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MARKET REVIEW
MAY 2019



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TO PREDICT OR PREPARE, THAT IS THE QUESTION.

Young Prince Hamlet's famous soliloquy, "To be or not to be: that is the question" (Shakespeare, *Hamlet*, Act 3, Scene 1) depicts his inner struggle over life and death. Although Hamlet's angst may have little in common with investing, investors share a dilemma that at times can feel as serious as life and death. The investor's dilemma is whether and how to react to the latest economic or political news report.

There are two general ways investors can react to new information. Investors must draw a distinction between preparing for and predicting the ups and downs in the markets when interpreting the near daily onslaught of economic data and earnings reports. Investment success can hinge upon striking the right balance between these choices.

NOWCASTING

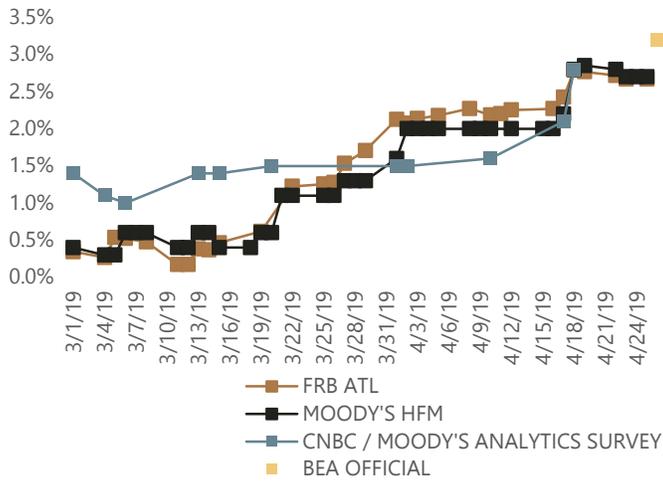
Ancient Greeks consulted the Oracle of Delphi for guidance of the future. Often her predictions were delivered in complicated messages and easily misinterpreted. Economists just might be considered modern day oracles, and their predictions for economic trends may have similar efficacy. A typical forecast from an economist involves analyzing a variety of economic data points to develop a numerical result. Typically, these forecasts cover a number of years, and generally provide better results for direction than magnitude.

Recently a new technique for forecasting economic growth has gained prominence. Commonly known as "nowcasting," the technique involves starting with the previous quarter's result and then adjusting the forecast for the current quarter as new data emerges. Several institutions publish these forecasts, and it is interesting to watch how they develop over time. The nowcasts for the Federal Reserve Bank of Atlanta, Moody's High Frequency Metrics, and the CNBC/Moody's Survey for first quarter 2019 Gross Domestic Product (GDP) growth are shown on the next page. Also shown is the official result as measured by the Bureau of Economic Advisors (BEA).

Readers with a keen memory may recall that the tone of economic news at the beginning of the year was quite dim. The holiday shopping season was modestly disappointing relative to expectations, and retail sales for January and February were much weaker than expected. These consumer trends showed up in the nowcasts, which began at a very sluggish pace. However, as the data for the first quarter slowly emerged, what they revealed was more strength than initially expected. In fact, just a few days before the official announcement, nowcasts for 1Q GDP were back to fairly robust levels (2.67% Atlanta Fed, 2.7% Moody's, 2.8% CNBC). However, all three ended up short of the 3.2% actual result. Interestingly, equity markets picked up steam in March and April, coinciding with the nowcasts ramping higher. Perhaps equity markets were picking up on the same signals as the nowcasts.

NOWCAST VS ACTUAL GDP GROWTH

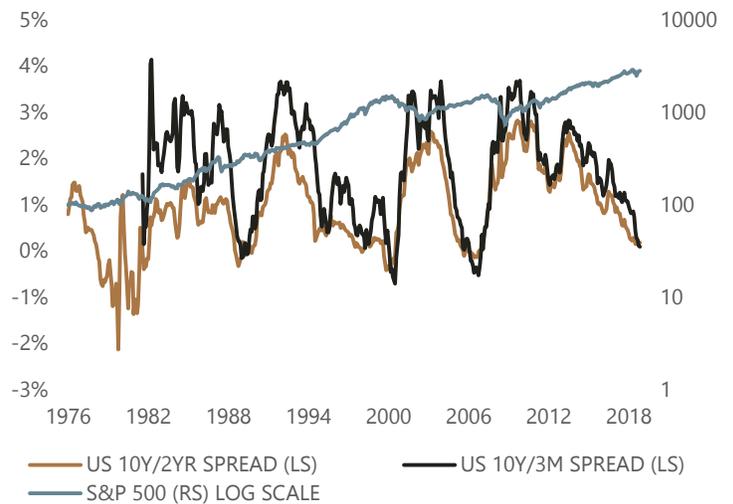
MARCH 2019 THROUGH APRIL 2019



Source: FRB Atlanta, Moody's, CNBC, BEA
Past performance does not guarantee future results.

YIELD CURVES AND S&P 500

JUNE 1976 THROUGH APRIL 2019



Source: St. Louis Federal Reserve Database (FRED), Bloomberg
Past performance does not guarantee future results.

YIELD CURVE INVERSIONS

The slope of the yield curve is the difference between longer and shorter term interest rates, most often defined as the difference between U.S. Treasury securities of 10-year maturities and either two-year or three-month maturities. According to economic theory, the slope of the yield curve is a reasonably accurate predictor of changes in the business cycle¹. As the gap shrinks between market interest rates, measured by longer term bonds like the 10-year, and policy rates, measured by three-month or two-year rates, the theory argues that economic growth expectations and inflation expectations are waning. When these expectations fall far enough, they eventually contract, and a recession ensues. The danger sign is when the slope falls below zero. This is referred to as an inverted yield curve because short rates are higher than longer rates.

The chart above (right) shows the yield curve's slope contrasted with the S&P 500 in logarithmic scale. It ought to be apparent when the yield curve has inverted that significant bear markets have often followed. Both the "tech wreck" of the early 2000s and the sub-prime housing crisis of 2008-2009 are discernible bear markets in the chart. However, during the latter phase of the bull markets that preceded the bear markets of the early 2000s and 2008-2009, other forces were at play unrelated to the yield curve. These included excessive valuations for technology stocks in the late 1990s and early 2000s, and excesses in the residential real estate markets in the years leading up to 2008.

Though economically deterministic, whether an inverted yield curve can serve as an effective tool for investors remains another matter. There's an old joke among money managers that goes "the yield curve has predicted 14 of the last 11 recessions." This alludes to the difficulty of using the yield curve to a significant degree.

CONCLUSIONS AND INVESTMENT IMPLICATIONS

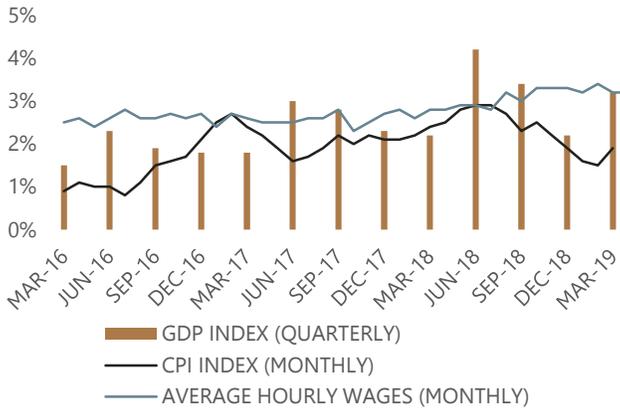
If neither economic forecasts nor signals from the yield curve have the potential to consistently provide investors an edge, why, then, do so many pay so much attention to them? And, why should they? The answer lies in how best to use the data. Prediction is extremely difficult. Not just in the field of investing and economics, but just about everywhere you look, the so-called experts often get it wrong. Perhaps a better approach is to not seek guidance from these experts, but to instead gather insights from their pronouncements in order to be better prepared for the upcoming twists and turns in the marketplace. An informed investor, working with qualified advisors, can adhere to a well-conceived investment strategy aligned with his or her investment goals.

¹Federal Reserve Bank of New York, Current Issues in Economics and Finance, Volume 2, Number 7, July 1996

ECONOMY

GDP, CONSUMER PRICES AND WAGE INFLATION

MARCH 2016 THROUGH APRIL 2019

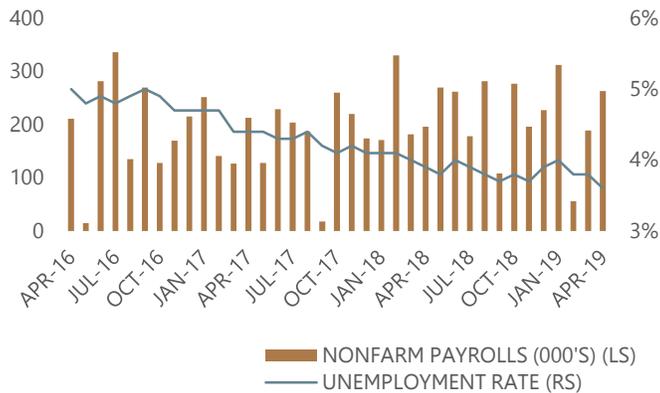


Source: Bloomberg

- U.S. economic growth increased to an annualized rate of 3.2% in the first quarter of 2019, ahead of economists' consensus forecast of 2.3% growth. Rising inventory levels due to businesses restocking helped boost GDP but this could hurt future readings as inventory levels normalize.
- The Core Personal Consumption Expenditure (PCE) price index, the Fed's preferred inflation measure, fell to 1.3% on a year-over-year basis in the first quarter.
- The Core Consumer Price Index (CPI), which excludes volatile food and energy costs, climbed 0.1% in March. The year-over-year reading for Core CPI fell to 2.0%.

LABOR MARKET

APRIL 2016 THROUGH APRIL 2019

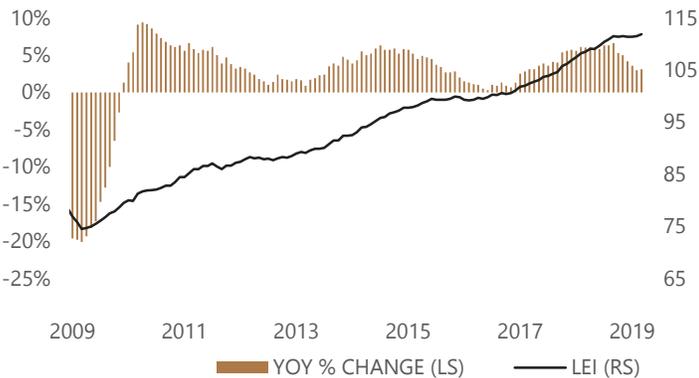


Source: Bloomberg

- The U.S. economy added 263,000 non-farm payrolls in April, significantly higher than the consensus estimates of 190,000 for the month.
- The unemployment rate fell to 3.6%, the lowest level since December 1969. The decline was due in part to fewer Americans actively seeking employment. The labor force participation rate has fallen from 63.2% in January to 62.8% in February, while the total labor force has shed approximately 760,000 workers over the same period.
- The year-over-year change in average hourly earnings remained at 3.2% in April, matching the prior month's increase.

LEADING ECONOMIC INDICATORS

JANUARY 2009 THROUGH MARCH 2019



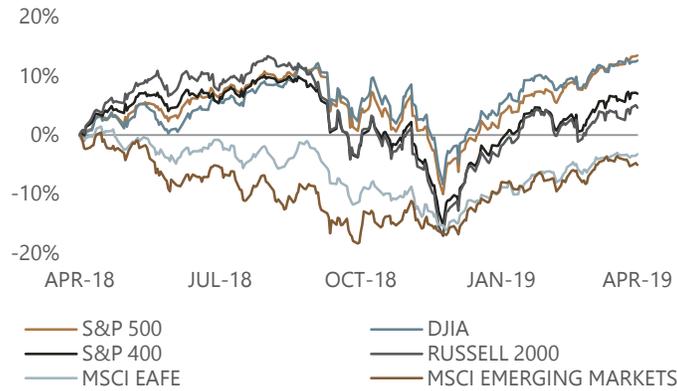
Source: Bloomberg

- The U.S. Conference Board Leading Economic indicator (LEI) Index increased 0.4% in March to 111.9. This followed a 0.1% increase in February and no change in January. The LEI Index's year-over-year growth rate increased slightly to 3.1%.
- The increase in the LEI in March was driven by strength in labor markets, consumers' expectations, and financial conditions.
- Despite the large gain in March, the trend in the U.S. LEI continues to moderate towards the long-term growth rate.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, APRIL 2018 THROUGH APRIL 2019

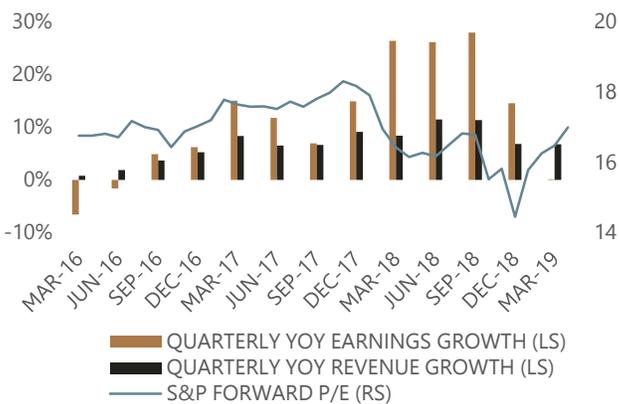


Source: Bloomberg

- This year's resurgence in global equities continued in April. The S&P 500 led global markets with a 4.1% monthly gain, reaching a new record close late in the month by surpassing its previous high of 2,930.75 on September 20, 2018.
- One of the main factors supporting equities last month was first quarter earnings results being reported better than feared. Over the last several months, analysts' estimates for S&P 500 first quarter earnings growth were revised lower into negative territory. The S&P 500 reported results are defying those negative estimates with flat earnings growth.
- Encouraging economic data in Europe helped foreign developed equities register a solid monthly gain of 2.9%.

S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, APRIL 2016 THROUGH APRIL 2019

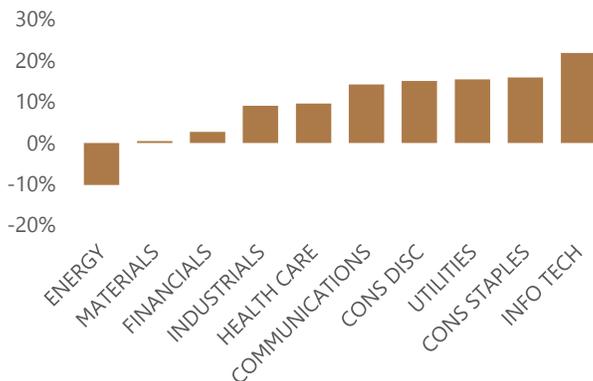


Source: Bloomberg

- Over 75% of S&P 500 companies have reported first quarter earnings. Earnings are on track for 0.05% year-over-year growth, much better than the negative 4.1% growth rate analysts were originally projecting at the start of the reporting season. A mixture of tough comparisons to 2018's strong earnings and slower global growth led analysts to project negative earnings growth.
- Margin improvement from reduced expenses appears to be the primary driver behind the better-than-expected earnings considering sales growth of 6.7% has matched analysts' estimates.
- Analysts are projecting an improvement in earnings growth in the second half of this year and mid-single digit earnings growth for the full year.

S&P 500 SECTORS 12-MONTH PRICE RETURNS

APRIL 2018 THROUGH APRIL 2019



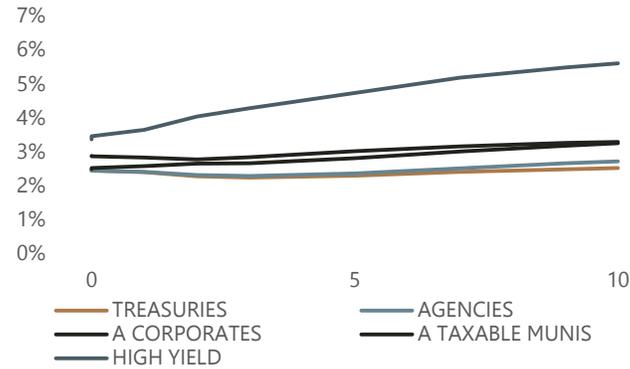
Source: Bloomberg

- There was a wide dispersion of returns between the best and worst sectors last month. The financials sector was the top performer, registering a monthly gain of 9.0% and benefiting from better-than-expected earnings and a steepening Treasury yield curve following a brief inversion in late March.
- The worst performing sector, health care, declined 2.6% and, along with real estate, was one of two sectors with a loss. The threat of tighter health care regulation including "Medicare for All" policies promoted by several high-profile Democratic presidential candidates weighed heavily on the health care sector.

FIXED INCOME

CURRENT YIELD CURVES

YIELD CURVES AS OF APRIL 2019

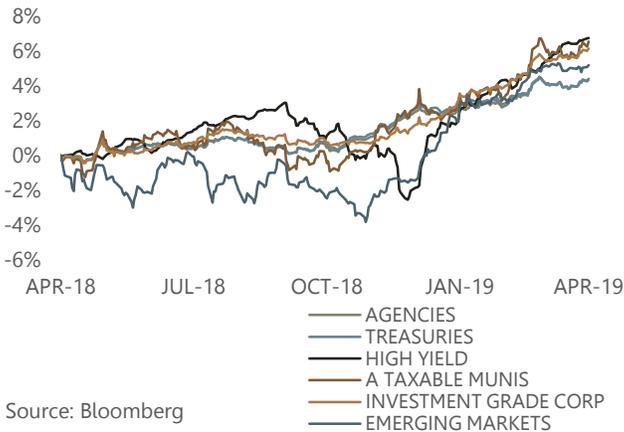


Source: Bloomberg

- After touching 2.37% near the end of March, the yield on the U.S. 10-year Treasury note climbed to 2.59% by mid-April before ending the month at 2.50%. Much of this move higher coincided with a better-than-expected earnings season, positive news on global growth and an upside surprise for retail sales in the U.S.
- From the end of March to the end of April the difference between the yield on the ten-year and the two-year Treasury notes climbed nine basis points.
- During April, the likelihood of a Fed rate cut by the end of 2019 has ranged from 40% to 67.2%, according to the fed funds futures market.

12-MONTH RETURNS, TAXABLE BOND SEGMENTS

APRIL 2018 THROUGH APRIL 2019

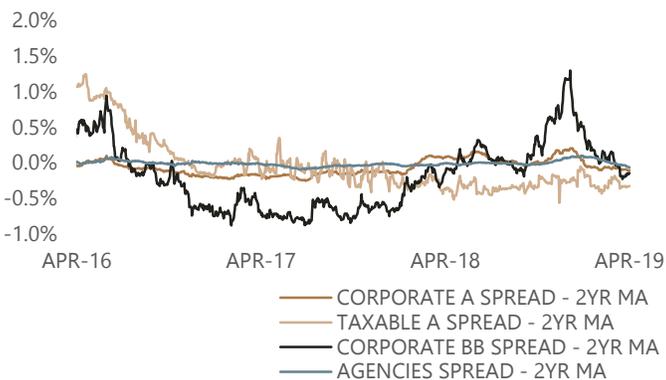


Source: Bloomberg

- Over the last twelve months, high yield bonds posted the best performance of the fixed income sectors tracked in the chart at left. The below investment-grade index posted a return of 6.74% over that time period, while the U.S. Treasury index only managed a return of 4.37% for the same time period.
- In April, high yield bonds posted the strongest performance, outperforming the next strongest performer, A-rated investment-grade corporates, by a sizable margin of 100 basis points.
- Of the spread sectors we follow, only taxable municipal bonds experienced negative returns in the month of April.

SPREAD VS. TREASURY LESS 2-YR MOVING AVG

APRIL 2016 THROUGH APRIL 2019



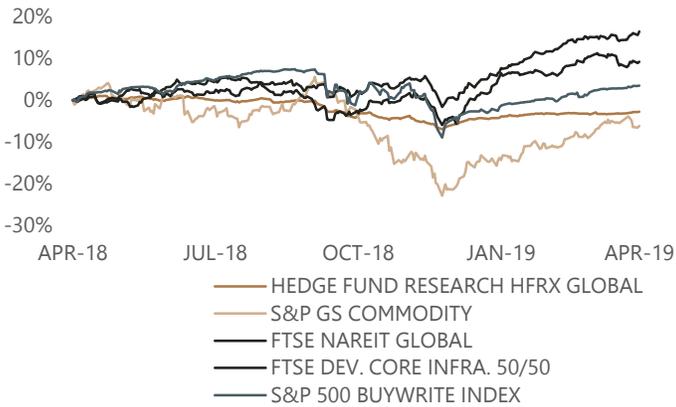
Source: Bloomberg

- All four of the listed bond sectors shown in the chart at left appear unattractive relative to their two-year moving average. Of the four bond sectors shown, U.S. Agency bonds appear to be the most attractive, while taxable A-rated corporate bonds appear to be the most unattractive.
- High yield spreads peaked this year on January 3 at a level of 536 basis points. Spreads have tightened each consecutive month thereafter to end April at a level of 310 basis points.
- In April, U.S. Agency bonds gave up some spread relative to their lower quality high yield and A-rated investment-grade corporate counterparts.

ALTERNATIVES

ALTERNATIVES, 12-MONTH RETURNS

APRIL 2018 THROUGH APRIL 2019

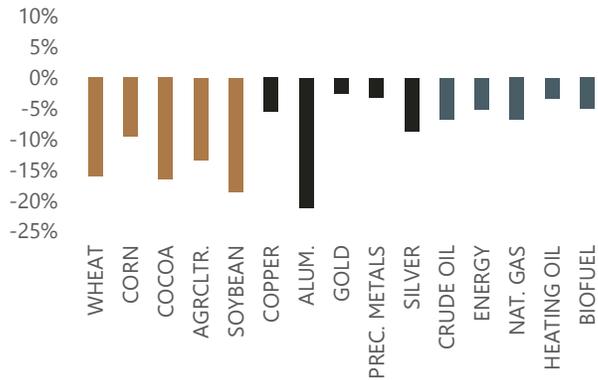


Source: Bloomberg

- Significant dispersion of returns materialized across the five alternative asset classes tracked in the chart at left over a volatile twelve-month period ending April 30, 2019.
- The global REIT and developed market infrastructure indexes significantly outpaced the MSCI ACWI Index's 3.0% price return over the previous twelve months. Meanwhile, the global hedge fund and commodities indexes produced negative returns over this period.
- After declining by 23% in the fourth quarter, the broad commodities asset class advanced 19.3% in the first four months of 2019, driven by a 6.4% advance in U.S. crude oil prices from \$45.41 per barrel on December 31 to \$63.91 on April 30.

COMMODITIES, 12-MONTH SPOT RETURNS

APRIL 2018 THROUGH APRIL 2019



Source: Bloomberg

- Against a backdrop of U.S. dollar strength and concerns about oversupply, all commodities tracked in the chart at left experienced price declines over the twelve-month period ending April 30.
- Some market commentators have suggested that expiring Iran sanction exemptions combined with further supply disruptions in Venezuela and Libya could pave the way for an extension of the early 2019 rally in crude oil prices.
- Commodity market participants will be paying particularly close attention to the path of the U.S. trade-weighted dollar and U.S. Fed policy direction relative to other major global central banks in coming months.

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