

ECONOMIC OUTLOOK

Summary

Last month we addressed the question about whether the U.S. economy was in recession. The answer was no but certain areas of the domestic economy were clearly in deceleration mode. However, the same might not be said about Germany and the Eurozone. Industrial manufacturing orders in Deutschland dropped 8.2% year-over-year and are the worst since 2002, when excluding the 2008 Financial Crisis. The broader Eurozone Purchasing Manager Index (PMI) reads as follows from the last four months (51.5, 49.7, 47.6 and 44.1), numbers below 50 represent a contracting manufacturing economy.

The U.S. economy has never been led into a recession from weaker trading partners around the globe, but other countries can and do experience recessions. We shouldn't ignore these other economic data points and it helps to view our domestic economy through the lens of the global economy for some perspective. The second largest economy in the world is China and trade tariffs, supply chain disruptions and trade tensions are having a negative impact on their growth. China's manufacturing PMI has been below 50 three of the prior four months (49.4, 49.5 and 49.2) until a 50.5 print last month. South Korea's manufacturing PMI has been below 50 for the last five months.

So where does this lead us? The global manufacturing PMI readings have been weakening, while the global service sector PMI's have softened, but are generally above 50. Investors should watch these PMI series data closely for signs that the trend lines

are stabilizing or increasing, to have greater confidence in a "soft landing" for the U.S. economy. We believe a patient Fed and lower trade tensions as the year progresses, will achieve the desired result. In the meantime, a soft Q1 and Q2 in 2019 should lead to some stabilization and better economic growth for the second half of this year.

Positives

ISM Manufacturing Index 55.3, 54.3 was expected

New home sales 667,000 (annualized), 620,000 was expected

Trade balance -\$51.1 Billion, -\$57.0 Billion expected (net add to GDP from forecast)

Negatives

ADP employment change - 129,000 jobs, 175,000 was expected

ISM Non-Manufacturing Index 56.1, 58 was expected

Capacity utilization was 78.2% last month, down from 79.2% the prior month

EQUITY OUTLOOK

Summary

Risk assets continued to perform well in March with the S&P 500 up 1.9%, marking an end to the impressive first quarter that saw the index rise 13.6%. This year has gotten off to a historic start following the broad weakness in equity markets in the closing months of 2018. Comments from the Federal Reserve's most recent meeting cemented their dovish pivot helping fuel the recent stock market rally. U.S./China trade optimism poured additional petrol on the fire though it is still not abundantly clear how close we stand to an eventual resolution.

While equity markets were broadly higher, there were a few notable trends apparent in the month of March. Domestic large cap growth stocks once again outperformed value as the Russell 1000 Growth climbed 2.8% vs the Russell 1000 Value up 0.6%. Real estate (+5.1%) and information technology (+4.8%) were the top two performing economic sectors while financials (-2.6%) and industrials (-1.1%) were the laggards. Middle and small sized companies failed to keep pace as the Russell Mid Cap Index rose just 0.9% and the Russell 2000 declined 2.1%. International returns were also muted in March. The developed MSCI EAFE Index inched 0.6% higher and the MSCI Emerging Markets Index rose 0.8%.

While it's comforting to see global stock markets stabilize and rebound as they have, we continue to caution more volatility could be on the horizon. Attorney General Barr's summary of the Mueller report gives the Trump administration some political cover in the near term,

divisiveness will continue to intensify as we approach the 2020 campaigns and election. A continued global economic slowdown appears inevitable at this point, which should remove some of the breeze behind the sails of the equity market rally.

We remain cautious in the near term as equity markets navigate the multitude of uncertainties, although an accommodative Fed should provide a nice long-term catalyst. We also see the recent rally as an opportunity to reevaluate risk tolerance and asset allocation targets and rebalance as appropriate.

Positives

Accommodative Federal Reserve

China/U.S. trade progress

Negatives

Slowing economic growth domestic and abroad

Investor sentiment overly optimistic

Unknown

Brexit path and impact

FIXED INCOME OUTLOOK

Summary

After a couple of months of relatively stable interest rates across the curve, yields plunged in March as the Federal Reserve reevaluated its position on the most likely path for the overnight interest rate. The “pivot” in policy came at the March 20 meeting of the Fed’s Open Market Committee (FOMC) when they announced no change in the overnight rate and removed all expectations of future rate increases for the entire year. Not only did they change their expectations for the overnight rate but they reversed course on their previous plan to reduce the size of their balance sheet over time. The process known as “quantitative tightening,” where they stopped reinvesting proceeds from their massive balance sheet was expected to continue for years to come. Now, the fed announced they would shrink the run-off amount in May and stop the run-off completely in September.

The Fed clearly acknowledged monetary policy is now near neutral and given the risks in the global economy and the lack of inflationary pressures, there is no reason to become restrictive. Following this surprise announcement, in the last eight trading days of March, bond yields dropped sharply through the low end of the trading ranges that had been in place for most of the year. The 2-year Treasury note ended the month 25 basis points (bps) lower at 2.26%, while the 10-year notes ended 31 bps lower at 2.41%. Considering the entire curve, out to 10 years, is yielding less than the upper bound of the overnight rate and the 5-year yield is slightly below that of the 2-year, the bond market believes that a rate cut is as likely as a rate hike this year. We concur with this outlook.

Credit spreads were little changed in March trading around the 120 bps level for the investment-grade universe of corporate

bonds in aggregate. We believe this level of incremental yield is attractive given the risk of a Fed policy error has been significantly reduced after their recent meeting and there is little reason to expect a recession in the next year.

Positives

Weak economic data out of Europe will keep a lid on their interest rates

Core inflation is below the Fed’s target and likely to remain low

Negatives

Near record levels of unemployment could cause wage pressures to accelerate further

Lack of fiscal discipline in Washington has led to increasing budget deficits

Unknown

The outcome of trade negotiations with China

The impact of Brexit, should it happen, on the U.K. and European economies