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# First Quarter Market Watch

Late 2018 saw a cyclical bear market amidst investor concerns about the slowdown in economic growth due to the persistent US and China trade tensions, fading effects of the US tax reform, and geopolitical uncertainty. Defying this negative sentiment coming into 2019, first quarter market returns were impressive, as the S&P 500 gained 13.6%, the NASDAQ returned 16.8%, and the MSCI All Country World Index was up 12.3%. This year-to-date rally has essentially recouped all of the December 2018 losses, as investors sentiment was boosted by the renewed dovishness among global central banks, as well as signs of progression in the US-China trade negotiations.

The US Federal Reserve policy has pivoted from tightening to a potential easing by taking a pause on interest rate hikes and the balance sheet reduction. The European Central bank has also abandoned plans for any rate hikes in 2019 and introduced a new round of cheap financing for European banks.

The US economy is operating at full capacity, with consumer and business confidence near 30-year highs, unemployment near a 50-year low, S&P 500 profits and operating margin near peaks. Still, investors are trying to square their big returns with the fact that they have arrived while the global economic outlook has grown dimmer. The International Monetary Fund cut its outlook in April for global growth in 2019, warning that trade tensions and declining business confidence were weighing on nearly all countries around the world. The US Federal Reserve and the European Central Bank have also trimmed their growth forecasts. In China, policy makers have increased spending and cut taxes so as to boost a slowing economy.

Entering into the first quarter corporate earnings reporting season, the financial market will likely face a test in the coming months. Due to the  waning boost from 2017's US tax reform, the 35-day government shutdown, US-China trade tensions, a soft-patch in consumer spending related to tax refund uncertainty and overly tight monetary policy late last year, the S&P 500 companies are expected to report their first year-over-year earnings decline since 2016. While some of the factors that weighed on earnings might be short-lived, others may have just started to affect profitability. For example, rising costs for labor and manufacturing inputs could see the effect of higher oil prices in the year to date.

Interest rates around the world and across the yield curve have fallen. In the US, investors have embraced the Fed's pause in rate hikes, as well as discounted further hikes this year. This policy shift has led to declines across the yield curve. The 10-year US Treasury yield has decreased from 2.68% in December 2018 to 2.42% at the end of March 2019. The 2-year US Treasury yield has contracted 23 bps, to 2.27% at the end of Q1 from 2.50% at the end of 2018. In the developed international markets, both German and Japanese 10-year bond yields are now back into negative territory.

| | Date | 1 Quarter Ago | | 1 Year Ago | |
|---|---|---|---|---|---|
| | 3/31/2019 | 12/31/2018 | % chg | 3/31/2018 | % chg |
| DJIA | 25,928.68 | 23,327.46 | 11.8% | 24,103.11 | 10.1% |
| S&P 500 | 2,834.40 | 2,506.85 | 13.6% | 2,640.87 | 9.5% |
| NASDAQ Composite | 7,729.32 | 6,635.28 | 16.8% | 7,063.45 | 10.6% |
| Russell 2000 | 3,826.64 | 3,351.51 | 14.6% | 3,801.01 | 2.0% |

| | Date | 1 Quarter Ago | | 1 Year Ago | |
|---|---|---|---|---|---|
| | 3/31/2019 | 12/31/2018 | % chg | 3/31/2018 | % chg |
| Japan Nikkei 225 | 21,205.81 | 20,014.77 | 5.0% | 21,159.08 | -7.3% |
| MSCI EM (Emerging Markets) | 1,058.13 | 965.78 | 10.0% | 61,022.73 | -6.9% |
| MSCI EAFE | 1,875.43 | 1,719.88 | 10.1% | 2,002.23 | -3.1% |
| MSCI AC World | 508.55 | 455.66 | 12.3% | 505.44 | 3.2% |
| FTSE 100 | 6,515.26 | 5,950.36 | 12.0% | 6,049.76 | -5.1% |
| SSE Composite Index | 3,090.76 | 2,493.90 | 26.6% | 3,160.53 | -6.5% |

## US Equity Style

| | Q1 | 1-yr ret. |
|---|---|---|
| Consumer Discretionary | 15.7% | 9.9% |
| Consumer Staples | 12.0% | 10.0% |
| Energy | 16.4% | -7.1% |
| Financials | 8.6% | -4.4% |
| Health Care | 6.6% | 12.2% |
| Industrials | 17.2% | 0.8% |
| Information Tech | 19.9% | 11.1% |
| Materials | 10.3% | -5.6% |
| Communication Services | 14.0% | 6.0% |
| Utilities | 10.8% | 18.7% |

## US Equity Style

| | Q1 | 1-yr ret. |
|---|---|---|
| Russell 1000 Value | 11.9% | 3.6% |
| Russell 1000 Growth | 16.1% | 9.3% |
| Russell 2000 Value | 11.9% | -3.0% |
| Russell 2000 Growth | 17.1% | 0.0% |

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Turning to crude oil prices, the US Energy Agency now expects consumption of liquid fuels to outpace production between 2016 and 2020. The spot price of West Texas Intermediate, the benchmark for US crude oil, ended Q1 at $60.14, gaining 32% from a year ago the end of 2018. The strong US crude oil prices were propelled by the announcements of production cuts from the OPEC, the US sanctions on energy producers Iran and Venezuela, and a slight decline in US crude oil inventories. While energy prices are difficult to predict and have been historically volatile throughout market cycles, our investment professionals are vigilant in identifying energy companies with attractive risk and reward trade off over the long term.

As mentioned, another key item among investor concerns has been the ongoing trade war between the US and China. Since 2018, the escalated trade tension between the US and China had triggered market turmoil and negatively affected global economic activity, including negative 2018 import and export growth. In early December President Trump delayed additional tariffs, and the market has been anxiously awaiting the details ever since. While a trade deal is in the interest of both countries, there are still areas of concerns, such as the timing of tariffs, Chinese purchase agreements, as well as enforcements of the agreements. At the conclusion of the spring meetings of the recent International Monetary Fund and World Bank in Washington, DC, Treasury Secretary Steven Mnuchin and the Chinese delegate both commented optimistically about the progress toward finding a framework of reinforcement on both sides.

Elsewhere in the world, Brexit developments have intensified and resulted in turmoil in financial markets. Prime Minister Theresa May asked for an extension of the March 29 deadline. In response, the EU decided to give the UK a new deadline until October to choose whether it wants to leave with a deal. Despite this extension, an accidental "no deal" cannot be ruled out.

## Bond Yields

| | Mar 19 | Dec 18 | 1 Yr. Ago |
|---|---|---|---|
| Treasury Bill, 90 Day | 2.39 | 2.45 | 1.72 |
| Treasury Note, 2 Year | 2.27 | 2.50 | 2.26 |
| Treasury Note, 5 Year | 2.24 | 2.51 | 2.56 |
| Treasury Bond, 10 Year | 2.42 | 2.68 | 2.74 |
| Treasury Bond, 30 Year | 2.82 | 3.01 | 2.97 |

## Commodities

| | Mar 2019 | 1 Qtr Ago | 1 Yr. Ago |
|---|---|---|---|
| Gold | 1,298.50 | 1,281.30 | 1,327.30 |
| Crude Oil | 60.14 | 45.41 | 64.94 |
| UD Dollar Index | 96.28 | 95.74 | 89.81 |
| Bloomberg Commodity Index | 81.09 | 76.72 | 87.47 |

## US Bond Sector Performance

| | Q1 | YTD | 1-Year Return |
|---|---|---|---|
| BAR CAP Govt. Interm. TR | -0.7% | -0.7% | -0.3% |

## Interest Rates

| | Mar 20 19 | 1 Qtr Ago | 1 Yr. Ago |
|---|---|---|---|
| PRIME RATE | 5.50 | 5.50 | 4.75 |
| FEDERAL FUNDS RATE | 2.41 | 2.41 | 1.68 |
| US 2Y T-Note Yield | 2.27 | 2.50 | 2.26 |
| US 10Y T-Note Yield | 2.42 | 2.68 | 2.74 |
| 30YR FIXED MORTGAGE | 4.06 | 4.51 | 4.45 |

## Exchange Rates (Rate per US dollar)

| | 3/31/19 | 1 Qtr Ago | 1 Year Ago |
|---|---|---|---|
| Canadian Dollar | 1.336 | 1.366 | 1.289 |
| Mexican New Peso | 19.398 | 19.694 | 18.254 |
| Euro | 0.891 | 0.875 | 0.813 |
| British Pound | 0.767 | 0.785 | 0.713 |
| Swiss Franc | 0.996 | 0.986 | 0.958 |
| Chinese Yuan | 6.720 | 6.866 | 6.292 |
| Indian Rupee | 69.275 | 69.815 | 65.222 |
| Japanese Yen | 110.685 | 109.715 | 106.350 |

## Economic Sentiment

| | Mar 2019 | 1 Yr. Ago |
|---|---|---|
| Unemployment Rate | 3.80 | 3.90 |
| Average Single Family Home | 298,100 | 294,600 |
| Capacity Utilization | 78.80 | 79.50 |

In its 10th year of expansion, the US economy is now late in the cycle. With the US unemployment rate unlikely to drop further from today's record low level, rising wages and eventual interest rate hikes render the US economy more vulnerable to a deceleration. However, we do not believe recession is on the horizon in the near term, given the underlying strengths cited above. While the US equity market is off to a strong start in 2019, a deceleration in corporate earnings growth, along with elevated geopolitical and policy uncertainty will likely lead to a resumption of higher volatility for the remainder of 2019. Turning to international equities, investor sentiment in 2019 has shifted notably more optimistic with the hopes that global economic growth will resume. Looking ahead, rising macro-economic and geopolitical uncertainty make it increasingly challenging to predict asset performances. Our investment professionals at the 1911 Trust Company exercise great scrutiny in portfolio allocations and security selection, and continue to maintain a disciplined investment approach to safeguard our clients' assets.

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