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3Q 2019 Market Commentary *"Weird Ways"*

We enter the 4th Quarter of 2019 after a tumultuous year in the markets and geopolitical arenas. Last October, we highlighted the impact of two years of monetary tightening on various asset classes, which resulted in an ugly October for stocks before an absolute meltdown in December after the Fed's final rate hike of the cycle. The Fed, which has historically operated free of political influence, caved to an onslaught of pressure from President Trump and market pundits in January - the "Powell Pivot", whereby the Fed abruptly abandoned its tightening bias and began telegraphing the rate cuts that commenced in July.

Two years of Fed rate hikes threatened to end the decade-long bull market. Stocks only recovered in January after the Fed abandoned its tightening policy. Since the beginning of 2018, investment-grade bonds have significantly outperformed stocks.

The headwinds emerging a year ago are now serious risks set to push the global economy into recession in 2020 – just ahead of the US Presidential election. Last year's trade tensions have blossomed into a full-blown trade war between the world's two largest economies, and Europe continues to slide into recession due to its weak banking system and shrinking industrial production. Europe is the home to over half of the world's $17 Trillion in negative yielding debt, the dubious result of a decade of central bank money printing that punishes savers and destroys banking systems. President Trump's assault on the Fed has intensified, as he claims the US should push toward negative interest rates, where investors pay for the privilege of lending money. Economic data here in the US is starting to show trade-related weakness in the industrial sectors and a loss of consumer confidence. Finally, the breakdown in the Repo market suggests that the plumbing that provides liquidity to the US banking system isn't functioning properly.

Geopolitical risks have also intensified since last year. The US's surprise exit from Syria has further destabilized an already fragile situation in the Middle East and further empowered Russia's influence in the region. Brexit still hasn't been resolved and its potential economic impact is still hard to assess. Perhaps most importantly, impeachment proceedings here in the US, which looked like a long shot just a month ago, are on target to fill the quiet news gap between Thanksgiving and Christmas.

So with that as the backdrop, what could possibly go wrong?

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Outlook:

We expect the Fed to cut interest rates a quarter point to the 1.50-1.75% range at its FOMC meeting on October 30th, then set the markets up for a pause in rate cuts. After some gaps lower in rates earlier this year, US Treasuries seem to have settled into a range that suggests slower growth and exogenous factors such as trade will continue to be a drag on growth, but not a disaster. An acceleration of the trade war or intensification of impeachment proceedings would cause a flight to quality bid, prompting a move out of risk assets such as stocks. We are keeping a close eye on how well the Repo (interbank lending) markets are functioning, as these can be an early indicator of liquidity problems in the system. As we learned during the Financial Crisis, markets can still operate during times of economic weakness, but all hell breaks loose when liquidity disappears. We continue to believe short-term high-quality bonds offer relatively safe, positive total return potential in what we expect will be an increasingly volatile environment going forward.

Market Snapshot:

	12/31/18	9/30/19	YTD Change
Fed Funds Target Rate	2¼ - 2½%	1 ¾ - 2%	-0.50%
3-month US Treasury	2.41	1.80	-0.61%
2-year US Treasury	2.50	1.62	-0.88%
10-year US Treasury	2.68	1.68	-1.00%
30-year US Treasury	3.01	2.13	-0.78%
S&P 500	2,507	2,977	+18.7%
Stock Mkt Volatility (VIX)	25.42	16.24	-9.18
US Dollar (DXY)	95.87	99.38	+3.7%
Oil	44.87	54.24	+20.9%
Gold	1,288	1,480	+14.9%
Bitcoin	3,839	8,260	+115%

ARX Spotify Playlist: "Weird Ways" by Strand of Oaks

About ARX Fund Management:

Established in 2011 by professionals with direct experience in complex litigation and institutional investment management, ARX offers an unmatched mix of capabilities relevant to managing 1.468B Qualified Settlement Funds. Our expertise investing conservative capital preservation products is directly related to the management of institutional QSFs. Contact us today at arxadmin@arxmgmt.com to discuss a customized QSF for your settlement.

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