Market Perspective

Q4 2019

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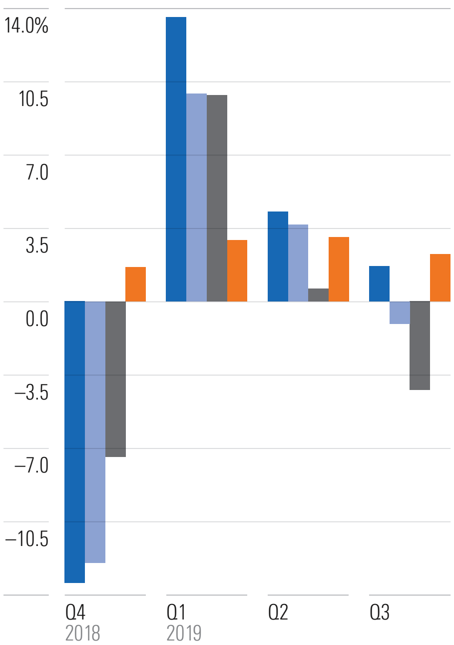
Quarterly Index Returns



Returns %	Q4 2018	Q1 2019	Q2 2019	Q3 2019
U.S. Stocks **S&P 500**	-13.52	13.65	4.30	1.70
International Stocks **MSCI EAFE**	-12.54	9.98	3.68	-1.07
Emerging Markets **MSCI Emerging Mkts**	-7.46	9.91	0.61	-4.25
Bonds **BBgBarc U.S. Agg.**	1.64	2.94	3.08	2.27

U.S. stocks ended the third quarter with a gain, further extending outperformance over international stocks. But bonds bested stocks in the quarter, as yields on U.S. Treasuries fell considerably. Emerging-markets stocks sank more than 4%.

Too Good to Be True?

U.S. stocks—as measured by the S&P 500—have climbed nearly 20% so far in 2019, a perhaps astounding outcome in a year riddled with uncertainty around trade wars and interest rates. Since the market's last rebound after the global financial crisis in March 2009, the S&P 500 has delivered an average annual return of nearly 16%—more than 50% greater than its long-run average return.

This latest bull run has stretched beyond a decade. These have been good times for investors in U.S. stocks.

But how long will it continue? This question seems to be asked more and more lately, with some market observers speculating whether a recession awaits.

Recessions and impending market loss can feel dreadful to investors, and rightly so. No one enjoys losing money, even if it's a number on a page or screen.

At Morningstar Investment Management, we are not fearing a recession. That's partly because we have long believed that the U.S. stock market has been overpriced relative to its underlying business fundamentals and expect a correction in prices to create buying opportunities for our portfolios.

"What's this?" you might be wondering, "my money manager wants prices to fall?" Well, not exactly. Again, falling prices would mean short-term pain for investors. But in the long run, significant buying opportunities typically happen after markets experience this sort of short-term pain. It seems as if these periods of short-term pain give birth to later periods of expanding growth and returns, much like the one investors have enjoyed the past decade.

The Importance of the Long Term

In the long run, even massive declines like the one experienced in the global financial crisis in 2008-09 have been overcome by the steady growth of companies and their stock prices. Again, the long-run average for stocks is over 10% a year; at that rate, your savings would double about every seven years. Of course, this compounding effect becomes more and more powerful the longer the investment period.

In fact, the latest SBBI Classic Yearbook states that $1 invested in U.S. large-cap stocks (like the S&P 500) at the beginning of 1926 would have grown to $7,030.31 as of year-end 2018. A similar investment in small-cap stocks would have netted $32,645.08. Mind you, that period includes many bad times—the Great Depression and the global financial crisis to name two. Yet, these markets multiplied $1 into thousands.

The Importance of Price

So, for investors, the key is to stay invested, knowing that historically down markets haven't derailed investors from long-term strong performance, as outlined above. However, we can't all invest for 90-plus years, as in the SBBI example. Many investors may be facing retirement soon and wonder what a recession or market downturn could mean for them. Of course, no one can know for sure, but if we return to looking at history, it may give us some clues.

Often when markets fall hard, they tend to fall beyond what may be justified by the circumstances. For example, during the global financial crisis, stock prices implied that markets believed that stocks would never grow again. Clearly this is an extreme assumption and one that proved to be very wrong, as the past decade of stock returns illustrates.

As valuation-driven investors, we expect to buy into falling markets once prices have dipped below our estimates of their fair value. Buying after a fall when prices are cheap means there's more room for an asset's price to grow and less room for it to fall.

As you might expect, we aren't waiting for a market crash to buy assets this way. Every day we search for assets priced attractively, but those assets are harder to find after a period of extended growth. Still, we expect that our buying discipline combined with our conservative positioning (which is based on our understanding of the market being overpriced) will serve our investors well in the event of a market decline.

Taken together—that is, aiming to buy low, be patient, sell high, and stay focused on the long term—we think this approach will help investors reach their financial goals.

Thank you for your consideration.

Opinions expressed are those of Morningstar Investment Management LLC and are as of September 30, 2019; such opinions are subject to change without notice.

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Index Information

Individual index performance is provided as a reference only. Each index is unmanaged and is not available for direct investment. Since indexes and/or composition levels may change over time, actual return and risk characteristics may be higher or lower than those presented. Although index performance data is gathered from reliable sources, we cannot guarantee its accuracy, completeness or reliability. Index data sources are as follows.

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.