F.L.PUTNAM
INVESTMENT MANAGEMENT COMPANY

September 30, 2019

Quarterly Review

Updates on: US Equities | International Equities | US Fixed Income | Asset Allocation

US Equities

Trade conflicts and mixed economic readings made for a choppy third quarter in US equity markets, as shown in the chart below. Domestic stocks rose to fresh highs in July in the run-up to the Federal Reserve (Fed) rate cut but retreated in August as business sentiment surveys and commercial tensions between the US and China worsened. US equity markets rebounded back toward July levels again in September as investors bid up value sectors that had lagged for much of the year, and closed out the quarter up roughly 1.7%.

While US equities have been driven by complex and interrelated moving parts, we believe there are three key forces at work:

Trade: In early August, the US announced that further tariffs on $300B of Chinese goods would be implemented in September and December. Later that month, China declared retaliatory levies on US goods; Washington responded by increasing its previously announced tariff rates. In early September, both countries began imposing new tariffs on specific products but officials also agreed to meet for another round of high-level trade talks in mid-October.

Macroeconomics: Global industrial indicators, particularly in the EU, have ticked down over the past twelve months. In September a US manufacturing index sunk to its lowest level in a decade with producers noting geopolitical and trade uncertainty as key impediments. While some recent surveys suggest that companies may need to restock their inventories to meet sales, newly placed orders have not yet buttressed that possibly positive sign. On the other hand, US service sector measures remain in growth territory despite year-to-date deceleration. The potential for continued growth in the service sector supports the notion that a recession is not imminent, particularly because manufacturing is a smaller component of overall domestic output.

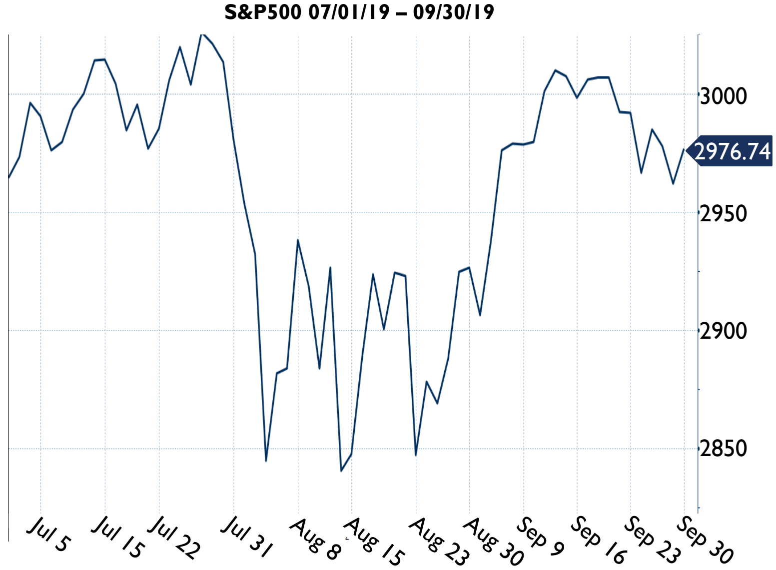
Monetary Policy: The Fed reduced interest rates twice during the quarter, representing its first cuts in over a decade and executing on its previously telegraphed pivot towards proactive stimulus.

Underlying the S&P 500's modest Q3 advance, returns varied markedly among sectors with defensive groups such as utilities, Real Estate Investment Trusts (REITs), and consumer staples demonstrating continued market leadership. These businesses tend to have stable sources of demand that are less sensitive to worldwide industrial activity and are often viewed as safe havens during periods of uncertainty. Defensive dividend-paying equities have also benefitted from their attractiveness as bond proxies given low yields among fixed income investments. While defensive stocks sustained their upward momentum during the third quarter overall, value sectors posted a notable rally in September as slight bumps in interest rates and flashes of better-than-expected economic data drove investors into areas such as financials and energy.

In total, the S&P 500 returned 20.6% through the first three quarters of 2019, posting its largest gain in the same period since 1997. This impressive number, however, belies the index's subdued 2.2% trailing twelve month result, which reflects Q4 2018's sharp selloff.

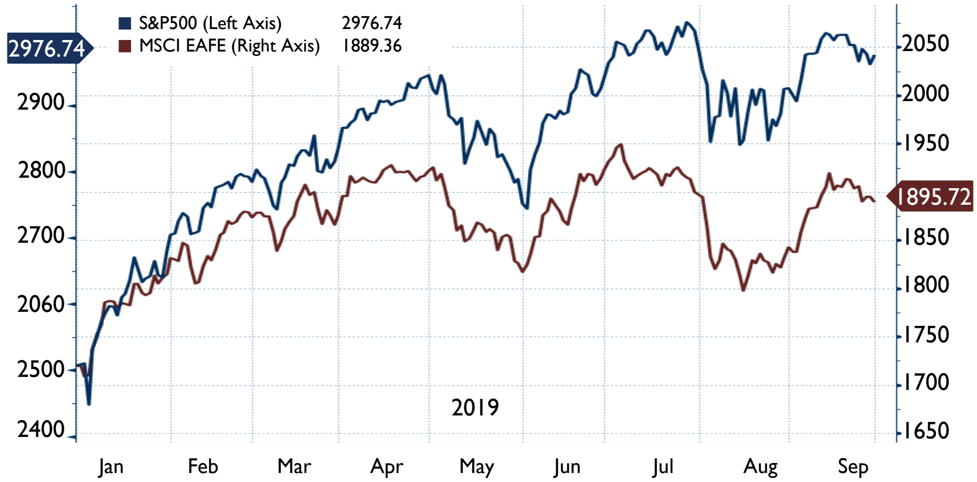
Looking ahead, Wall Street expects S&P 500 constituents to report year-over-year earnings changes of -3.7% in Q3 and 2.9% in Q4, which would bring overall 2019 earnings growth to 1.3%. Analysts forecast earnings expansion of 10.6% in 2020 but some market signals hint at investor skepticism about this reacceleration. For example, the difference between the broad stock index's earnings yield (which is the inverse of its price-to-earnings ratio) and the US government's 10-year Treasury yield is 4%, a spread so narrow that it typically only happens during recessions. Additionally, defensive stocks are trading at 20% valuation premiums relative to cyclicals, 1.4 standard deviations higher than the historical average differential. Given these factors, US equities already seem priced for a lackluster economic environment and could potentially surprise to the upside. We maintain our tilt towards the reasonably priced, high-quality and growing companies that we view as best positioned to appreciate in this late-business-cycle environment. ■

S&P500 07/01/19 – 09/30/19



INTERNATIONAL EQUITIES

In 2019 international equity markets were driven by global rather than local events, and especially the US-China trade dispute. As the chart at right shows, the performance of international markets mirrored the vagaries of US-China trade negotiations and expectations for monetary policy support. Worryingly, while international markets moved largely in line with the S&P 500 earlier in the year when optimism for a trade deal was high, they have since lagged as trade and economic uncertainties became more pronounced over the summer.



At the beginning of 2019, the concerns over faltering global economic growth, US-China trade uncertainties and tight US monetary policy that set off a market correction in December 2018 quickly faded. The US and China reached a trade truce and the Fed unexpectedly adopted a more dovish monetary policy stance. This optimism, however, took a decisive dip in May when the much-anticipated trade deal failed to materialize. Nonetheless, markets marched convincingly upwards in expectation of US monetary stimulus until July as discussed in our US equity market update.

Disappointment in US monetary policy guidance, signs of economic deterioration in Europe and China, and an escalation of trade rhetoric triggered a summer sell-off. In response to the Trump administration's threat to escalate tariffs, China took the pivotal step on August 4th to effectively devalue its currency, a gesture that signaled a hardening of resolve to "manage" the tariffs (by offsetting their impact through its currency) rather than make concessions. At the same time, democracy protests in Hong Kong (widely considered to be China's gateway to foreign capital) and the possibility of Chinese military intervention added fuel to the fire. In addition, economic data in the second quarter showing that Germany had fallen into a manufacturing recession and that China had grown at the slowest pace in seventeen years renewed worries of a global recession.

By early September, however, calm returned to the markets as China made overtures for a resumption of trade negotiations (scheduled for October 10th) and global monetary authorities including the Fed and the ECB provided much anticipated interest rate cuts. In addition, the British Parliament passed legislation outlawing a no-deal departure from the EU while the Hong Kong government formally withdrew the problematic extradition bill. Markets rallied following these developments, although some of the gains have been given back on recent news of possible capital controls in China. Year-to-date, EAFE is up 10.8% in US dollar terms.

Notwithstanding these positive developments, we remain cautious with respect to international developed markets. Trade tensions remain high. While negotiations are scheduled to re-start on October 10th, it is not clear they will result in a comprehensive deal. We believe that some of the issues underlying the dispute speak to the governance of China and are structural in nature. Regardless of the breadth of a potential deal, international economies expect some elimination of tariffs, which means that "trade" may remain a material risk even if a deal can be struck. The local political uncertainties that weigh on individual countries are also critical. The UK still lacks a plan to address Brexit given the fractured nature of its political body. Similarly, while the Hong Kong government has offered an olive branch to the democracy movement, their demands, such as universal suffrage, will remain a thorn in the side of the Chinese government.

All the major economies, including Germany, the UK, and Japan have seen downgrades to their economic outlook. In its revised outlook issued in July, the International Monetary Fund (IMF) forecast sluggish GDP growth in 2020 – 1.9% in the eurozone and a mere 0.4% in Japan. While global monetary policies will remain accommodative, it is unclear they will be sufficient to overcome the drag of tariffs on two of the largest economies in the world. Risks remain to the downside: deceleration in manufacturing activity could spill over into services and consumer spending, and crimp growth further. After repeated downward revisions, EAFE constituent companies are forecast to see average annual earnings per share growth of only 5% (from 18% in 2019) over the next two years. Even though individual security selection opportunities exist, valuation relative to growth is not particularly attractive with EAFE trading in line with its historical average.

Finally, from a currency perspective, US interest rates are the highest among developed countries, and it is likely the spread between US rates and the rest of the world will continue to place upward pressure on the US dollar. A stronger dollar provides a disincentive to invest in unhedged assets denominated in other currencies. For all these reasons, we continue to maintain a cautious approach to investing in developed international equities. ■

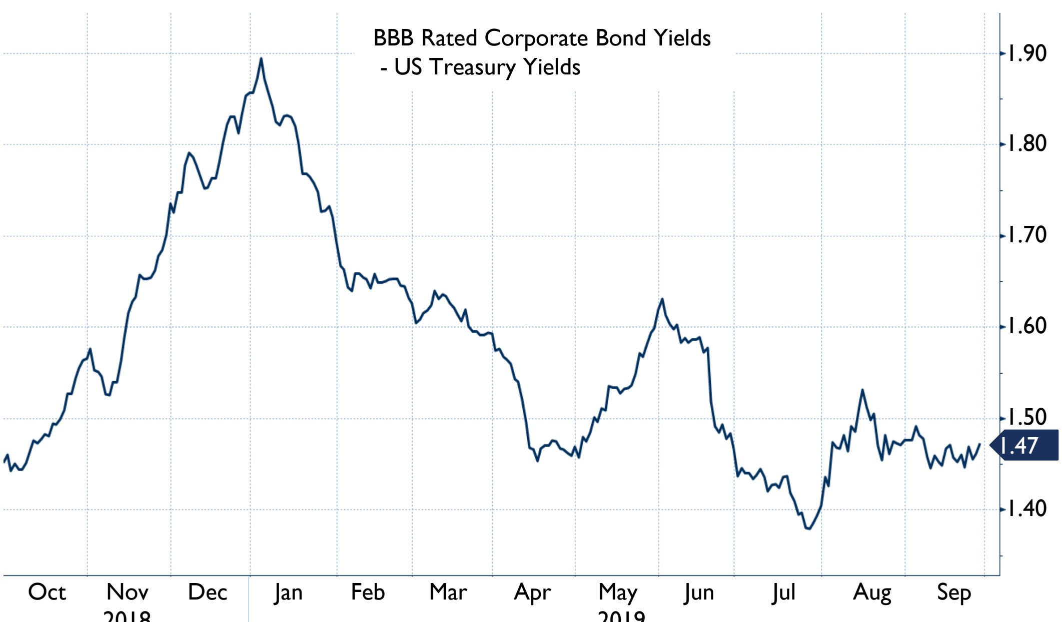
Global interest rates continued their year-to-date descent during the third quarter of 2019 as global monetary authorities responded to decelerating economic activity. In the US, the benchmark 10-year treasury yield began the quarter at 2.01% and declined as far as 1.46% before rebounding and finishing the quarter at 1.68%. While declining interest rates have led to surprisingly strong year-to-date returns for fixed income investors, these returns may prove to be unsustainable.

Since our last update, growth has continued to slow with the International Monetary Fund (IMF) cutting global growth expectations again while industrial and trade activity around the globe have begun to decline outright. In the US, the Leading Economic Indicators (LEI) have declined steadily while the yield curve briefly completed the inversion we discussed in recent newsletters. The slowdown has been most pronounced in the industrial economy that has felt the bulk of the impact of elevated trade tensions. The consumer economy has so far offset some of this weakness due to a robust labor market and low interest rates. Economic data remains mixed at best, but has come in slightly better than expectations in recent months.

The Fed reacted to this shift in the economic environment by reducing short-term interest rates twice in the last quarter, but cast doubt on future rate cuts at their meeting in September. Interest rate markets can be used to estimate market expectations for the probability of a Fed Funds rate cut. The probability of a third cut in 2019 rose from close to zero in May to 99% in August before declining toward the 72% level where it ended the quarter. The Fed remains under little economic pressure to reduce interest rates as it seems close to achieving its dual objectives of full employment and price stability. Unemployment remains near the lowest levels since the 1960s and the Fed's preferred measure of inflation has picked up marginally in recent months and is now just below their target of 2.0% at 1.8%. As a result, the Fed characterized recent interest rate cuts as a "mid-cycle adjustment to policy" rather than the start of a more aggressive cycle of monetary easing. Their caution in continuing to cut interest rates seems reasonable given mixed economic data and political pressure that makes it difficult to continue reducing interest rates without more decisive evidence of a downturn.

Much like the Fed, we are striving to remain "data dependent" in our fixed income tactics. We continue to gradually rotate into higher quality securities in recognition of the late stage of the business cycle while maintaining a shorter duration profile. We have been and remain wary of locking in today's low interest rates for the long term. One of the key missing ingredients for a more aggressive rotation into longer-term government securities is some evidence of weakness in credit markets. Corporations have increased their debt burdens substantially in recent years, but credit markets have so far remained remarkably stable despite slowing economic growth. The chart below depicts the difference in BBB-rated corporate bond interest rates and treasury bond interest rates over the past year. This "spread" expanded during the financial market volatility in late 2018 and improved dramatically in the first half of 2019. Since then it has bounced around at low levels despite economic deceleration, which may indicate that monetary policy's transmission mechanism is working effectively – investors are extending credit in order to generate interest income as the Fed reduces short term interest rates.

Overall, we continue to focus on the philosophy that drives our fixed income investment process, which prioritizes income generation and stability over appreciation from interest rate timing. Interest rates remain low and unattractive relative to historical levels and current inflation trends, but bonds still provide a valuable offset to volatile equities. In an economic downturn, interest rates in the US could join those overseas at much lower levels and make bonds an extremely useful diversifier for portfolios of cash and stock. For the moment, we remain defensively positioned with shorter maturities and a bias towards high-quality corporate bonds, consistent with a goal of stability and income generation given mixed economic data. At the same time, we are watching carefully for signs of rising recession risk as overall portfolio stability may eventually require increased allocations to longer maturities and government bonds. ■



ASSET ALLOCATION

The third quarter of 2019 was a roller coaster ride for investors, as stock and bond prices moved sharply in response to economic and political developments during the period but ended only slightly higher than where they began. Trade tension with China ruffled investors and focused attention on the continued global manufacturing slowdown. The UK and German economies contracted in the second quarter and negative interest rates alarmed investors. This was offset by a solid but slowing US economy that was primed by monetary and fiscal support to keep its engine rolling. As trade tensions eased and the European Central banks reduced interest rates, markets rallied into the end of the September.

US stocks outperformed international equities for the quarter as the large company S&P 500 Index returned 1.7% and is up 20.6% year to date. Large companies in the US beat out mid- and smaller-sized companies, which yielded returns of -1.3% and -2.4% respectively for the quarter. International stocks lost money for the three-month period as developed nations returned -1.0% and emerging markets returned -4.2%. For the year, international developed nations have returned 13.4%, while emerging market nations produced a return of 6.2%. Bonds were the big winners over the three months as investors positioned in intermediate-term corporate exposure were rewarded with returns of 2.6%.

Economic signals seem to be pointing to a slowing US economy, but one that is still growing around its long term trendline. The US consumer is healthy with unemployment at 3.7%. While unemployment claims moved higher recently, they still point to sustained labor market strength. After accelerating sharply in the second quarter, consumer spending slowed in the latest quarter. Trade war concerns have also weighed on consumer confidence, which declined in September according to the Conference Board. With 70% of the US economy riding on the consumer, these are key areas for us to monitor. Manufacturing isn't faring as well and appears to be impacted by global trade tensions. US business investment contracted in the second quarter as well. We remain concerned with global growth and do not see signs of a pickup in growth anytime soon. As such, we are under-weighted in international equities and have no exposure to international fixed income.

Our asset allocation strategy during the quarter focused on staying fully invested in equities with the belief that this economic cycle will continue in the near term. We reduced our overweight exposure to mid-sized companies and redeployed the proceeds to large capitalization companies. We remain underweight small companies that tend to struggle late in economic cycles. We are significantly tilted toward US versus international firms given the lack of growth abroad. Our fixed income strategy remains focused on owning corporate credit over government debt and staying short of the benchmark duration as the recent decline in interest rates seems unsustainable. This credit exposure is entirely investment grade debt as we have no position in high yield currently.

Overall, our asset allocation strategy is increasingly focused on higher quality US companies both in equities and fixed income.

GLOBAL MARKET RETURNS

		Last 3 Months	Last 12 Months*	30-Year Annual Return**
US Equities	S&P 500 *(Large US Companies)*	1.70%	4.25%	9.71%
	Dow Jones Industrials *(Selected Large US Companies)*	1.83%	4.21%	10.65%
	Russell 2000 *(Small US Companies)*	-2.40%	-8.89%	8.96%
	Russell 3000 *(All US Companies)*	1.16%	2.92%	9.72%
International Equities	MSCI World Index ex-US *(Developed Markets)*	-0.93%	-0.95%	4.54%
	MSCI Emerging Markets *(Emerging Markets)*	-4.25%	-2.02%	N/A
Fixed Income	Bloomberg Barclays Int. US Gov't/Credit *(Intermediate Investment Grade Maturities)*	1.37%	8.17%	5.50%
	Bloomberg Barclays US Corporate High Yield *(Non-investment grade "junk")****	1.33%	6.36%	8.13%
Inflation	US CPI Urban Consumers Less Food and Energy NSA	0.60%	2.39%	2.41%
Treasury Bill	US 3-Month Treasury Bill Index	0.56%	2.39%	2.97%

Source: Bloomberg Capital Markets

* Includes dividends for equity indices
** Annualized
*** CPI data for time periods is date ended 8/31/2019

FLP FINANCIAL PLANNING

As year-end approaches, many of us turn our attention to matters of financial housekeeping with December deadlines. With that in mind, we are dedicating this quarter's Financial Planning newsletter to two such topics:

Required Minimum Distributions (RMDs) and Medicare Enrollment.

REQUIRED MINIMUM DISTRIBUTIONS

The annual RMD (Required Minimum Distribution) is a rite of passage for retirees of all stripes. As with many other areas in Financial Planning, this topic is littered with shorthand, acronyms, and calculations. Looking for clarification online? Buckle up; you will be inundated with strategies, tips, and opinions. With this in mind, and as the end of the year approaches, we wanted to take some time to review some frequently asked questions on the topic of RMDs.

What is an RMD and why do I have to take it?

Traditional retirement assets are funded by pre-tax contributions and have enjoyed years of tax-sheltered growth. The IRS requires those of us with retirement accounts to take incremental distributions once we reach a certain age. These distributions are taxable as "ordinary income." In this fashion, the IRS gradually collects long-deferred income tax from the assets as you incrementally draw down the account. This is the tradeoff of the traditional retirement asset: tax-deductible contributions and tax-sheltered growth in exchange for eventual incremental, taxable withdrawals.

How is an RMD calculated?

RMDs are calculated by dividing FMV by LEF.

Fair Market Value (FMV) is the value of the retirement asset at the end of the prior calendar year.

Life Expectancy Factor (LEF) is an actuarial figure identified in the IRS life expectancy tables. This number increases incrementally with your age and can be found in IRS Publication 590*.

***Example*:**

On 12/31/18 your IRA FMV =	*$100,000.00*
Your LEF =	*÷ 27.4*
Your RMD due 12/31/19 =	*$3,649.64*

* IRS LEF Tables: https://www.irs.gov/pub/irs-pdf/p590b.pdf

What age do I need to start taking RMDs?

70½

Your first RMD takes place in the calendar year in which you reach the age **70½**.

***Example*:**

You're born on	*October 1, 1949*
You turn 70 ½ on	*April 1, 2020*

You should take your first RMD by 12/31/2020.

Can I delay my first RMD? YES! *but...*

Yes. First-time RMD withdrawals may be delayed until April 1st of the next tax year. This allows some extra time to organize withdrawals. But, such a delay would increase the total RMD income in that second year, as you'd have to take two distributions.

Consider the above example. The investor could delay her first RMD, taking it in March 2021. But she'd also be on the hook that year for her second RMD – due by 12/31/2021 – which would result in higher income for the year. Depending on a retiree's circumstances, this may or may not be a good approach. ***Accordingly, such a strategy should be reviewed with a tax professional.***

More RMD FAQs >

FLP FINANCIAL PLANNING

Medicare Open Enrollment Is Now

Medicare's open enrollment period runs from October 15 to December 7

Whether you are new to Medicare or you had Medicare coverage through 2019, it's time to look at your coverage options for next year.

There are essentially two avenues for coverage. First, there is Traditional Medicare with Parts A, B and D, each part covering a different range of needs. Alternatively, individuals can elect Medicare Advantage (also known as Medicare Part C). What you choose depends largely on your personal needs.

Traditional Medicare provides Part A for hospital insurance, Part B for medical, and an option to add Part D to cover your prescription drug costs. Part A coverage generally has no premium, Part B premiums currently start at $135.50/month and could increase based on your income level. Likewise, Part D premiums start at $0 and go up incrementally according to your income.

Medicare Advantage plans are provided by Medicare-approved companies. They usually cover the same services contained within Parts A, B, and D. However, they may also include additional services* that otherwise wouldn't be covered. You can use this option to shop for a plan that serves your specific needs.

How to decide? Start by looking the current year's needs. Make a list of any prescription drugs that you take and the dosage. Consider any conditions that need regular monitoring or treatment. Having a sense of your current medical care consumption should help you understand what type of services you may need in the coming year. Also, consider how much you are willing to spend in premiums to reduce your possible out of pocket costs.

It's a good idea to shop around before making any decisions. You can preview 2020 Medicare plans online at https://www.medicare.gov/plan-compare/#/?lang=en. Keep your list of prescriptions and services handy as you explore your options. Finally, contact us for help. Your financial planner may be able to shed some light or refer you to an insurance specialist who can guide you through the process.

*For a comprehensive description of Medicare options, consult the Medicare Handbook at https://www.medicare.gov/pubs/pdf/10050-medicare-and-you.pdf.

More RMD FAQs >

Are Roth IRAs subject to RMDs? NO! *But...*

Roth IRA accounts are not subject to RMD requirements, and can enjoy tax-sheltered growth for the duration of your lifetime. But, if you have assets in a Roth 401(k), these funds may be subject to RMD rules. Consider rolling your Roth 401(k) dollars into a Roth IRA.

While these are questions we frequently receive, there are certainly other facets of RMDs and retirement assets to explore. Furthermore, currently pending legislation may signal changes for some RMD rules in the near future. Bottom line? Keep in touch with your F.L.Putnam advisor and/or tax professional to ensure you are meeting your obligations and optimizing your situation.

Must I take an RMD from each of my retirement accounts individually? NO! *But...*

While each retirement account generally has its own RMD, some types (like IRAs) allow you to aggregate RMDs and withdraw the total amount due from a single account. Employer sponsored plans like 401(k) or 403(b) accounts do not typically allow for this type of aggregation.

Can I give my RMD to charity? YES! *And...*

Yes. A direct gift of cash from your IRA to a charity, within certain dollar limits, is called a ***Qualified Charitable Distribution (QCD).*** Such a distribution not only counts towards toward your annual RMD, *but also bypasses your tax return to the extent of the gifted amount.* In such a fashion, RMD obligations, tax reduction, and charitable giving intentions can all be addressed at once.