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WEALTH MANAGEMENT

INSIGHT

PERSPECTIVES FOR THE GOAL-FOCUSED INVESTOR

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A Stellar Start to 2019. Will it Last?

By: Brandon Ross, CMT

2018 began with great optimism, but ended on great pessimism. Investors first started to panic after the Federal Reserve Chairman, Jerome Powell, sounded very hawkish in an October address. Many were worried the Fed was going to tighten monetary policy too much, and this tightening would cause a recession in 2019. Additionally, the trade wars were starting to show their negative effects, and fears of a global recession started weighing on investor's minds. China was slowing down faster than was expected, and European economies were falling apart. From peak to trough, the S&P 500 fell just a little more than -20% during the fourth quarter. The S&P 500 closed the year down more than -6%.

Eventually, Powell provided a floor for the stock market in another address, and promised to keep policy on hold until more information came out. This provided a boost to stocks and bonds, and the market hasn't looked back since. The S&P 500 is up more than 13% in the first quarter. Recession fears have seemingly vanished. Now, investors are expecting slower growth in the beginning of the year, but a recovery in the later half.

While the S&P 500 has great numbers so far in 2019, we need to put these into context. Year over year, the S&P 500 is up 7.33%, which is what investors expect as average. However, over the last 6 months, the S&P 500 is still down -2.73%. The S&P 500 and other major averages are still below the all-time highs they made in September, so the amazing returns this quarter are coming off of very poor performance in 2018. Thus, the major stock market averages are trading in a wide range.

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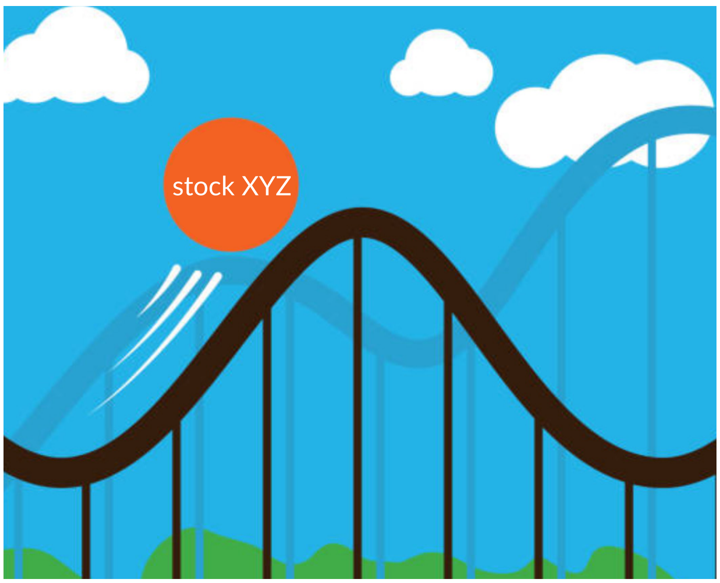
The major stock averages have been in a range since the beginning of 2018. In technical analysis, a range is defined as a stock's price moving in an area between two price levels. For example, stock XYZ is in a range between $20 and $25 dollars. When the stock reaches $25, it falls back towards $20. Once the price hits $20, it starts to move back up towards $25. This is a great trading tool to have. But the reason this matters is because it means stocks haven't really gone anywhere over the last 15 months or so. Yes, we are now near the top of the range, but it is almost as if 2018 was a lost year. For long-term focused investors like us, it can be disheartening to see that your portfolio is essentially the same value as it was 6 and 15 months ago.



Now, we look to the future. Many economists believe the slowdown in growth is temporary, and growth should strengthen in the latter half of the year. This earnings season will be especially important. If earnings guidance starts to show the rest of the year as weak, then investors may jump ship like they did in October. Guidance is extremely important because no economist can predict the future of a business like the business itself. They need to have the clearest and most accurate information because their bottom lines depend on accurately predicting what they need to do in the future.

However, we are starting to see some leading economic indicators show strength again. The U.S. PMI index grew in March, indicating stronger growth expectations. Plus, Chinese PMI numbers show economic expansion, which is a very important market for U.S. investors and businesses. PMI stands for Purchasing Managers Index. It is a survey that asks senior executives how they feel the future will be based on new orders, inventory levels, production, deliveries, and employment. When the PMI reaches an expansionary level, this tells us the managers are bullish on the future of the economy, and they are preparing for it by ramping up production. Hopefully earnings guidance will come inline, or better than expectations. It may give the juice the stock market needs to make new all-time highs once again, in 2019.

The Fed & Election Cycles

By: Robert Borden CFP, EA

After a precipitous decline in the fourth quarter of 2018 and specifically December - markets reversed course after Christmas Eve, which happened to be the worst Christmas Eve on record, as the S&P 500 gained 13.1% in the first quarter while Technology was even stronger as the Nasdaq Composite returned 16.5%.

What was behind the sharp market reversal?

As economic growth numbers slowed slightly in the fourth quarter, investors began to realize as the new year approached that perhaps 3 to 4 quarter point rate hikes weren't in the cards for 2019. The Federal Reserve confirmed as much with their statement on January 30th that not only dropped any reference to "further gradual rate increases" but that their next move could take a much more flexible data dependent approach and could just as easily be down as up. The Central Bank reiterated this outlook on March 20 trimming the number of forecast increases from two to zero. The Federal Reserve, and specifically Fed chief Jerome Powell's, about-face is fairly dramatic. As recently as December 19, Powell continued to insist the Central Bank was on autopilot in both raising rates throughout 2019 and tightening their balance sheet. In early October he stated that the Fed was "a long way" from neutral. As a result of the mixed signals not only have equity markets been volatile in recent quarters, but treasuries have experienced relatively dramatic fluctuations. While the Federal Funds Rate directly impacts short-term Treasury rates even the longer term 10 Year Treasury Note yield peaked in 2019 at 2.79% preceding the Fed's dovish turn and then promptly reversed course bottoming at 2.39% on March 28. Although the economy may be slowing going into the remainder of 2019, investors have taken a "risk on" stance in recent months as the prospect of a neutral or easing monetary policy along with muted inflation has driven performance of growth and Technology stocks.

It is noteworthy that while the financial media largely focuses on the Federal Reserve's sentiment as it relates to US interest rates, another factor should be taken into consideration – global competition for high-quality sovereign government debt. As I write this, as of April 11, the US 10 Year Treasury Note is yielding 2.49%. Compare that to the UK 1.15%, Japan -0.06%, Germany -0.03%, Canada 1.72%, and Switzerland -0.31%. As a matter of fact the only developed countries with 10 year government yields surpassing the US are Italy 2.50% and Greece 3.38%. As you move along the yield curve the disparities are even more dramatic on the short end as the US 90 day Treasury Bill is yielding 2.42% compared to Japan at -0.19% and Germany at -0.55%. Global investors have nowhere to go to purchase sovereign debt securities with both the yield and credit quality of the US government, which should keep a lid on rising US interest rates for the foreseeable future.

As has been in the headlines recently, President Trump has been tweeting his discontent regarding the Fed's 2018 tightening cycle and of course is now pushing for them to reverse course and lower rates. On that note we decided to take a look at historical market performance following mid-term elections. Going back to 1982 the S&P 500 has posted positive returns 9 months after the election every single time, that's 9 out of 9. In some cases the gains were dramatic such as 1982 when the market gained 35.9% in the nine months after the November elections. Returns were more muted in the period following the 2014 election with a 5.3% return (Source: Haver Analytics). Historically, the third year of a presidency has been the strongest with the DJIA averaging a 14% return going back to 1928 while the second year has been the weakest with an average 4% return (Source: Riskhedge). Of course this is simply market history and doesn't necessarily reflect what may happen this election cycle. Nevertheless the Wilshire 5000 (which represents the entire US stock market) has gained 5.9% between November 6, 2018 and April 10, 2019. There could be many reasons for this phenomena besides earnings or economic conditions. Uncertainty often surrounds the second year of a presidency and the 10 month period prior to the mid-term election. Investors like certainty and knowing the economic and fiscal policies likely to be implemented (or not) adds to their confidence of future political action. Additionally, mid-terms are often characterized by the opposition party gaining control of one or both houses of Congress resulting in government stalemate, and inaction, over the following two years which can be perceived as a positive as little fiscal change occurs. Regardless of historical election cycle returns, it remains critical to focus on the long-term and hold high quality companies in any fiscal or regulatory environment.