.77	0.74	0.75	0.87	1.02	1.25	1.44	1.63
New Zealand	1.00	0.77	0.80	-	0.89	0.99	1.09	1.28	-	-
Canada	1.75	1.71	1.58	1.51	1.40	1.37	1.37	-	1.51	1.53
United States	2.00	1.75	1.62	1.56	1.55	1.62	1.67	-	-	2.12

Source I Bloomberg

Figure A I Interest Rates on Sovereign Bonds — As of 9/30/2019 and a cut in the Fed Funds rate, investors added cyclical exposure in hopes of accelerated economic growth. As has often been the case, those hopes were shortly undermined by weak data from U.S. manufacturing and the Eurozone. China's export-oriented economy continued to feel the impact of the trade war as well, with Hong Kong's Hang Seng Index down -7.82% for the quarter, and China's Shanghai Shenzhen CSI 300 Index down -3.13%.

More broadly, U.S. stock market valuations have barely budged over the last 18 months, with the S&P 500 Index trading at 18x forward earnings at the start of 2018, to 15x in last year's rocky fourth quarter, and back to 18x currently. Earnings have continued to be marked down, setting a low bar for the end of the year.

In China and other markets, headline risks, mostly trade-related, outweighed fundamental data. Chinese monetary policy has been largely expansionary in 2019 with the underlying data broadly supportive of a growing economy. In the U.S., consumer sentiment has been bouncing around all-time highs as measured by the University of Michigan Consumer Sentiment Index, supported by a strong job market and rising wages. The September jobs report was positive but noisy, with about 136,000 jobs added and the unemployment rate falling -0.2% to 3.5%. In addition, the prior two months were marked up, with August jobs climbing from an initial estimate of 130,000 to 168,000 and July jobs, from 159,000 to 166,000.

Federal Reserve Chairman Powell's communication skills, a source of considerable volatility over the past year, appear to have improved recently. In September he noted that the Fed's move to lower interest rates has supported continued economic growth and described the consumer as "strong." Markets are now expecting at least one more quarter-point cut, and perhaps two, by the end of the year.

Late cycle or not?

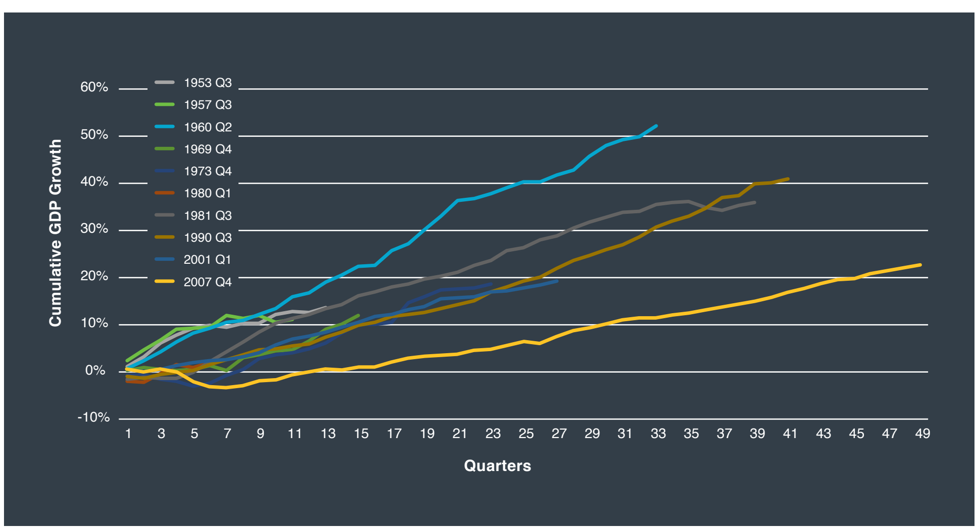
There has been a lot of waiting for more recessionary shoes to drop, with much of the media focusing on the "record long expansion." But while it is the case that we are experiencing the longest economic expansion since World War II, total GDP growth has trailed that of other post-recession periods.

As the accompanying chart illustrates (Figure B), we have not seen the kind of boom that usually accompanies a major bust. The 2007-2008 Great Recession was the most significant economic downturn in nearly 80 years, yet the corresponding recovery is the weakest on record going back to at least 1948. There appears to be no reason that we are "due" for a recession despite what many in the market and the media appear to believe.

Consumers, whose spending has roughly tracked the increase in wages and makes up about 70% of U.S. GDP, are not acting like a recession is imminent. Investors, however, are skeptical about the market's outlook. Though equities remain near an all-time high, the lack of upside momentum, coupled with the emerging conviction that the trade wars will not end anytime soon, has driven a lot of cash to the sidelines. Money market assets are now at their highest level since the Great Financial Crisis (GFC), as measured by the ICI Money Fund Assets Index, currently sitting at almost $3.5 trillion (it was $3.8 trillion at the height of the GFC in March 2009).

Markets are now awaiting a catalyst that will drive prices higher or lower. There are several candidates. Third quarter earnings, and particularly companies' forward-looking guidance, will be important. Next year's presidential election is starting to round into view, and several of the Democratic contenders are promoting policies that are less than investor-friendly. Factors weighing against this are generally supportive economic data, at least in the U.S.; the possibility of some reasonable outcome in the China-U.S. trade dispute (before the next round of tariffs go into effect at year-end); and the massive amounts of cash on the sidelines that could flow back into the market.

The idea that expansions end just because they have been around too long seems overly deterministic to us. Headline risk can cause temporary dislocations in the market, but whether the stock market goes up or down from here will depend more on the direction of the economic fundamentals and on the health of the consumer.



Source | Bloomberg

Figure B | Number of Quarters Since Prior Peak in Real GDP

As of 9/30/2019

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