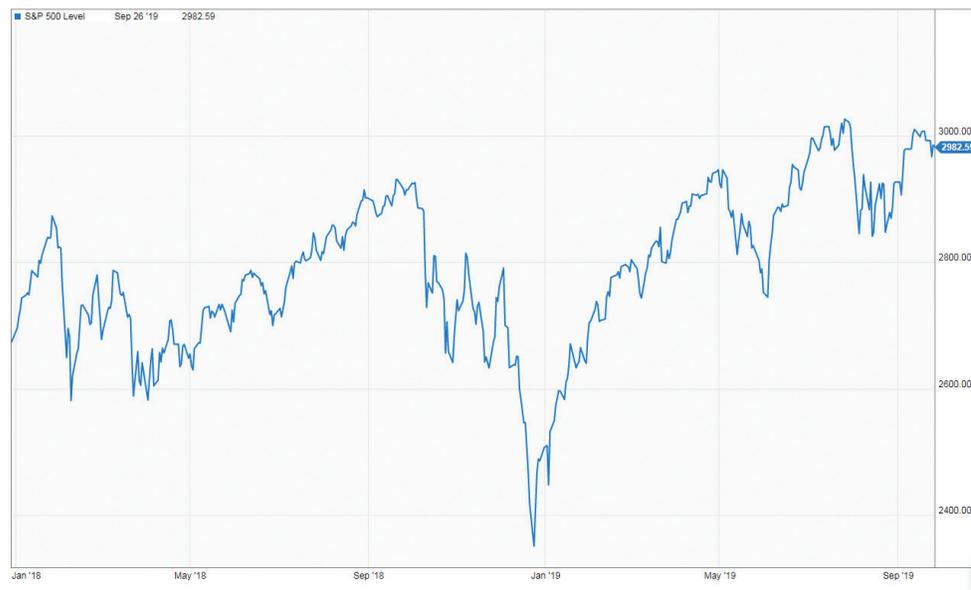


Economic Update

On a year-to-date basis and as we close in on the end of the third quarter, the major U.S. equity indices remain well into positive territory. As of 9/23/19, the S&P 500 and the Russell 3000 are each up just over 19% since the year began while the NASDAQ has advanced over 22%. U.S. equities started 2019 at a low point after falling precipitously throughout much of the 4th quarter of 2018. On a quarter-to-date and a last-twelve-months basis these same equity indices are mostly flat. Indeed, for the better part of the last 2 years, U.S. equity indices have traded within a relatively narrow range. You can see this in the S&P 500 chart below — between January 1, 2018 and 9/24/19, the S&P 500 had been mostly between 2800 and 3000. Despite this range-bound trading pattern of the last few years, many of the U.S. equity indices, including the NASDAQ, S&P 500, and Dow Jones Industrial Average, each made new all-time highs during the 3rd quarter of this year.



We think there are several key reasons why U.S. equity markets have not been able to break out of this trading range even though U.S. unemployment is quite low, wages are on the rise, inflation is manageable, housing data is turning more positive, and the Consumer Confidence Index continues to indicate the U.S. economy is expanding. These reasons include:

1. Global and domestic economic growth is slowing. While economic growth remains on a positive trajectory, the pace of growth has slowed. This growth slowdown is at least partly attributable to the ongoing trade dispute between the U.S. and China. According to Christine Lagarde, the current Chairperson of the International Monetary Fund and incoming President of the ECB, the tariffs China and the U.S. have imposed upon each other "are set to shave 0.8% off global economic growth in 2020" (<https://www.cnbc.com/2019/09/23/lagarde-trade-is-the-biggest-hurdle-for-the-global-economy.html>). This is a meaningful reduction in GDP growth. A number of economists also believe that U.S. GDP will feel the pinch of increased tariffs. UBS, a major Swiss bank, recently opined that "it sees U.S. gross domestic product growth slipping to 1.8 % in the fourth quarter before slowing to 0.5% in the first quarter of 2020 and 0.3% in the second quarter as the recent round of tariffs hits consumers' wallets" (<https://www.foxbusiness.com/economy/us-china-trade-war-economy-recession-impact>).

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In addition to the increased costs of the tariffs themselves, the unpredictable nature of this trade war and all the associated uncertainties are causing many business owners to just sit tight, act more conservatively, and delay expansion projects or hiring plans. Instead, they are exploring how to tweak or rebuild their supply chains to minimize and even avoid the tariffs. They are also waiting for more certainty and stability before assuming the risks of growth and expansion projects.

2. Interest rates are quite low around the world and upwards of \$17 trillion in bonds are now trading at negative yields (<https://www.smh.com.au/business/banking-and-finance/vaguely-troubling-negative-yielding-debt-hits-us17-trillion-20190922-p52t5m.html>). Monetary policies in the U.S. and Europe recently trended towards being more accommodative. The Federal Reserve dropped the fed funds rate by a total of 50 basis points (0.5%) over the last couple of months while the ECB just announced another round of quantitative easing. Current ECB President Draghi also specifically noted that European governments should consider implementing accommodative fiscal policies like tax cuts and increased government spending in order to further encourage and support economic growth. The Bank of Japan and the People's Bank of China have also hinted that further accommodative monetary policies may be put in place in the coming months should economic growth slow further. The progress, or lack thereof, towards resolving the China/U.S. trade dispute is a critical variable as all these economies are experiencing pain because of the heightened tariff environment.
3. Over the last several weeks, the overnight repo rate in the U.S. unexpectedly soared well above the fed funds rate. The repo market is a key source of short-term loans for major banks and hedge funds. At one point, the repo rate was just shy of 10% while the fed funds rate was hovering around 2%. Fortunately, the Federal Reserve acted quickly by funneling money into the U.S. financial system to restore order to this market and promised to continue doing so as needed. But, this recent stress in the overnight lending market suggests that perhaps the Fed was too aggressive in its efforts over the last 5 years to reduce its reserves which previously ballooned in response to the financial crisis. Other recent events contributing to this temporary shortage of overnight funds included a U.S. corporate tax deadline, a bank holiday in Japan, and even the failed WeWork IPO.
4. Political and geopolitical uncertainties in the U.S. and overseas have also contributed to a slowing economy and resulted in a reduced appetite for risk amongst investors and business owners. In the U.S., the threat of impeachment proceedings briefly unnerved equity markets during the last week of the quarter. It only took a day though for U.S. equity market to shake off this news. Of course, as these proceedings move forward (or not) U.S. financial markets will likely continue to react.

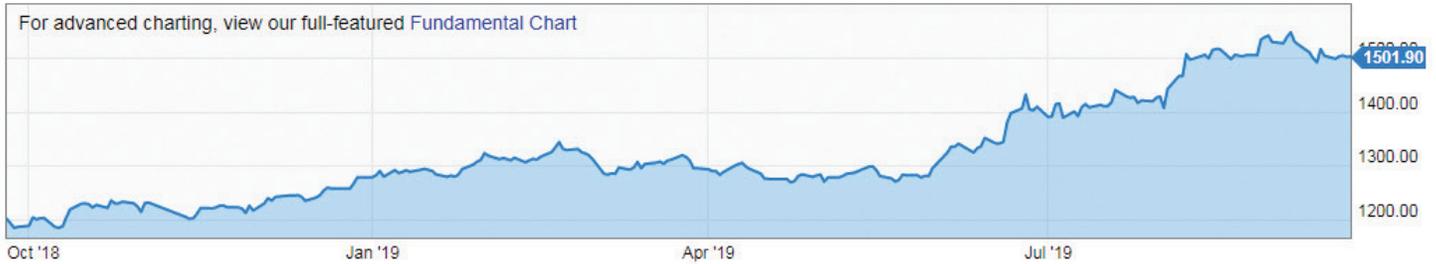
China is also juggling a number of difficult issues including the ongoing social and political unrest in Hong Kong, the trade war, and a slowing economy. China's GDP growth is at its slowest pace in 27 years and could fall below 6% in 2020 if the trade war continues (<https://www.scmp.com/news/china/diplomacy/article/3025771/trade-war-chinese-and-us-negotiators-agree-meet-early-october>). This could have long lasting social and political implications. For example, if China begins to experience mass layoffs or if millions of recent university graduates are unable to find employment, the potential for civil unrest rises.

Meanwhile, in the UK, the Brexit crisis continues to dominate headlines and inject large amounts of uncertainty into the British economy. There is some concern that a recession may be coming. Also, inflation has fallen well below the UK's 2% target and the value of the pound has dropped meaningfully in relation to many other major currencies.

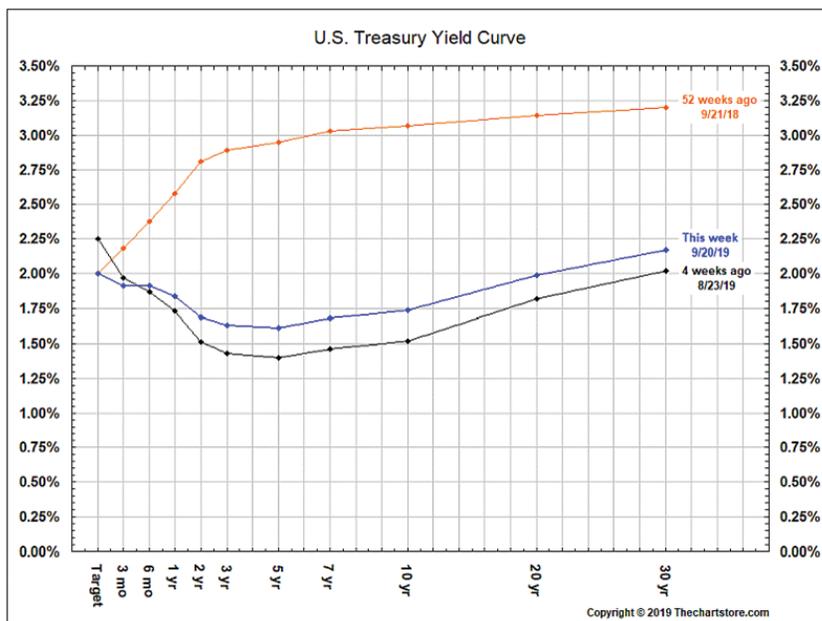
In the Middle East, Iran appears to be wreaking some havoc with drone strikes on two major oil facilities in Saudi Arabia and with the detention of several oil tankers near the Straits of Hormuz.

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There is no question that the list of issues weighing on domestic and global financial markets is daunting. The recent rise in gold prices attests to the many uncertainties plaguing financial markets and unnerving investors. Oftentimes, as uncertainties rise, the price of gold also increases. Some investors seek out gold in times of stress because they believe it has more immediate and reliable value than some other investments. You can see in the 1-year gold chart below that the price of gold is up about 22% over the last year as trade tensions and other issues have escalated.



As we look ahead to the remainder of 2019 and even into 2020, we think it is likely that heightened periods of volatility will erupt as these issues move closer to and/or further away from reasonable resolutions. It is also certainly possible that other unexpected issues will arise along the way, but, this is completely normal. We are encouraged that the Federal Reserve remains vigilant in its attempts to support the U.S. economy and that a number of the important central banks around the world are on the same page and acting to support their respective economies. Barring any unforeseen events, this should bode well for financial markets in the coming months.



Still, we are mindful that our slower growth environment causes some angst and that there may be a low level of pessimism simmering in the background. We also recognize that the U.S. economy is about 10 ½ years out from the end of its last recession (December 2007 – June 2009). This alone has some investors wondering whether we are close to a recession simply because this period of economic expansion has gone on for so long. Similarly, the inverted positioning of the U.S. treasury yield curve tends to be viewed as a strong indicator of a coming recession. The yield curve is inverted when the yields on shorter-term bonds exceed the yields on longer-term bonds. In a “normal” yield curve, the shortest-term bond has the lowest yield and the yields gradually climb higher as the maturity dates of the bonds are longer. As you can see in the yield curve graph

at left, however, much of the curve is inverted as most of the bonds are yielding less than the target rate (aka the fed funds rate which is an overnight rate).

In our opinion, the current inversion in the treasury yield curve is more an unintended byproduct of central bank policies around the world and less an indication that recession is imminent. Also, it is important to keep in mind that an inverted yield curve does not actually cause a recession. We think it is quite possible the Fed will announce another 1 or 2 interest rate reductions this fall or winter and that this would help the yield curve return to a more normal (non-inverted) shape over the next 6 or so months.

We realize this can be a difficult and confusing market for many investors. If you have any questions or concerns, please do not hesitate to call or email your financial advisor.

**Thanks
for Your
Patience**

Thank you to all of our clients for your incredible patience over the last 6 months! We recognize all the recent changes at BLBB – especially the custodial changes – have been confusing for many of you and have also resulted in additional paperwork and occasional delays in processing your requests. While these requirements may seem unnecessary and might slightly delay the completion of your requests, they are designed to protect you and your assets.

Among other things, your account custodian is specifically responsible for the safekeeping of your assets and to protect your assets from theft, loss, or misappropriation. Unfortunately, however, financial services firms, including BLBB and your account custodian, can be the recipients of fraudulent requests for asset transfers and other nefarious attempts to access or manipulate your accounts. In order to combat against these illicit activities, the custodians mandate rigorous documentation and other requirements on us as your financial advisor and on you in order to protect your assets. As frustrating as these requirements may be, at the end of the day, they are designed to safeguard your assets.

In order to avoid any unexpected delays in processing your requests for ACHs, wire transfers, securities movements, IRA distributions, etc. please try to build an additional day or two into your timing. This extra time is especially crucial when you are sending money or securities to anyone other than yourself and when you are sending money to yourself but at a new account or a new financial institution. Also, please note that we are no longer able to issue checks for you to pick up at our office.

If you have any questions or concerns, please do not hesitate to contact your financial advisor.



L to R: Doug Huntley, Clif Haugen, John Lawton, Laura Brewer, Dean Karrash



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