

Quarterly Market Outlook

May 2019

Fed Pivot

In response to benign inflation pressure and signs of slowing global growth, the US Federal Reserve pivoted towards more supportive monetary policy in Q1. Chairman Jerome Powell emphasized a “patient” approach to further increases in interest rates. He also made it clear that they could adjust the pace of their balance sheet contraction if conditions warranted.¹ Bond markets now reflect a greater likelihood of easing than tightening through the remainder of 2019. This represented a significant shift from their December meeting where the Fed raised rates 0.25% and expected two more rate hikes in 2019.

Easier Monetary Policy Supporting Asset Prices

Just as tightening monetary policy was a headwind for all assets in 2018, a shift towards easier monetary policy has been supportive of all asset prices in 2019. All major asset classes recorded strong Q1 performance (global equities +12%, bonds +3%, commodities +6%)². Equities have recovered the majority of Q4 losses, with several indices nearing all-time highs.

China Stimulus and Progress on US-China Trade Discussions

The Chinese equity market was among the strongest performers in Q1 (+24%)³, as the Chinese authorities launched targeted stimulus programs to support economic growth. Investor sentiment also benefited from perceived progress in negotiations between the US and China over longstanding trade disputes.

Inverted US Yield Curve

Optimism in the US equity market stands in stark contrast to the bond market, where the yield curve inverted (i.e., the 10-year Treasury yield fell below the 3-month T-Bill yield) at the end of March. Historically, this has been a precursor to recessions as markets reflect an expectation that the Federal Reserve will have to cut interest rates.

Slowing US Growth

While we don’t believe a recession is imminent, we expect US growth to slow over the course of 2019 as the benefits of last year’s tax cuts fade. We do not view the recent Q1 US GDP report (+3.2%)⁴ as a sign that growth is reaccelerating as the largest driver was a temporary build-up of inventories (which will unwind in future quarters).

Few Bullets Remaining

With the recent shift away from tightening, the Fed has used one of its few remaining bullets. At this point, they will need to cut more than expected to generate additional stimulus. Looking forward, we are concerned about the ability of the Fed and other major central banks to stimulate effectively in the next recession, as interest rates remain near historic lows across the yield curve.

¹ Source: ‘Powell Says a ‘Patient’ Fed Is Watching for Signs of Economic Weakness’, *NYTimes.com*, January 4, 2019.

² Source: Bloomberg. Global Equities represent the MSCI World Index (NDDUWI). Bonds represent the Bloomberg Barclays US Aggregate Bond Index (LBSTRUU). Commodities represent the Bloomberg Commodity Index (BCOMTR). See Disclosures for more index detail.

³ Source: Bloomberg. The Chinese equity market represents the Shanghai Stock Exchange Index (SHCOMP). See Disclosures for more detail.

⁴ Source: Bureau of Economic Analysis.

A Brexit Deal Remains Elusive

After months of negotiations, UK Prime Minister Theresa May was unable to secure a Brexit deal before the original March 29th deadline and the extended April 12th deadline. The EU eventually granted the UK an extension until October 31st. While not a significant driver of the global economy, we see Brexit as emblematic of the political uncertainty gripping many countries in the developed world.

2020 Presidential Election Cycle is Underway

The US 2020 presidential election cycle is officially underway with more than 20 candidates vying for the Democratic nomination. Most have adopted a more liberal agenda that includes Medicare for all, free university tuition and higher taxes. As both parties move further from the center, the potential for significant political change increases, with knock-on effects to markets and economies that we are closely monitoring.

Goldilocks Market Conditions are Unlikely to Persist

With continued low inflation and ample liquidity, markets have entered a short-term “goldilocks” environment. However, high traditional asset valuations, limited central bank ability to ease and growing political uncertainty temper our enthusiasm over the medium term. As a result, we are emphasizing strategies that are less dependent on continued economic growth.

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