EQUITY ALLOCATION

WHAT HELPED:
» Value-Oriented Equities
» U.S. Technology Sector
» International Equities

WHAT HURT:
» Emerging Market Equities

Global equities turned in another solid, albeit volatile, quarter as global central banks continued to ease financial conditions. While global economic data continued to deteriorate, the uplift in sentiment from lower interest rates and expectations of easy money policy played a bigger role in bolstering equity returns. The breakdown of trade negotiations between the U.S. and China resulted in a negative May, but a quelling of tensions resulted in equities advancing toward annual highs. U.S. equities outperformed international, with emerging markets lagging the world in terms of equity returns. Cyclical sectors, such as technology, financials, and materials, outperformed traditionally defensive sectors.

The equity allocation posted a strong quarter of positive returns due to its tilt toward U.S. equities and sectors tied to U.S. economic activity, such as technology, financials, and consumer staples.

NOTABLE PORTFOLIO ADJUSTMENTS DURING THE QUARTER:
• Increased exposure to U.S. equities, emerging markets equities
• Added U.S. materials sector
• Reduced staples and financials sectors

FIXED INCOME ALLOCATION

WHAT HELPED:
» Preferred Stocks
» Mortgage-Backed Securities
» High-Yield

WHAT HURT:
» Investment Grade Corporate Bonds
» Long Treasuries

Bond yields posted further declines in the second quarter due to the perfect storm of slowing economic data, accommodative policy from the world’s largest central banks, and a continued dearth of income globally, as characterized by the record $12 trillion of negative-yielding debt globally. Credit spreads remained relatively stable as lower yields presented easier financials conditions, which is favorable for corporate debt. Mortgage-backed securities underperformed other fixed income sectors, as a sharply lower-yield environment is unfavorable for MBS due to its negative convexity characteristics.

The fixed income allocation turned in a positive quarter with nearly all sectors contributing, primarily corporates, mortgage-backed securities, and high yield.

NOTABLE PORTFOLIO ADJUSTMENTS DURING THE QUARTER:
• Extended duration of portfolio
• Added IG corporate exposure
• Added high-yield exposure

OUTLOOK AND CURRENT POSITIONING

• Amid a weakening global economy and trade concerns, accommodative central bank policy has bolstered risk markets, sent global rates falling, and is likely to be the trend for the near-term. This suggests staying risk-on, but for investors, the difficult questions have yet to be answered.
• Namely, is this policy shift a temporary boost that will reverse the economic slowdown, or the beginning of a long easing cycle to manage us through a recession?
  Unfortunately, second-quarter data has suggested the risk of the latter is growing.
• Going into the third quarter it makes sense to position for an easing bias, where risk assets and spreads are resilient but volatility is higher as the reaction to policy is fickle.
  This would include a long-duration bias, an overweight to spread sectors, and a fairly bullish stance within equity allocations.

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