McDONALD CAPITAL MANAGEMENT

Quarterly Commentary

July 18, 2019

MARKET OVERVIEW

Global equity markets shrugged off a potential trade war, Iranian aggression in the Strait of Hormuz, weak earnings and a slowing global economy to move notably higher during the first half of 2019. The US market indices were the stars of the globe as our economy remained the beacon of growth versus the rest of the world. Technology stocks have experienced a volatile ride this year but continue to lead the pack off the December 24th panic low.

Bond returns have been solidly in the black this year as well. Central Banks of the world reiterated their pledge to buy any asset in order to keep the party going. This action, combined with slower growth and a lack of "inflation", enabled interest rates to drop precipitously moving bond prices and interest rate sensitive stocks (utilities and real estate) higher. Remember, bond prices move inversely with the change in interest rates. Unlike last year where clients with a higher degree of bond exposure fared worse than equity investors, this year, bonds have provided solid returns.

The lower interest rate framework has also propelled gold, silver and other quasi-currency investments higher (including bitcoin!) as fears of much lower rates spread around the globe.

Market Sector Returns	*YTD 2019*
S&P 500 (total return)	*18.5*
DJIA (total return)	*15.4*
NASDAQ Composite	*21.3*
Russell 2000 (small cap)	*17.0*
EAFE (International)	*14.0*
MSCI AC World	*16.2*
MSCI Emerging Mkts	*10.6*
US Aggregate	*6.1*
US Treasury	*5.2*
Municipal Bonds (20 yr)	*5.1*
US Inv. Grade Corp	*9.9*
High Yield Bonds ("Junk")	*9.9*
Gold	*10.2*
WTI Crude	*29.4*
BBerg Commodity	*5.1*

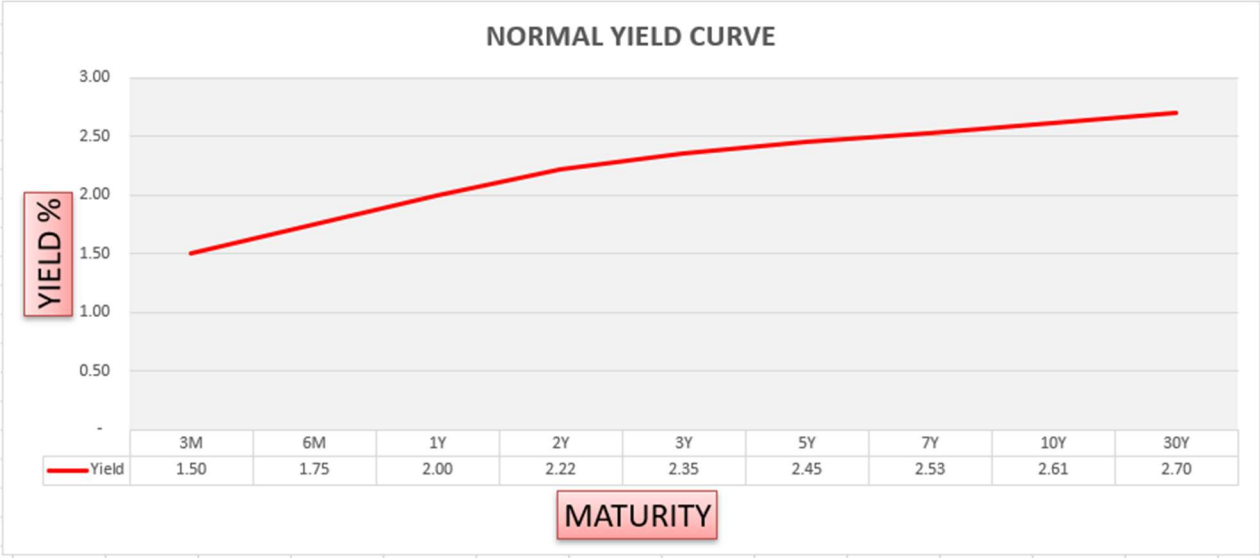
Fed Policy

The Federal Reserve has done a complete 180 on monetary policy since December of last year. The markets are now pricing, with 100% certainty, a rate cut of 25 basis points at next week's meeting. Economic data in the previous quarter was decent and did not scream recession. With inflation at target and unemployment still at all-time lows it is interesting to see the Fed cut interest rates. The last time the Federal Reserve cut rates when the market was at all-time highs was in 1995 which brought on the bull market that ended with the bursting of the tech bubble.

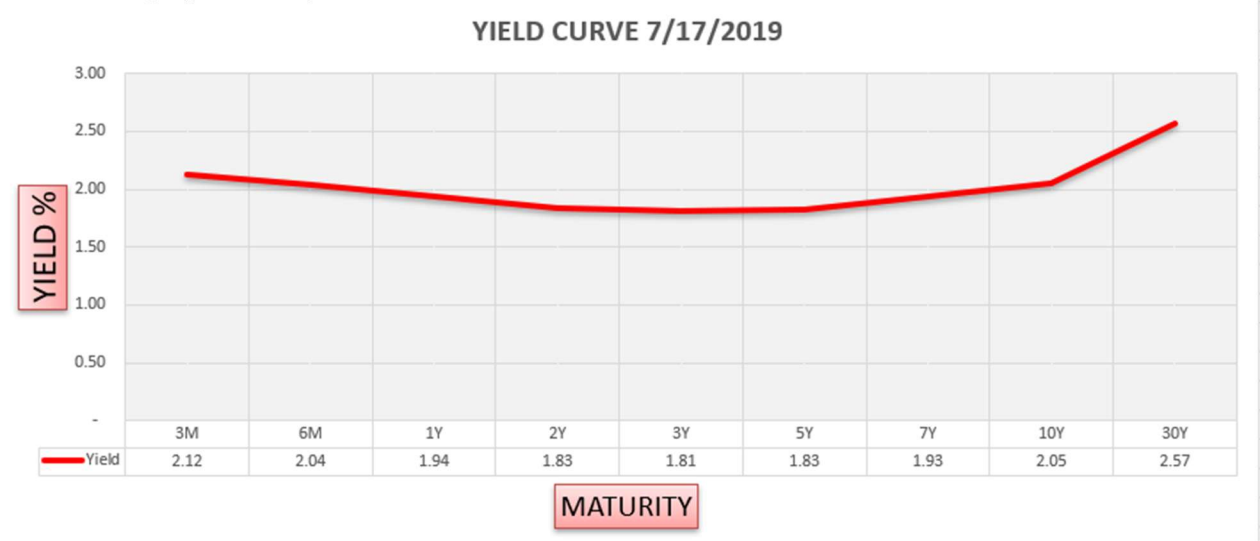
2019 2nd HALF OUTLOOK

Overall, our firm wide equity allocation to client accounts has increased slightly to roughly 60% of assets. We raised our allocation during the slight correction during May once it had been made clear that the Fed was planning to ease monetary policy.

When thinking about fixed income allocations it is always important to think about the shape of the yield curve. The yield curve shows the respective annual interest rates for bonds at different maturities. You may have heard us (or others) say that the *yield curve is flat or inverted*. What do we mean when we say that the yield curve is flat? Below is a graph of a "normal" yield curve, meaning that the longer the maturity of the bond, the higher yield you make.



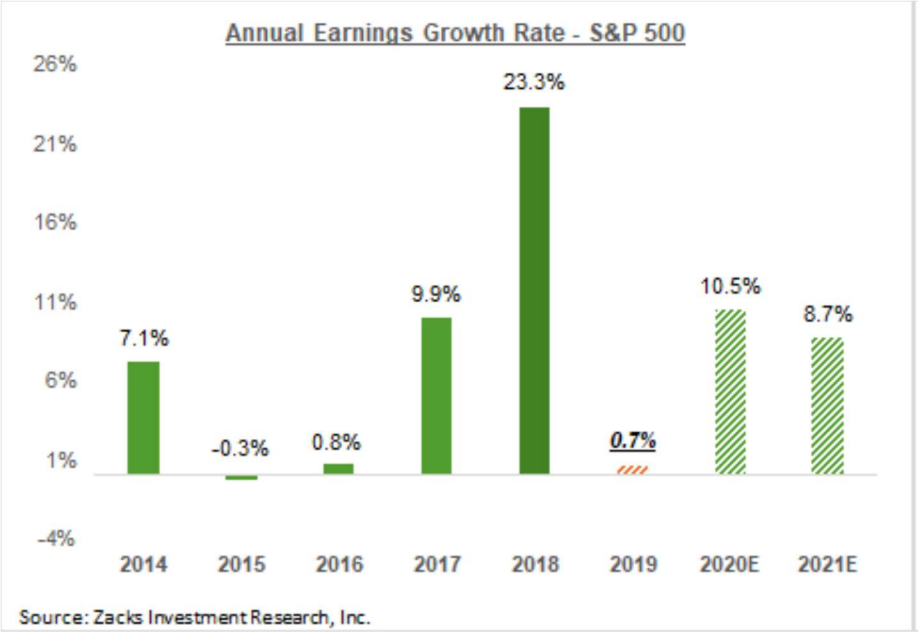
Below is a graph of the yield curve as of 7/17/2019:



The way the yield curve is shaped today is very flat and even inverted from 3 month to 10 year bonds. Many investors get sucked into the trap of thinking, "If I can make just as much money in a 3 month bond as a 10 year bond, why wouldn't I buy the 3 month?" These investors need to remember that bond yields are quoted in annual rates – meaning that in order to achieve the 2.12% yield on 3 month bonds, you must reinvest the proceeds of each 3 month bond at the same rate for one year. Typically, when the yield curve is flat the Fed is on the brink of cutting short term rates. Your 2.12% 3 month bond could be reinvested at lower and lower rates throughout the year, giving you a return much lower than if you locked in 2.05% per year for a 10 year bond. These are a series of small things that become big things over the course of an investors time horizon.

The interest rate environment is fueling a potential "melt-up" in asset prices in general. The strong move in stocks has resulted in high investor confidence and sentiment numbers – exactly opposite of the November-December 2018 readings. Investors were ready to throw-up in December; now they seem to want to throw a party! The earnings picture for 2018 and 2019 couldn't be more different as the post tax-cut boost came to an end. 2020 and 2021 are more

"normal" numbers with regard to earnings growth. Assuming the US avoids a recession in the next year, the resumption of earning growth should lead to continued stock market appreciation.



This year has been solid for balanced accounts and we are optimistic about the remaining months of 2019. Also, we are in the process of revamping our MCM website and hope to have it back up before the end of September. Please do not to hesitate to call the office with questions about accessing your client portal.

Thanks for your trust and support.

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