2019 - 1st Quarter Review & Outlook

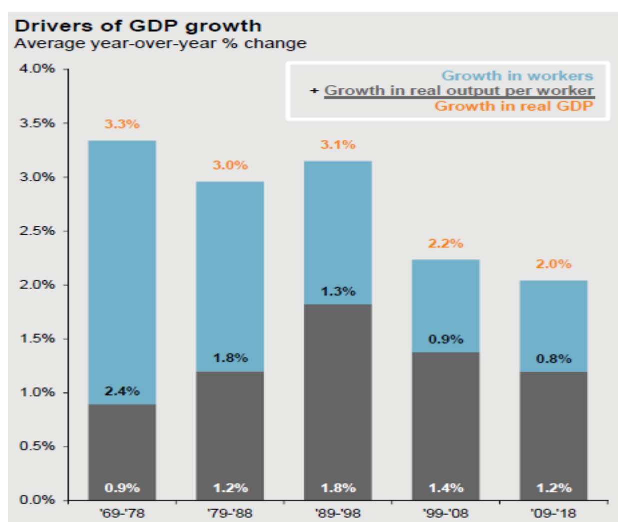
Economic and Investment Review

Economic Growth: The initial report for first quarter GDP surprised to the upside at 3.2% compared with the consensus estimate of 2.0%. The higher than expected number was driven by a decline in imports and inventory building. The number was impressive taking into consideration an estimate 0.5% drag caused by the government shutdown. One caveat was growth in consumer spending and business investment slowed from the previous quarter. U.S. Economic growth is still expected to dip from 2.9% in 2018 to 2.4% in 2019. Slower global growth and tariffs are identified as the primary reasons for the reduced growth rate.

Source: FactSet

The International Monetary Fund (IMF) recently reported that "after strong growth in 2017 and early 2018, global economic activity slowed notably in the second half of last year, reflecting a confluence of factors affecting major economies." Those factors included regulatory tightening in China, trade tensions (particularly between China and the U.S.) and weakened consumer and business confidence in Europe. Global growth is now projected to slow from 3.6% in 2018 to 3.3% in 2019 before returning to 3.6% in 2020. Businesses in the U.S. and globally have been hesitant to invest in new property, plant and equipment with trade issues in flux. On a positive note, recent data is pointing to improvement in China's economy. However, European economic growth data remains soft.

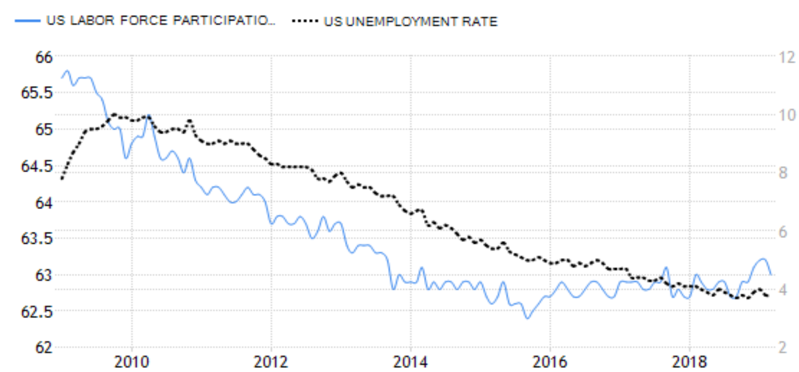
Expectations for U.S. economic growth in 2020, 2021 and 2022 have all converged lower to 1.8%. In addition to slower global growth, explanations for the slower domestic growth rates generally hinge on lower productivity rates. Productivity rates are dependent on growth in workers and growth in output per worker. Demographic trends point to slower growth in the working age population. This is due to a declining fertility rate and an increase in the number of retiring baby boomers.



Source: J.P.Morgan Asset Management

According to a report from the Centers for Disease Control and Prevention, the fertility rate in the United States has fallen to 1,765.5 births per 1,000 women of childbearing age—well below the rate of 2,100 births per 1,000 women necessary to keep the population stable. Immigration is keeping the population from declining.

The U.S. labor force participation rate has picked up some recently but any additional increase may be constrained by the low unemployment rate.



Source: TradingEconomic.com

Crude oil prices have been trending up since the end of last year and bumped up higher recently due to the end of waivers by Trump administration on Iranian oil imports. Additional available capacity from OPEC and Russia as well as increased domestic production should work to offset any near-term supply shortage.

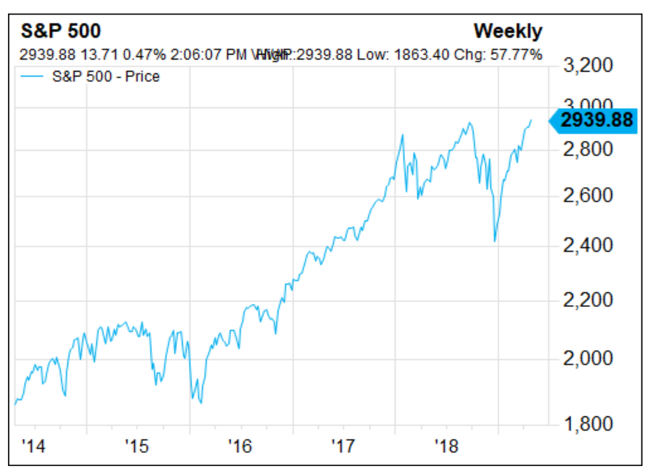
Any threat of recession has likely been delayed until at least 2020 and beyond. However, 2020 is an election year and political discussions about income disparities, the right to healthcare and college education as well as tax policy will contribute to market volatility and will impact equity economic sector performance.

Payroll growth remained moderately strong in the quarter, however manufacturing employment declined in the March report. Wage growth improved in the first quarter but consumer consumption may be tempered by rising gasoline prices and negative tax surprises due to limitations on deductions.

Federal Reserve policy makers left the fed funds target rate unchanged in March and are expected to stay on the sidelines again for the May meeting. Eleven of the sixteen voting Fed officials expect there to be no change in the fed funds target rate this year, while four expect one rate hike and two expect two rate hikes. Some economists and strategists are now looking for the next move to be a rate cut rather than a rate hike. This position is based on lower than expected inflation in a period of very low unemployment. Core measures of inflation have been generally coming in below the Fed's 2% target. The economic growth picture has brightened somewhat since March which may be a counter to those looking for or calling for a rate cut.

Equity Markets

The S&P 500 rebounded nicely in the first quarter, up 13.6%. Even though economic and earnings growth expectations have declined, interest rates have also declined as the Fed has appeared to pull back from earlier plans/expectations of two additional 0.25% rate increases in 2019. Also, the potential for a U.S.-China trade deal and the end of the Mueller investigation has buoyed investor spirits.



Source: FactSet

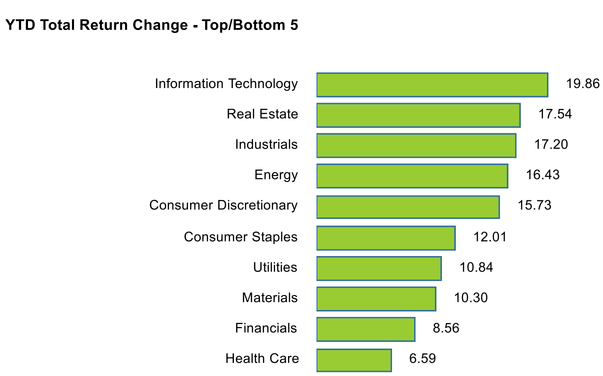
Mid Cap and Small Cap stocks moved up in similar fashion for the period. The S&P Mid Cap 400 was up 14.5% for the quarter and 2.6% for twelve months. The S&P Small Cap 600 was up 11.6% for the quarter and 1.6% for one-year trailing.

International stocks also participated in the upswing. The MSCI EAFE index (Developed International) was up 10.0% but was still down -3.6% for twelve months. The MCSI Emerging Markets index was up 9.9% for the quarter and down -7.3% for twelve months. Growth stocks trailed value stocks in the fourth quarter of 2018 but regained the lead for the first quarter of 2019 and maintained the lead for one and three years.

EQUITY	Q1 2019	1 Year 3.31.19	3 Years Annualized
S&P 500	13.65	9.50	13.51
S&P 500 Value	12.19	5.93	10.62
S&P 500 Growth	14.95	12.77	15.91
Dow Jones Ind Avg	11.81	10.08	16.37
S&P Mid Cap 400	14.49	2.59	11.24
S&P Small Cap 600	11.61	1.57	12.55
MSCI EAFE	9.98	-3.55	7.27
MSCI Emerging Mkts	9.93	-7.28	10.68

Source: FactSet

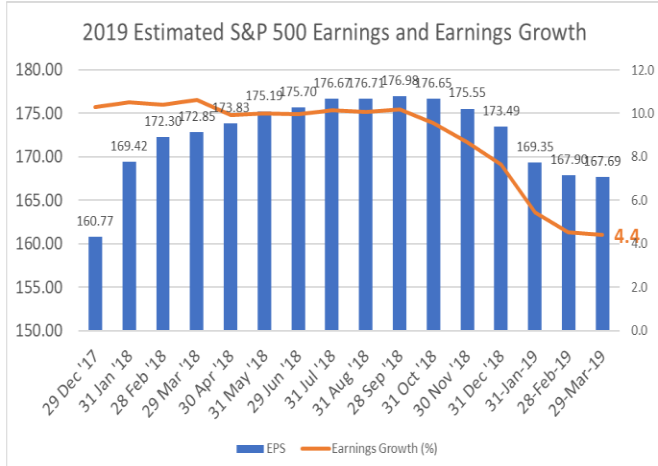
All economic sectors within the S&P 500 posted positive returns in the first quarter. Information Technology was the strongest sector in the quarter, followed by Real Estate. Health Care was the weakest.



Source: FactSet

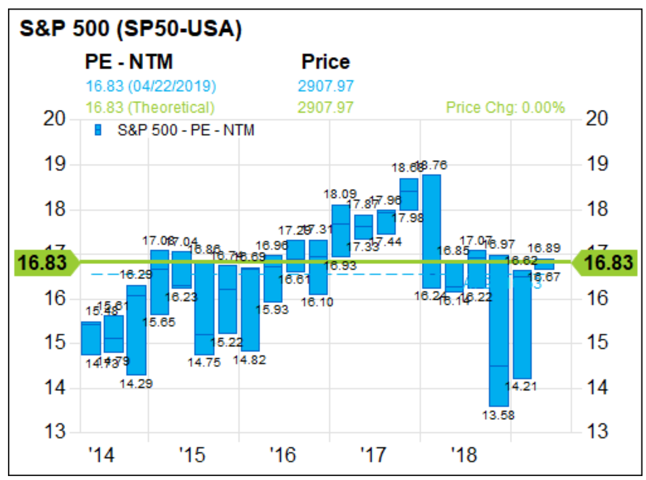
We are now in earnings season and attention will be focused on reported results for the first quarter and guidance for the second quarter and full year relative to consensus estimates.

Earnings growth estimates for 2019 have declined from over 10% in mid-2018 to 4.4% currently. The rate of decline has leveled out over the past several months.



Source: FactSet

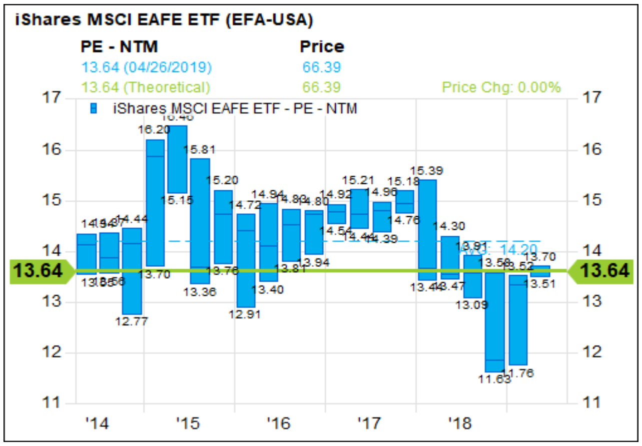
The S&P 500 is trading at a 17.4x P/E for calendar 2019 and a 15.6x P/E for calendar 2020. The index is trading at a 16.8X based on the next twelve months of expected earnings. This compares with the 5-year average of 16.5x.



Source: FactSet

Our 12-month forecast for the S&P 500 is 2885, indicating a flat domestic equity market for the remainder of 2019. The forecast is based on an adjusted earnings growth rate of 4.2% and a PE multiple of 16.75x.

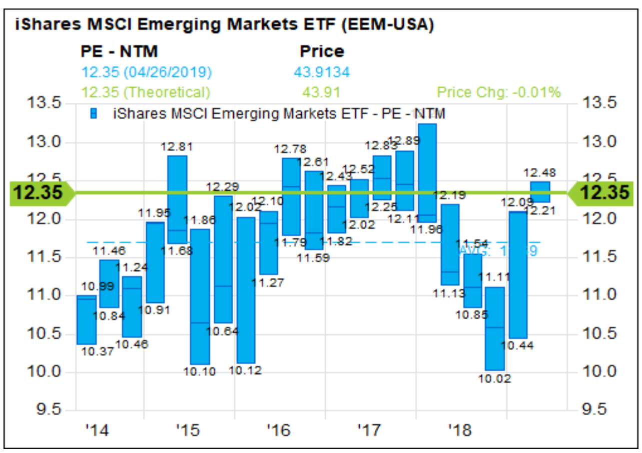
International-Developed markets are trading at 13.6x the next twelve months of expected earnings. This compares with the 5-year average of 14.2x.



Source: FactSet

The 2019 earnings growth consensus estimate for International-Developed markets has also declined to 4.4% from 8.0% mid-year 2018.

International – Emerging Markets are trading at 12.4x the next twelve months of expected earnings compared with the 5-year average of 11.7x.



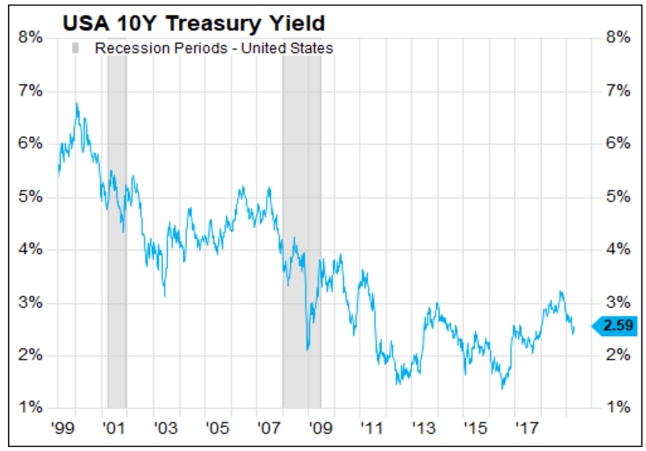
Source: FactSet

Estimates for earnings growth for International-Emerging Markets as represented by the MSCI Emerging Markets Index have declined to 2.3% from 11.6% at the mid-point of last year.

Fixed Income Markets

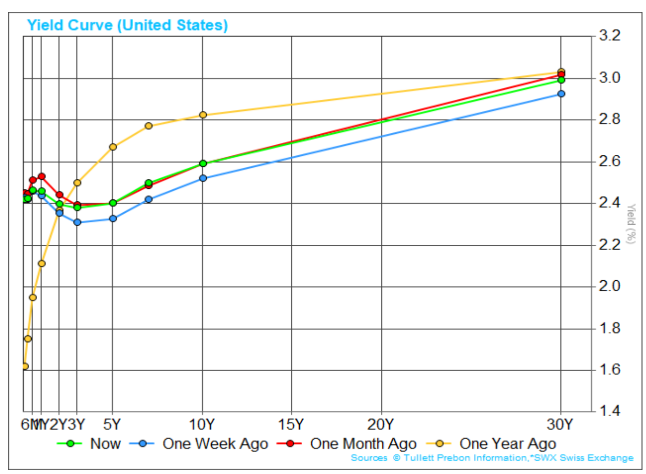
The Bloomberg Barclays US Aggregate Bond Index responded positively to declining interest rates in the first quarter, moving up 2.94%. The benchmark was up 4.48% for one year through March 31, 2019.

The U.S. 10-Year Treasury yield declined from 2.74% at the end of 2018 and March 31, 2018 to 2.42% at the end of the first quarter. However, bond prices have reacted negatively and yields have ticked up recently due to indications that the Federal Reserve may be willing to let inflation move higher than their long-term target. The Fed appears to be showing more flexibility in an effort to keep the economy growing.



Source: FactSet

Intermediate and longer-term bond yields remain below similar maturities from a year ago. However, shorter maturities have moved up from the prior year in response to the Federal Reserve increasing the Fed Funds rate by 1.0% (in four 0.25% increments) in 2018. The result has been an inverted yield curve (shorter maturity rates higher than longer maturity rates) from six months and one-year maturities nearly out to seven-year maturities.



Source: FactSet

The consensus among economists and interest rate strategists is for no additional increases in the Fed Funds rate in 2019 but they still expect the 10-year Treasury to end the year higher at 2.80%. This would still be considerably below the November 2018 peak of 3.46%.

The Bloomberg Barclay Municipal Bond Index was up 2.90% in the first quarter and 5.38% for one year through March 31. The 5-year annualized return is 3.73%. The municipal yield curve shifted down by about 25 – 30 basis points (0.25% - 0.30%) over the past month.

The High Yield Corporate Composite Index was up 6.91% in the first quarter and 6.21% for one year.

Disclosures

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