Quarter 1 of 2019 Calls for Cautious Optimism

Economic reports that were delayed due to the government shutdown have trickled in to reveal the economy slowed a bit more than expected in early 2019, reports Raymond James Chief Economist Scott Brown. However, the recent conclusion of the Mueller investigation with no pending indictments should serve as a market positive, according to Ed Mills, Raymond James managing director and Washington policy analyst.

In addition, it seems the Trump administration is prepared to continue negotiating with Beijing on trade, and the S&P 500 index had its best quarter since 2009, according to Bloomberg. This may be supported by a healthy labor market, as suggested by a two-month low in filings for U.S. unemployment benefits in the week ended March 23.

While most Federal Reserve policymakers expect to leave short-term interest rates unchanged over the course of the year, the federal funds futures market is pricing in about a 65% chance that the Fed will cut rates by the end of the year, explains Brown. He thinks the economy will continue to advance in 2019, but at a slower pace than last year with risks to that outlook tilted to the downside. Much has been made of a flattening yield curve, and it bears watching if the pattern sustains itself over an extended period of time.

The quarter ended positively, as did the month, for the Dow Jones Industrial Average, NASDAQ and S&P 500. The Russell 2000 Index also ended positively for the quarter, but negative for the month.

	12/31/18 Close	3/29/19 Close	Change Year to Date	% Gain/Loss Year to Date
DJIA	23,327.46	25,928.68	+2,601.22	+11.15%
NASDAQ	6,635.28	7,729.32	+1,094.04	+16.49%
S&P 500	2,506.85	2,834.40	+327.55	+13.07%
MSCI EAFE	1,719.94	1,875.43	+155.49	+9.04%
Russell 2000	1,348.56	1,539.74	+191.18	+14.18%
Bloomberg Barclays Aggregate Bond	2,046.60	2,106.83	+60.23	+2.94%

Performance reflects price returns as of 4:30 ET on March 29, 2019

Here is a look at what's happening in the economy and capital markets, as well as key factors we are watching:

Economy

- The Mueller investigation conclusion may have a real impact on President Trump's remaining first-term agenda, particularly on trade negotiations with China and domestic issues such as the budget or infrastructure, reports Mills.
- Slower global growth and trade policy uncertainty have weighed against business fixed investment, reports Brown. Orders and shipments of nondefense capital goods were on a softer track into early 2019; however, consumer spending growth should continue to lead the economic expansion this year.
- As mentioned above, the Fed has tabled its hopes of normalizing or raising interest rates, reports Doug Drabik, managing director, Fixed Income Research.
- The odds of a recession are about 25% in the next 12 months, shares Brown. It's not the most likely scenario, but too high for comfort, and the odds would rise if the curve further inverts, he notes.

Equities

- The inverted yield curve deserves investor attention, states Joey Madere, senior portfolio analyst, Equity Portfolio & Technical Strategy. However, he cautions investors from overreacting, as more time is needed to see if the inversion deepens, is longer lasting and if economic disappointments start to build. Right now, the economic data reflects a slowdown, not a contraction.
- Madere states that earnings expectations also reflect some slowing, natural following the 22% earnings growth received in 2018. However, he views underlying growth as still supportive for the S&P 500 in Q1 and full year 2019.
- Valuation is fair and still has room to expand given the low inflation and interest rate environment, explains Madere. However, the inverted yield curve and slowing macro will likely keep a lid on meaningful multiple expansion.

Fixed income

- Weak European data and waning domestic growth estimates have caused investors to gravitate toward more conservative assets, Drabik adds. The change in investor flow is contributing to a back-and-forth "toying" with a three-month to 10-year Treasury inversion, although many argue that the curve reflects government intervention, as well.
- Global interest rate disparity continues with U.S. domestic rates significantly higher across the curve than many major economic powers in Europe and Asia. As inflation expectations remain muted, Drabik expects low range bond rates to continue.

International

- After a strong performance during the first two months of the year, markets outside of the United States were pressured a little during March. This led to certain German and Japanese government bonds to trade at a negative yield and more volatile trading in equity markets, reports European Strategist Chris Bailey. Moving certain debates forward – including Brexit – may help build investor confidence.
- A Brexit compromise still remains likely and a slight delay was negotiated, but the continuing passage of time increases the risk of less straightforward outcomes.
- According to Brown, continued geopolitical tumult along with further signs of softening in the global economy have pushed long-term interest rates lower outside of the U.S., resulting in falling domestic bond yields as global investors seek a higher rate of return.
- China reported its lowest economic growth target in a generation – still a high level compared to most other global economies. The bounce-back performance of both the Chinese financial market and local currency bodes well for 2019, so far.

Bottom line

- Madere and his team hold a positive equity market stance until more evidence of a contraction appears.
- Bailey feels global investments outside of the U.S. continue to offer potential diversification opportunities, particularly if the dollar fades in value versus other major currencies in the world.
- According to Drabik, the corporate and municipal curves have maintained positive slopes and are viable sources for fixed income allocations.

Please let me know if you have any questions about recent market events or how to position your long-term financial plan for the months ahead. I look forward to speaking with you.

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