Quarterly Market Outlook

January 2019

End of the Bull Market?

Fears of tightening monetary policy, slowing growth and global trade tensions led to a significant drop in global equity markets during the fourth quarter. Global equities (MSCI All Country World) were down 12.8% while US equities (S&P 500) were down 13.5%. Several markets (NASDAQ, small caps, non-US equities) dropped into bear market territory with declines from peak of over 20%.[1]

Safe Haven Assets are Safe Again

After struggling earlier in the year, safe haven assets provided valuable diversification in Q4. Expectations of weaker growth drove strong positive returns for gold (+7.5%) and long-term Treasuries (+4.2%).[2] We continue to see these holdings as critical components of a well-balanced asset allocation.

Central Banks Withdrawing Support

Unlike earlier in the expansion, central banks continue to tighten in the face of equity market weakness. The Federal Reserve raised the Fed Funds rate another 0.25% in December, while the ECB moved forward with their plans to end new asset purchases at year end. While the interest rate moves are grabbing the headlines, we are more concerned about the reduction in asset purchases from global central banks, which have been the dominant support to asset prices over the past decade.

Collapsing Oil Prices

After touching multi-year highs in the summer, oil prices fell approximately 38% in Q4 on the back of growing US production and slowing global demand.[3] In an effort to stabilize prices, OPEC agreed to production cuts in December, which have since helped to stabilize prices.

Stubbornly Weak Inflation

Despite a historically long expansion and very low levels of unemployment, inflation remains stubbornly low. Secular forces related to globalization and automation have restricted wage inflation while falling energy prices and a stronger dollar have been shorter-term deflationary influences. With limited ability for central banks to ease, concerns about deflation are likely to surface in the next recession.

Pause for the Fed?

Despite the Fed's stated intention to raise interest rates two more times in 2019, bond markets now expect that we have reached the end of the Fed's tightening cycle. Given current conditions and the fading benefits of the 2018 tax cuts, we think that caution is warranted. The risks of over-tightening are high.

[1] Source: Bloomberg. See Disclosures for more detail on the MSCI All Country World Index and the S&P 500 Index.

[2] Source: Bloomberg. The return for gold was calculated using the change in spot price for gold (XAU). See Disclosures for more detail on the Bloomberg Barclays US Long-Term Treasury Index.

[3] Source: Bloomberg. Oil pricing was calculated using the change in spot price for oil based on the Bloomberg WTI Index (USCRWTIC).

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Progress on US-China Trade Relations

Presidents Xi and Trump agreed on a 90-day truce on additional tariffs to work through their trade disagreements. This has the potential to be a positive surprise to markets in 2019, though core issues like IP theft remain contentious.

Washington Gridlock

President Trump has refused to sign a budget that does not include funding for his promised border wall, leading to a government shutdown. While the impact to growth will be temporary (federal workers are expected to receive their pay when the shutdown ends), it is indicative of political gridlock that is likely to characterize the remainder of President Trump's first term.

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