Quarterly Commentary

First Quarter 2019

Investment Commentary

Stocks and bonds rocketed ahead in the first quarter after a more dovish Federal Reserve abandoned its hawkish bias from the fourth quarter of last year. The Trump-induced "dovish pivot" provided a much-needed tailwind for equity and bond investors and gave U.S. equity indices the fuel to post the strongest first quarter in nearly ten years. While some Economists interpreted the comments as an assessment of a weakening economic expansion, the move to a more neutral stance was positively received by the equity and fixed income markets.

The S&P 500 Index rose 13.1% for the quarter, erasing a 5% percent decline for 2018. The Dow Jones increased less than the S&P at 11.2% and the Nasdaq index of technology and growth stocks rose 16.5%. On the international front, the EAFE index gained 9%.

Gains were broad for the S&P 500 Index with all 11 sectors ending higher for the first quarter--this has not occurred since 2014. Technology, capital goods, transportation, and energy were among the best performing sectors for the quarter. Commodity prices also gained ground, validating a demand for economically-sensitive materials.

Emerging markets (EM) equities likewise registered a strong market return in this first quarter, spurred on by China implementing a new dose of government stimulus. The MSCI Asia ex-Japan index posted double-digit gains, though it slightly underperformed the MSCI World index. All markets in the region closed higher, helped in part by progress in US-China trade negotiations. The dovish shift by major central banks also boosted sentiment.

Economic Conditions

While financial markets did well for the past quarter, sluggish global growth remains a concern.

While China's financial markets rebounded sharply based on the anticipated positive impact of their new stimulus, its economy actually grew at its weakest pace since 1990. The Chinese government lowered its full-year growth target to 6%-6.5% and outlined higher public reserve requirement ratios for banks.

On a brighter note in the U.S., the December jobs report validated a much-anticipated gradual rise in U.S. wages. The unemployment rate fell to 3.8%, and this helped push wages higher as skilled workers become less available.

By the end of March, more realistic investors kept U.S. equity price increases more subdued as investors balanced the Fed's accommodative tone with the broader implications for economic growth. As the quarter ended, the Fed lowered its projections for US growth and inflation, and reduced its expectations for interest rate hikes. Some forecasts now suggest there will be no Fed rate hikes this year and only one in 2020.

Bond Behavior

Corporate bonds had a strong quarter, retracing the weakness experienced in Q4 2018. High yield credit outperformed investment grade bonds, with both outperforming government bond markets and shorter duration bonds.

Emerging market (EM) bonds had a positive quarter with US dollar-denominated debt outperforming local currency bonds as certain EM currencies weakened.

The yield on the 10-year Treasury fell to 2.41% at the end of March, down from its peak yield of 3.25% in October 2018. Short-term bond yields rose above longer-term bond yields for a short while in March, creating an "inverted yield curve." Normally, short-term yields are lower than long-term yields

(over)

and an inverted curve may be a harbinger of an economic slowdown.

The Fed's shift from a tightening mode to a hold mode is interpreted by some economists and analysts as a lack of confidence in economic growth. During the first quarter we lengthened durations in some of our balanced accounts seeking to increase total returns.

European Market Dilemmas

The United Kingdom continued to experience a drop in production, as the country's pending exit (Brexit) from the European Union produced tremendous uncertainty among all sectors of the British economy.

Negative yields on some European government bonds reflect minimal growth expectations with subdued inflation throughout the European Union. Concerns surrounding economic momentum in Europe became more prevalent as Europe's Central Bank signaled that it would maintain interest rates below zero longer than anticipated. The pending outcome on how and when Britain exits the EU also stresses Britain's trading and business partners in Europe.

Worldwide Debt on the Rise

Corporate debt worldwide has become a growing concern among central bankers and international finance managers. An extended period of ultra-low interest rates has persisted following the monetary stimulus programs of central banks worldwide. This allowed companies from all over the globe to issue debt at very low rates. When monetary policy shifts and rates rise following a decade of stimulus, the cost of debt increases, creating financial difficulties and a hurdle to growth for businesses.

Of the more than $164 trillion of global debt, nearly three quarters of it is held by advanced economies such as the U.S., Britain, and Germany.

Our Expectations

We view the first quarter's rebound as a correction to the overly pessimistic take on the economy that we saw during 4Q 2018. Many market observers expect a lower rate of earnings growth this year, compared to the strong growth in corporate earnings that we saw in 2018. At the time of this writing, we have entered "earnings season" where companies report their quarterly earnings and provide forward guidance. We will have greater visibility on earnings prospects after the next few weeks.

Call us cautiously optimistic. With only a small risk of inflation for 2019, the year is off to a great start and, while there remain risks, the overall economic backdrop appears mildly positive in our view. On balance, the global economy is slowing but not at the risk of dipping into a recession in the near term. Still, the economy is not so strong that it's about to run off to the races, either.

This first quarter should not be confused with a continuing "all systems go" approach to assuming greater risk in our portfolios. We have been here before and acknowledged that uncertainty needs to be managed prudently. Accordingly, we will stay diversified and continue to wait for tactical opportunities.

Best Regards,

Clear Point Advisors Inc.

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