As central banks have become collectively more dovish throughout 2019, monetary stimulus appears to be back in control of the economic cycle. The Federal Reserve ratcheted up their easing posture at the June Federal Open Market Committee (FOMC) meeting as one voting member dissented from the group *in favor* of a rate cut. There were other non-voting members even arguing for a 50 basis point rate cut on concerns about the economic outlook and still muted inflation pressures. Keep in mind this abrupt flip in policy is coming despite unemployment at near half-century lows and inflation hovering around 2.0%, the supposed Fed target.

With that backdrop in play, it is no surprise that June was a good month for all risk assets. Within the Fixed income arena, the riskiest of bonds outperformed against the spectrum of safer fixed-income products. As the table below highlights, every major category performed well with emerging markets (EM) leading the way and investment grade (IG) and high yield (HY) corporate returns close behind.

RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return	Current Yield to Worst
U.S. Aggregate	1.26	3.06	5.98	7.65	2.50
Agg. Treasury	0.92	3.00	5.10	7.08	1.92
Agg. Investment Grade - Corp.	2.45	4.42	9.50	10.31	3.16
Agg. High Yield - Corp.	2.28	2.51	9.64	7.42	5.87
Agg. Securitized (ABS, MBS, CMBS)	0.73	2.03	4.25	6.23	2.68
Agg. Investment Grade - Muni.	0.37	2.12	5.00	6.54	2.02
Agg. Emerging Markets	2.71	3.72	9.07	10.55	4.88
Data as of 06/30/2019					

Fixed income has now completed a ?round trip? from June 2018 as yields and spreads in almost every category are back below the levels observed at the same time last year. The tables below illustrate those moves in both yields and spreads.

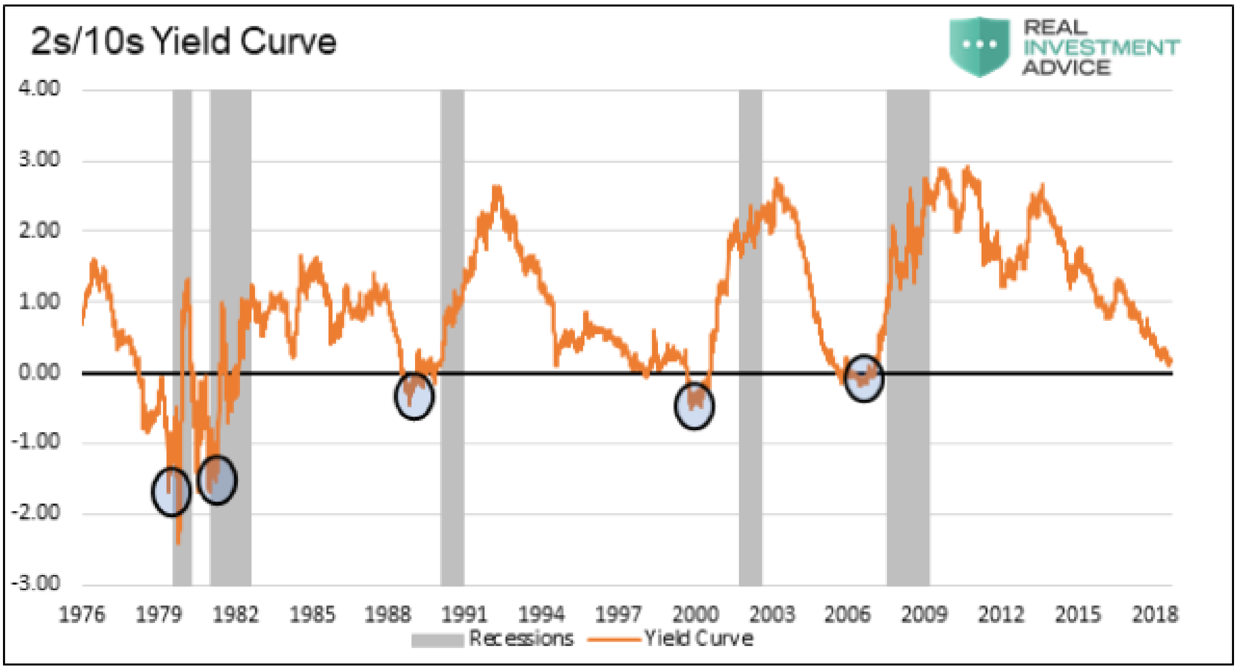
Sector	Yield (%)		
	6/30/2018	12/31/2018	6/30/2019
2-Year UST	2.52	2.49	1.75
5-Year UST	2.74	2.51	1.76
10-Year UST	2.86	2.68	2.00
Aggregate Index	3.29	3.28	2.49
Investment Grade	4.02	4.20	3.16
High Yield	6.50	7.95	5.86
Emerging Markets	5.76	6.05	4.87

Sector	OAS		
	6/30/2018	12/31/2018	6/30/2019
Aggregate Index	0.44	0.54	0.46
Investment Grade	1.23	1.53	1.14
High Yield	3.63	5.26	3.77
Emerging Markets	3.00	3.42	2.91

The anticipation of what is being called ?insurance rate cuts? from the Fed as well as easing measures expected from the European Central Bank (ECB), offered investors comfort that these potential actions will keep downside risk and volatility at bay. The hope is that the central bankers are sufficiently ahead of the curve in combating weaker global growth.

Despite investor optimism about the outlook as evidenced in the first half performance, risks remain. Most notably, ongoing deceleration in trade and industrial activity could worsen and bring an end to the current record-long economic U.S. expansion. The United States is surrounded by economies that are faltering, including Canada, Australia, Europe, Japan, much of southeast Asia and, most importantly, China. The Trump trade policy agenda only adds to these risks, especially for those countries dependent on exports for economic growth.

If risks do not abate, then we should expect forceful actions from central bankers. The common response of Treasury yields and the yield curve is for the short end (out to two- or three-year maturities) to drop significantly and the long end to either hold steady or fall but much less so than short rates resulting in what is called a bullish curve steepener. As we discussed in Yesterday?s Perfect Recession Warning May Be Failing You, past episodes of rate cuts illustrate this effect.



With investors complacent, yields and spreads on risky assets back to extremely rich levels, and global trouble brewing, the pleasant by-product of recent Fed rhetoric might quickly be disrupted. If so, the gains of the first half of 2019 would become a vague memory.

Apart from slowing global trade and industrial activity, keep in mind there are plenty of other potentially disruptive issues at hand including China leverage, Brexit, the contentious circumstances between the U.S. and Iran, the Italian government fighting with the European Commission on fiscal issues, Turkish currency depreciation, on-going problems in Argentina and more.

At the moment, the Fed and the ECB appear to have the upper hand on the markets, and higher yielding asset alternatives that reward an investor for taking risk are benefiting. Still, a critical assessment of the current landscape demands that investors engage and think critically about the risk-reward trade-off under current circumstances. The Fed and the ECB are not hyper-cautious and dovish for no reason at all. There is more to the current economic dynamic than meets the passive observer?s eye.

All Data Courtesy Barclays