ECONOMIC AND MARKET COMMENTARY

2nd Quarter 2019

SMITH SHELLNUT WILSON

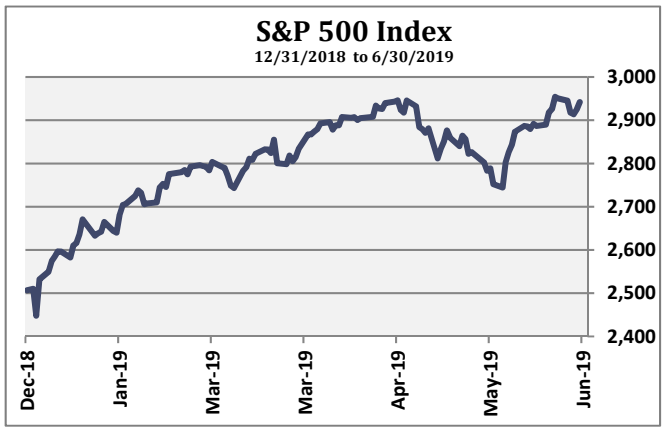
OUR MISSION

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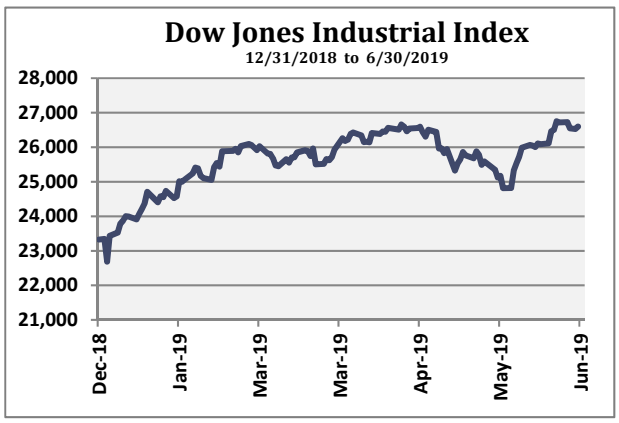
I. SECOND-QUARTER EQUITY MARKET RECAP

U.S. stock indexes ended the second quarter on a strong note, despite trade-induced jitters in May. For the six months ended 6/30/19, the S&P 500 was up by 18.54%, its best first-half showing in over two decades. For the quarter, the S&P 500 index rose by 4.30%, while the Dow Jones Industrial average notched a 3.21% gain, both including reinvested dividends.



The rally in equities has been partly supported by the Federal Reserve, as policy makers have indicated a willingness to trim rates in the face of ongoing global economic and trade headwinds, saying that they will "act as appropriate" to maintain the current economic expansion.

Over the coming months, markets will face ongoing trade concerns, the standoff between the U.S. and Iran in the Middle East, the next step in the ongoing Brexit saga, the increasing rhetoric from what could be the most contentious Presidential election in U.S. history, and continued uncertainties with respect to global economic growth and monetary policies- - all, high-profile issues, any of which could lead to increased market volatility.



On the domestic economic front, economists and investors alike are braced for some rather lackluster gross domestic product (GDP) numbers for the second quarter. The initial estimate will not be published for another four weeks, but the Atlanta Fed's "GDPNow" forecasting tool is

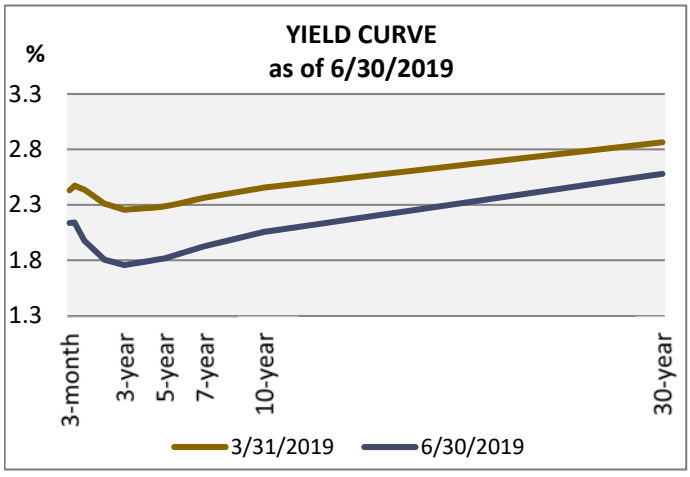
*Registration of an Investment Adviser does not imply any certain level of skill or training.

currently predicting 1.5% GDP growth for the second quarter, down from 2.1% just a week earlier. The New York Fed's "Nowcast" model has been posting readings below the Atlanta Fed model, and is currently forecasting 1.3% GDP growth for the second quarter, well below the 2.2% prediction in early May.

Coinciding with weaker second-quarter GDP expectations, the overall earnings trend of major companies has been weakening, with most investors hoping that trade resolutions and a Fed rate cut at the July FOMC meeting will underpin equity markets moving into the third quarter.

II. SECOND-QUARTER BOND MARKET RECAP

U.S. Treasury yields fell precipitously during the second quarter, with 2-year yields tumbling by 51 basis points, while 5-year and 10-year yields declined by 47 and 40 basis points, respectively, on the back of weakening economic data and a perceived reversal of policy stance on the part of the Federal Reserve.



U.S. investment-grade corporate debt rallied alongside of the Treasury market, as a dovish Federal Reserve, excess cash and light supply pushed the asset class to a 9.85% gain in the first six months of the year, marking its best first-half performance in nearly a quarter of a century.

The municipal market likewise fared well during the first half of the year, with the Bloomberg Barclays Municipal Bond Index posting returns of 2.90% in the first quarter of 2019 and 2.14% in the second quarter, even on the back of a 5.7% increase in supply during the first half of the year.

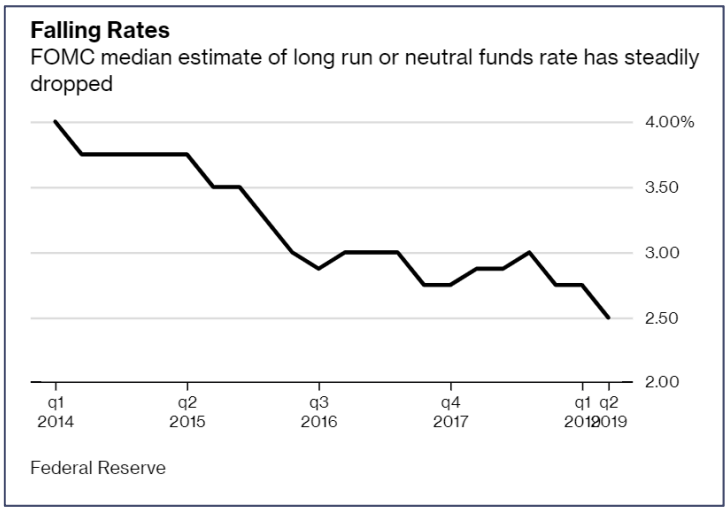
III. POLICY MAKERS SEE LOWER LONG-RUN RATE OUTLOOK AS GROWTH DIMS

Federal Reserve policy makers are discovering that they likely need to shift into an even lower gear if they are to speed up the U.S. economy.

Chairman Jerome Powell and his colleagues last month estimated that the so-called neutral interest rate -- the level which neither stimulates nor restricts growth -- now sits at around 2.5%, down from 2.75% in March and as high as 4% in 2014.

That means that the Fed's current benchmark of 2.25%-2.5% is unlikely to provide the power policy makers once assumed it would, leaving eight out of twelve FOMC members anticipating that they will have to reduce rates this year amid growing risks to the economic outlook.

For many years, the Fed has been arguing that monetary policy was easy and accommodative, supporting growth. After a decade of easy monetary policy, the Fed has decided that policy is no longer stimulative.



Reasons listed for the lower neutral rate include ongoing fallout from the financial crisis, weaker productivity, continued slackness in the labor market, and an aging population, which, when combined, leave the economy structurally weaker and more vulnerable to rate hikes.

The upshot is that the Fed may have to lower rates if it wants to boost expansion to offset global headwinds, including slow global growth and trade disruptions from President Donald Trump's tariff battles.

Futures Contracts

Fed funds futures contracts are pricing in at least a 25 basis-point cut in July, with roughly a 44% chance of a 50 basis-point cut. Those expectations for a steeper drop in the policy rate have grown in the days since Powell signaled a willingness to act swiftly "as needed" to protect the economy.

Forecast Shift

Fed officials didn't explain their reasoning in changing their forecasts in their latest Summary of Economic Projections. While some, including Powell, have said that they hope tax and fiscal policies will boost productivity, their lowering of the neutral rate is a concession that they are not expecting fiscal stimulus to be sustained. They estimate long-term economic growth at 1.8% to 2%.

"There was never going to be a big pickup in growth," according to Brad DeLong, an economist at University of California at Berkeley, who worked in the Treasury Department in the 1990s with Lawrence Summers, and, like Summers, has cautioned that growth is in a period of "secular stagnation."

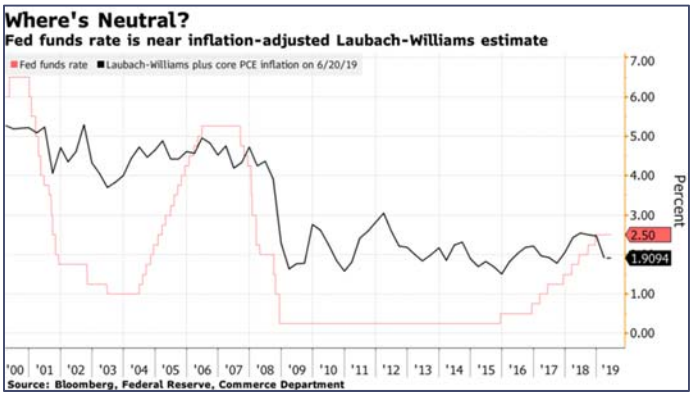
Estimates of the neutral rate of interest -- sometimes called "R-star" -- have helped to guide Fed policy for years as a loose benchmark that didn't get too much attention. Powell raised interest in the theoretical rate last October when he allowed that rates were "a long way from neutral," implying many hikes to get there. He backtracked a month later by saying that rates were just below a range of estimates of neutral.

The Fed's target rate has never peaked at such a low level, rising to more than 5% before the last two recessions. Policy rates averaged 4.8% in the 20 years ended in 2007.

"Low neutral interest rates are very real, and they're here to stay," New York Fed

President John Williams, a leading researcher of the neutral rate, said in a speech in June. He cited low productivity, slower population growth and a decline in demand for savings.

Williams and two Fed colleagues, Kathryn Holston and Thomas Laubach, have used economic data in a model to estimate the "real", or inflation-adjusted, neutral rate, pegged at 0.42% as of the first quarter, implying a nominal neutral rate of about 2% or so when inflation is included. That compares to rates of more than 5% in the 1960s and 3.5% as recently as the late 1990s.

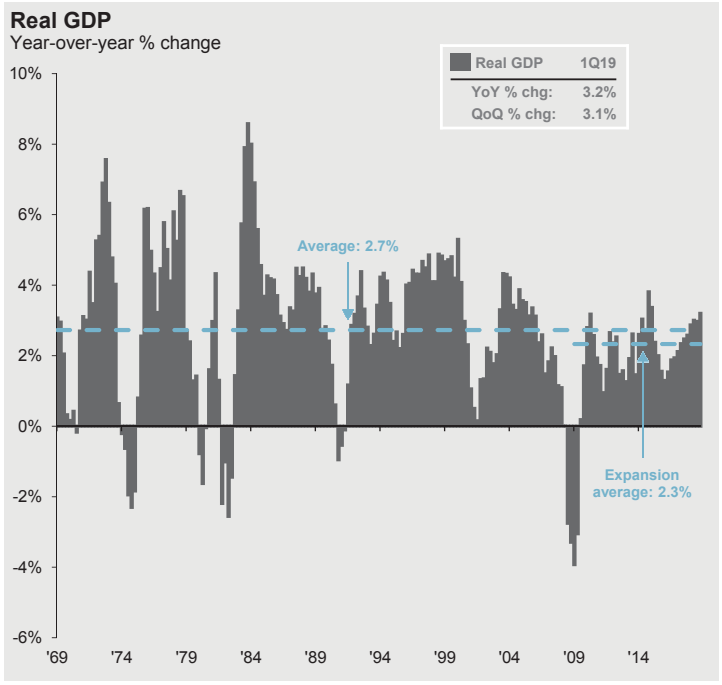


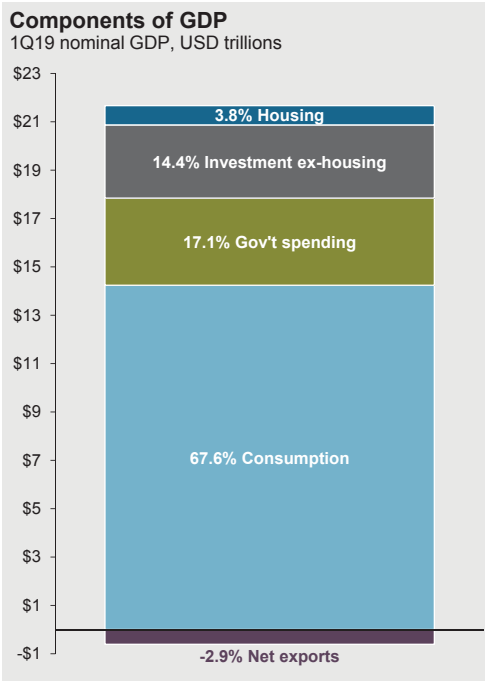
While estimates of long-term productivity have been unreliable, and some economists point to artificial intelligence and machine learning as potentially raising the level in the future, an aging population makes it unlikely there will be a big pickup in labor force growth. And, without a pickup in labor force growth, productivity, economic growth and interest rates are liable to remain low for the foreseeable future.

The source of the information in this commentary is SSW and Bloomberg unless otherwise noted.

Economic growth and the composition of GDP

Economy

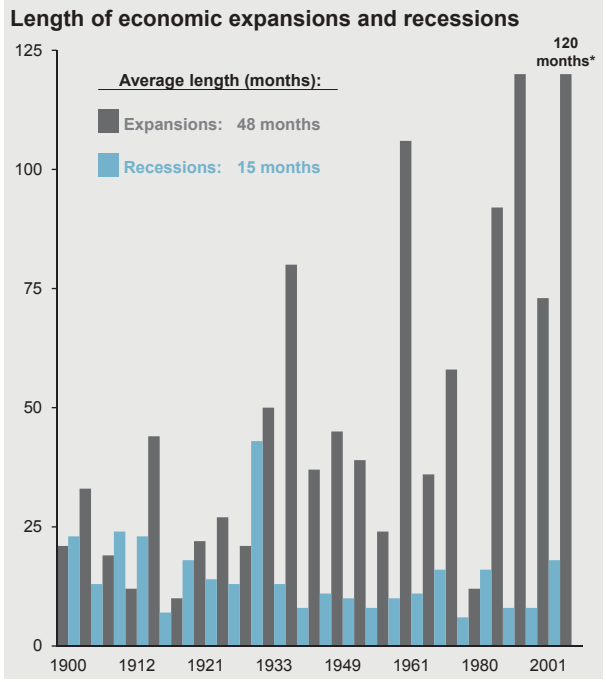


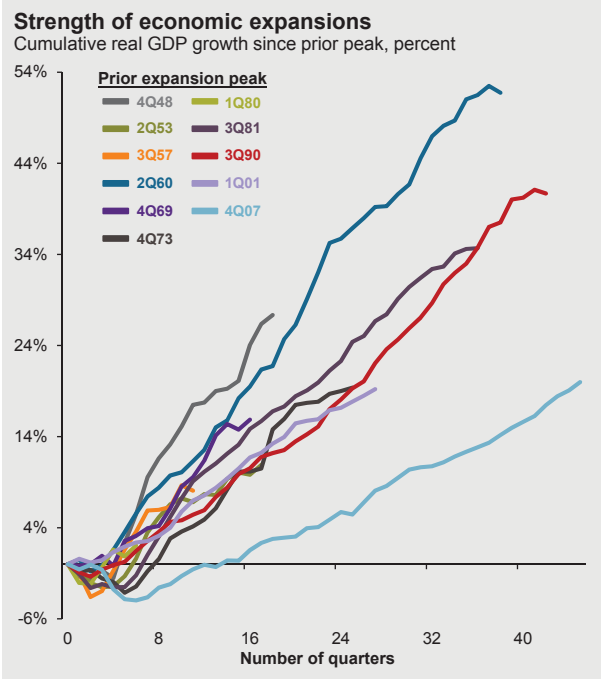


Source: BEA, FactSet, J.P. Morgan Asset Management.
Values may not sum to 100% due to rounding. Quarter-over-quarter percent changes are at an annualized rate. Average represents the annualized growth rate for the full period. Expansion average refers to the period starting in the third quarter of 2009.
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The length and strength of expansions

Economy





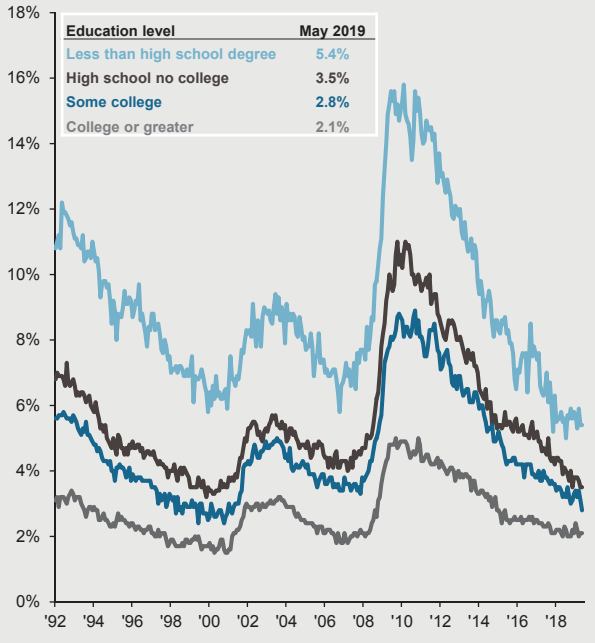
Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through June 2019, lasting 120 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/cycles/ and reflect information through June 2019. Past performance is not a reliable indicator of current and future results.
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Employment and income by educational attainment

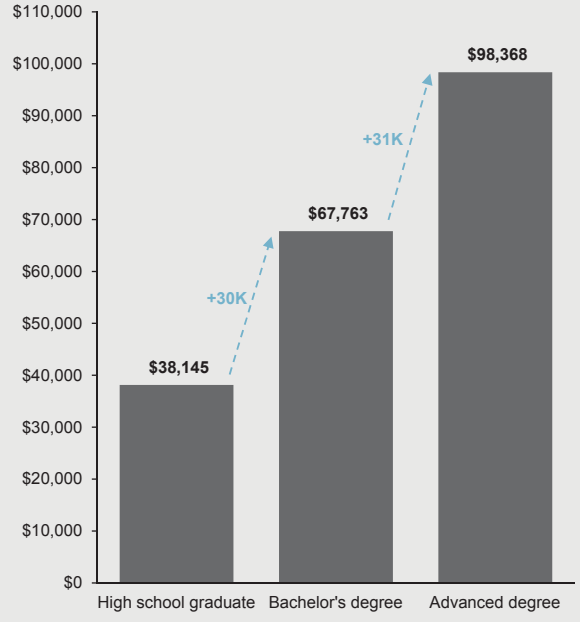
Economy

Unemployment rate by education level



Average annual earnings by highest degree earned

Workers aged 18 and older, 2017



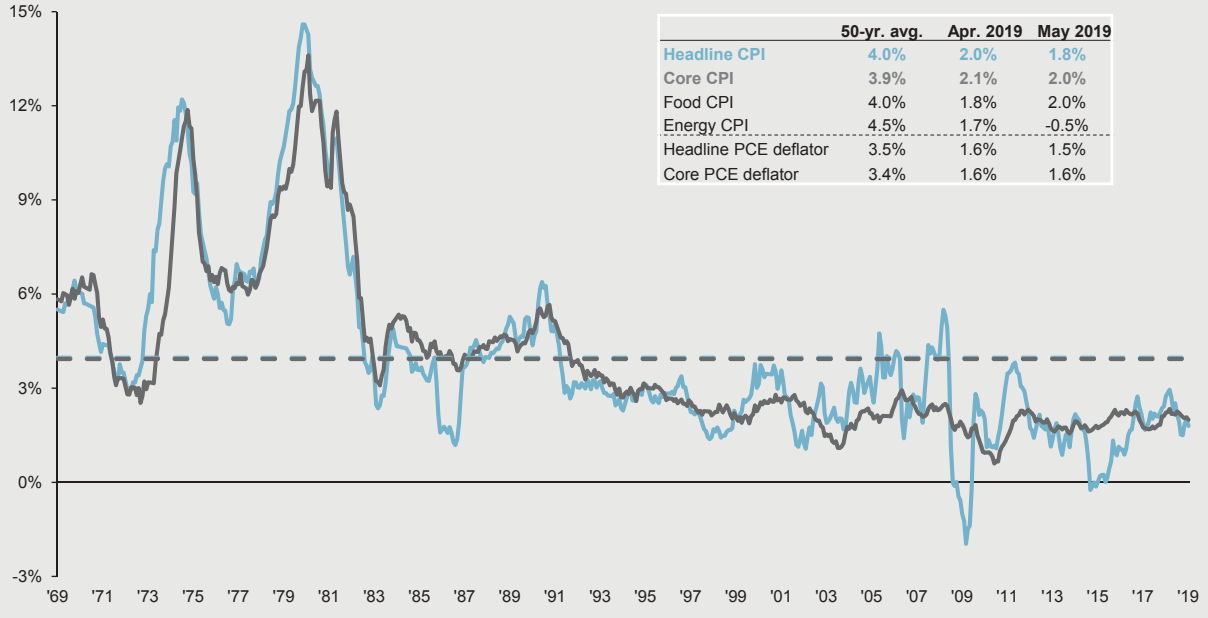
Source: J.P. Morgan Asset Management; (Left) BLS, FactSet; (Right) Census Bureau.
Unemployment rates shown are for civilians aged 25 and older. Earnings by educational attainment comes from the Current Population Survey and is published under historical income tables by person by the Census Bureau.
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Inflation

Economy

CPI and core CPI

% change vs. prior year, seasonally adjusted



	50-yr. avg.	Apr. 2019	May 2019
Headline CPI	4.0%	2.0%	1.8%
Core CPI	3.9%	2.1%	2.0%
Food CPI	4.0%	1.8%	2.0%
Energy CPI	4.5%	1.7%	-0.5%
Headline PCE deflator	3.5%	1.6%	1.5%
Core PCE deflator	3.4%	1.6%	1.6%

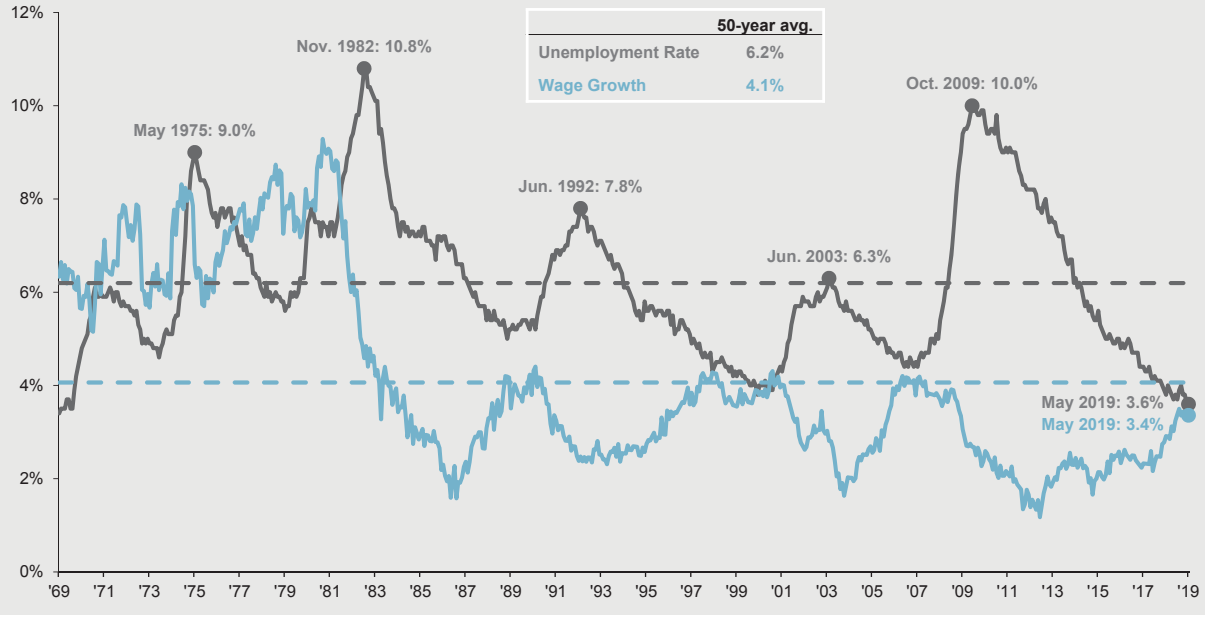
Source: BLS, FactSet, J.P. Morgan Asset Management.
CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations.
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Economy

Unemployment and wages

Civilian unemployment rate and year-over-year wage growth for private production and non-supervisory workers
Seasonally adjusted, percent

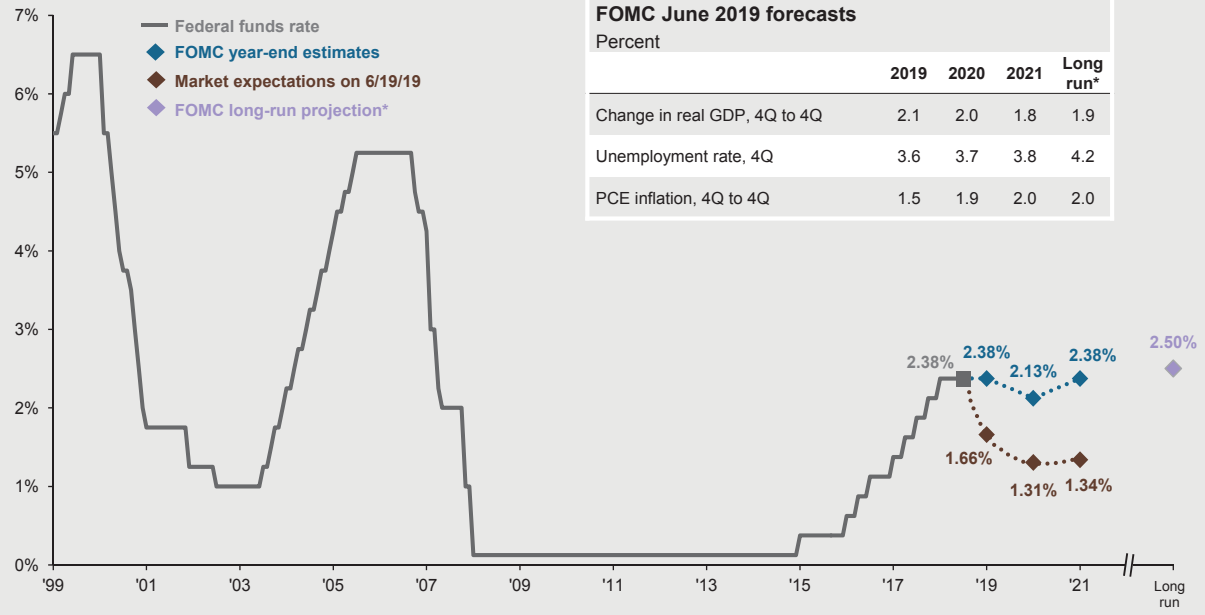


Source: BLS, FactSet, J.P. Morgan Asset Management.
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Fixed income

The Fed and interest rates

Federal funds rate expectations
FOMC and market expectations for the federal funds rate



FOMC June 2019 forecasts
Percent

	2019	2020	2021	Long run*
Change in real GDP, 4Q to 4Q	2.1	2.0	1.8	1.9
Unemployment rate, 4Q	3.6	3.7	3.8	4.2
PCE inflation, 4Q to 4Q	1.5	1.9	2.0	2.0

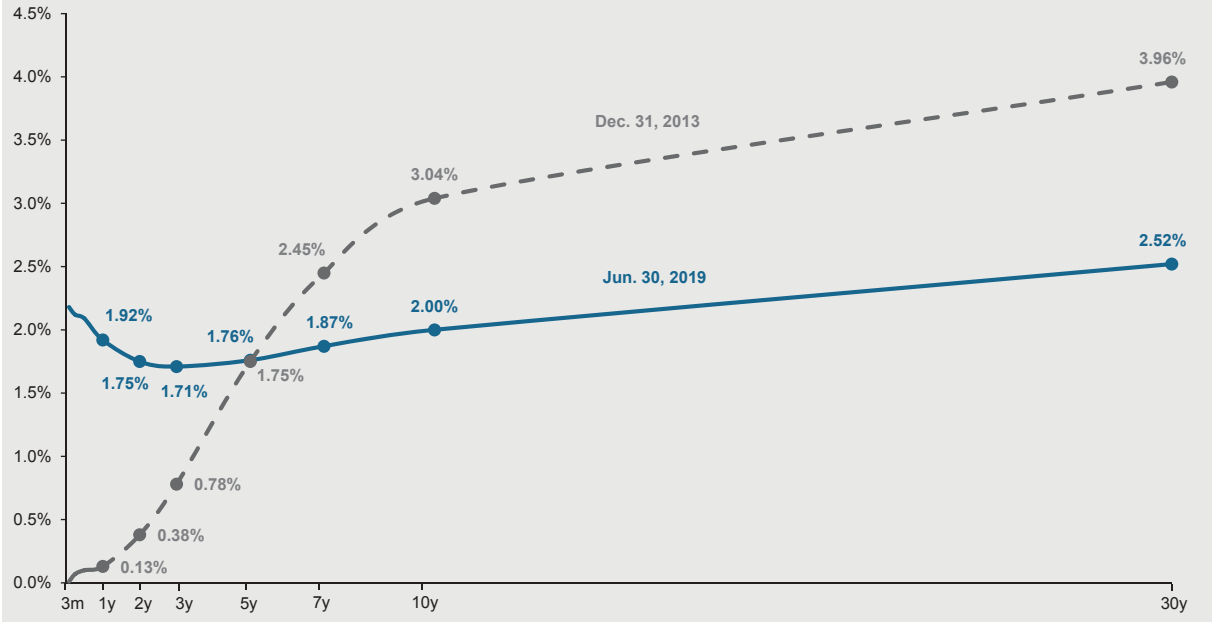
Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Market expectations are the federal funds rates priced into the fed futures market as of the date of the June 2019 FOMC meeting and are through December 2021. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy.
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Yield curve

Fixed income

Yield curve
U.S. Treasury yield curve

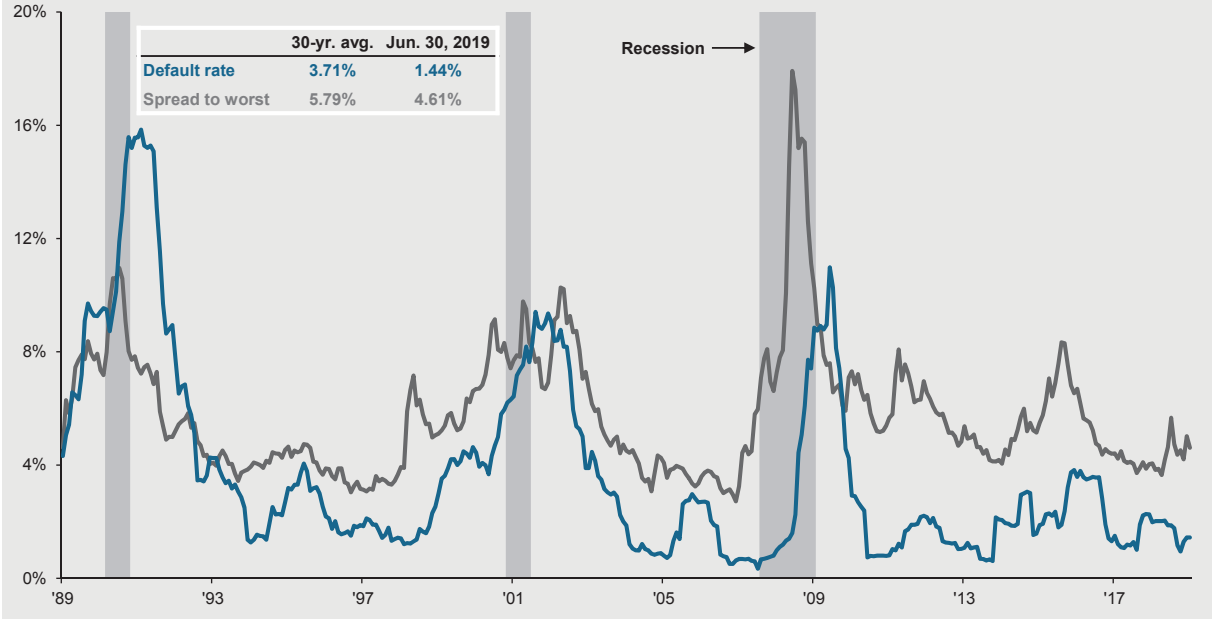


Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
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High yield bonds

Fixed income

Default rate and spread to worst
Percent



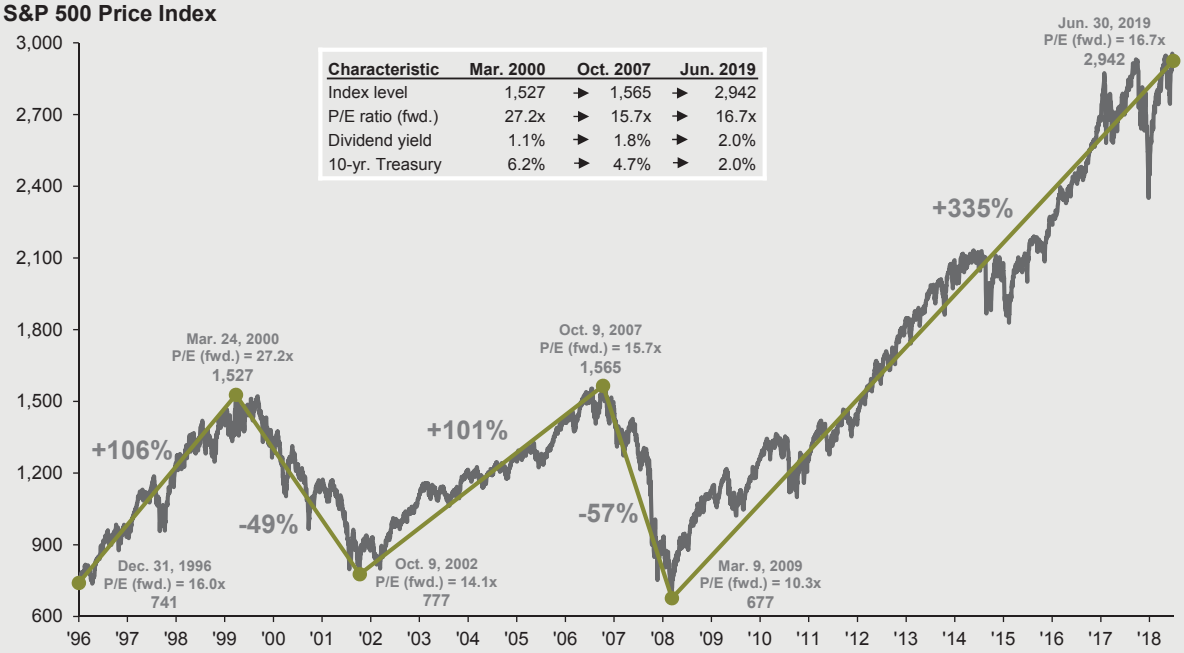
Source: J.P. Morgan Global Economic Research, J.P. Morgan Asset Management.
Default rates are defined as the par value percentage of the total market trading at or below 50% of par value and include any Chapter 11 filing, prepackaged filing or missed interest payments. Spread to worst indicated are the difference between the yield-to-worst of a bond and yield-to-worst of a U.S. Treasury security with a similar duration. High yield is represented by the J.P. Morgan Domestic High Yield Index.
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S&P 500 Index at inflection points

Equities

S&P 500 Price Index



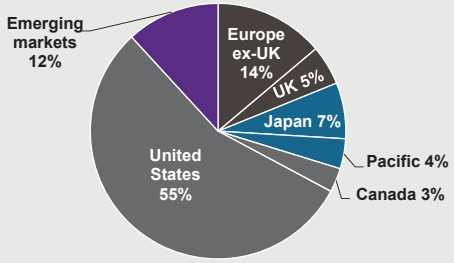
Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
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Global equity markets

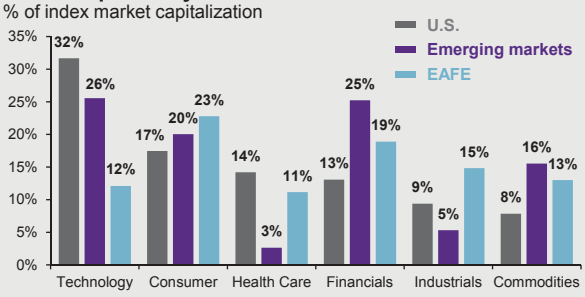
International

Returns	2019 YTD		2018		15-years	
	Local	USD	Local	USD	Ann.	Beta
Regions						
U.S. (S&P 500)	-	18.5	-	-4.4	7.8	0.86
AC World ex-U.S.	13.3	14.0	-10.2	-13.8	5.7	1.11
EAFE	14.1	14.5	-10.5	-13.4	5.2	1.07
Europe ex-UK	18.1	17.8	-10.6	-14.4	5.7	1.22
Emerging markets	10.2	10.8	-9.7	-14.2	8.3	1.27
Selected Countries						
United Kingdom	13.0	13.0	-8.8	-14.1	4.1	1.01
France	19.3	18.9	-7.5	-11.9	5.4	1.23
Germany	15.8	15.4	-17.7	-21.6	6.1	1.34
Japan	6.0	8.0	-14.9	-12.6	4.0	0.76
China	12.9	13.1	-18.6	-18.7	9.9	1.24
India	6.5	7.7	1.4	-7.3	10.0	1.38
Brazil	14.7	16.0	16.7	-0.1	10.0	1.50
Russia	21.3	31.6	18.1	0.5	4.8	1.53

Weights in MSCI All Country World Index
% global market capitalization, float adjusted



Global equities by sector
% of index market capitalization



Source: FactSet, Federal Reserve, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
All return values are MSCI Gross Index (official) data. 15-year history based on U.S. dollar returns. 15-year return and beta figures are calculated for the time period 12/31/03-12/31/18. Beta is for monthly returns relative to the MSCI AC World Index. Annualized volatility is calculated as the standard deviation of quarterly returns multiplied by the square root of 4. Chart is for illustrative purposes only. Please see disclosure page for index definitions. Past performance is not a reliable indicator of current and future results. Sector breakdown includes the following aggregates: Technology (communication services and technology), consumer (consumer discretionary and staples) and commodities (energy and materials). The graph excludes the utilities and real estate sectors for illustrative purposes.
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