Market Commentary
April 2019

Introduction

After the worst year for stocks since 2008 the market made a "V-shaped" recovery in the first quarter of 2019 to make back much of what it lost in 2018. Economic data is still positive even though it has slowed from the impressive levels of 2018. The labor market is still healthy with the unemployment rate at 3.8%; GDP is up an annualized 2.2% for Q4, although it is forecasted to moderate because of ongoing trade tension and slowing global economic momentum, and inflation has stabilized with CPI up 1.5% over the past year. The Federal Reserve moved to an even more dovish stance, leaving the Federal Funds rate unchanged during their March FOMC meeting due to decelerating economic data. With the Fed on hold for the remainder of the year, equities should fare well, however, as global growth slows and key geopolitical events loom (i.e. Brexit and the China trade war), we believe investors should prepare themselves for bouts of volatility.

Domestic Equities

U.S. stocks made impressive gains throughout the first quarter of 2019 with the S&P 500 returning 13.65%. Most of the gain in the first quarter came in January, which was the best January in three decades, with the market posting a return of 8.01% for that month alone. With the market oversold coming out of 2018 and valuations looking attractive, this recovery in January seemed justified. The primary catalyst supporting stocks throughout the quarter was strong earnings and sales growth for companies within the S&P 500, which were up 12% and 6%, respectively. A strong consumer has helped top line revenues while low borrowing costs, relative to history, manageable inflation, and lower tax rates have helped companies' bottom line earnings. Although earnings have been positive, the benefit from fiscal stimulus like tax reform is expected to fade as we move later in the year, resulting in lower earnings growth in the quarters ahead. U.S. equities look poised to generate positive returns for the year but market participants are looking for reasons to run to the sidelines, so we have reduced our equity allocation from an overweight to a neutral position.

International Equities

International developed equities and emerging market equities returned 9.98% and 9.91% for the first quarter, respectively, both lagging the S&P 500 but by a smaller margin than what we saw in 2018. The rally we saw in foreign equities was mainly supported by a softer U.S. dollar, dovish central banks, and the tentative truce reached between the U.S. and China on trade issues. However, downside risks surrounding slowing global economic growth persist. Among advanced economies, growth disappointed in the euro area and the United Kingdom, due to slower export growth and political uncertainty. Germany, the economic powerhouse of the euro zone, narrowly avoided falling into recession in the second half of 2019 after recording zero growth in the fourth quarter. The United Kingdom failed to reach an agreement on Brexit by the March 29th deadline, creating prolonged uncertainty. The Bank of Japan, while confident about moderate expansion in the near future, tempered its optimism on exports and factory output due to bleak growth overseas.

Within emerging markets, the trade tension between the U.S. and China continues to weigh on major emerging market economies such as China and other Asian countries. Despite fiscal stimulus that offsets some of the impacts of higher U.S. tariffs, China's economy is expected to slow as a result of the combined influence of financial regulatory tightening and trade measures from the U.S.. The improvement on energy prices, while benefitting oil exporters such as certain Latin America and Middle East countries, hurt oil-importing countries such as India. Overall there are many uncertainties but due to inexpensive valuations and the potential resolutions to the pending conflicts, there may be buying opportunities in the future.

Fixed Income

Fixed income recovered from a flat 2018 to post positive returns of 2.94% as measured by the Bloomberg Barclays US Aggregate Bond index in the first quarter. Lower quality corporate bonds benefited from an overwhelming risk-on sentiment in financial markets while longer maturity bonds were supported by interest rates going down. Signaling a change in pace from 2018, the Federal Reserve adopted a more dovish tone over the past quarter, indicating zero rate hikes for 2019 compared to previous forecasts of one or two rate hikes. As a result of a steady outlook for interest rates, demand for longer duration securities increased and pushed yields down, with the 10-year U.S. Treasury yield ending the quarter at 2.40%, a drop of 0.28% from the beginning of the year. As long-term rates came down during the quarter, the difference between long and short-term rates narrowed to as little as 0.12%. When the two-year yield surpasses the 10-year yield, it has historically been a leading indicator of a recession in the next 20 months, but we do not expect this to happen in the near term. We believe the projected path for interest rates will remain stationary, as the Federal Reserve has less incentive to raise rates in the face of slowing economic data. Moving forward, we believe fixed income securities will provide significant diversification benefits to equities as economic and corporate growth slows.

Alternatives

Alternative asset classes rebounded along with equity markets at the start of the year. Oil prices rallied throughout the first quarter as supply cuts from OPEC and continued disruption/uncertainty from Venezuela continued to weigh on oil supply. U.S. crude ended 2018 at $45.41 per barrel and finished the first quarter at $60.14 per barrel. The Morningstar Diversified Alternative index ended the quarter with a return of 2.72% underperforming the S&P 500. While this return does not seem beneficial to overall portfolio performance, this index produced significantly less volatility (as measured by standard deviation) than pure U.S. large cap equities. Alternatives should continue to play a key role in lowering overall volatility within investors' portfolios as global growth slows.

Real Estate

The housing sector continues to experience headwinds as buyers and builders remain cautious despite higher wages and lower median home prices. The latest data has been mostly negative with residential startups falling -8.7% in February, led by the sharpest decline in single family units (-17%) since mid-2017. Residential building permits, which can signal how much construction is in the pipeline, dropped -1.6% in February after declining in January too. However, there is some optimism as existing home sales jumped 11.8% in February due to falling mortgage rates. The NAHB index, an index that tracks homebuilder optimism and a leading indicator for the housing market, held steady from February to March, indicating the housing market may be stabilizing. Although affordability issues appear to be dissipating, the lack of skilled workers in the construction industry should continue to be an issue throughout the year.

Conclusion

Investors enjoyed the first quarter of 2019 as most asset classes recovered from their lows last year. Despite markets rebounding sharply, economic data has softened and is forecasted to go lower so we are being mindful of the risks we are taking in our portfolios. Due to our concerns about the slowing economy, we have moved our portfolios to a more conservative position and will closely monitor economic data to help make our portfolio management decisions.

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