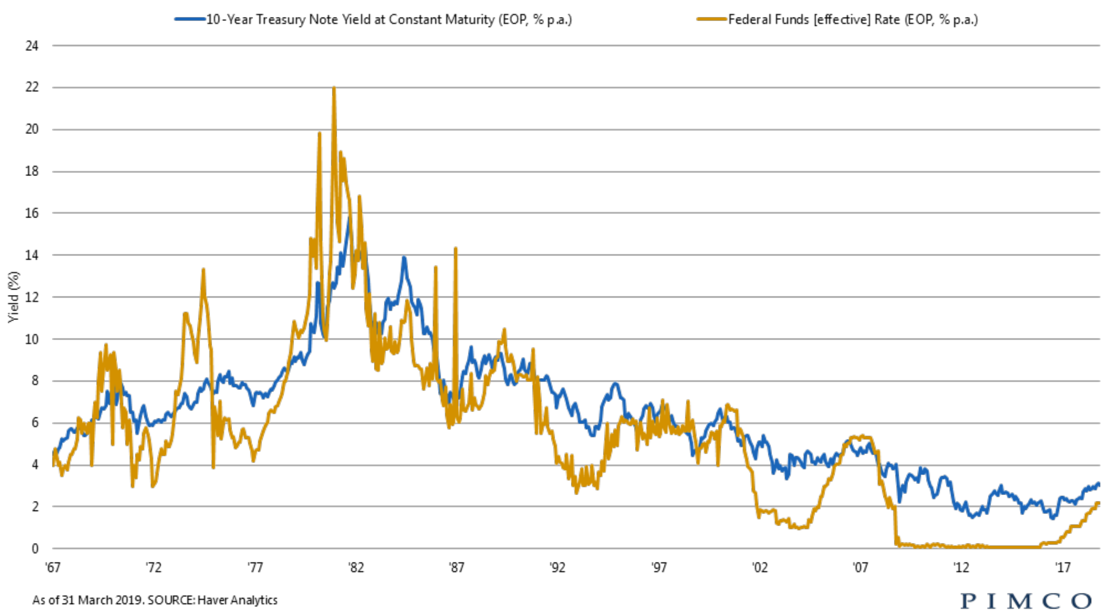
May 13, 2019

The Big Picture and Key Takeaway - April 2019

The Big Picture – Interest Rates Remain Historically Low in the Face of Solid Economic Growth



In April, the U.S. economy continued to show resilience as global economic growth shows signs of slowing down. First quarter GDP delivered growth of 3.2% (quarter-over-quarter, annualized), above economists' forecasts of 2.5%. The stronger than expected growth was lifted by strong net exports and companies building up inventory. Personal spending, a reflection of the consumer, was somewhat subdued at 1.2% growth. Along with strong GDP in the U.S., the job market continued to hum along as the economy added 263,000 new jobs and the unemployment rate dropped to a generational low of 3.6%. Unemployment has not been this low since 1969. Wage growth, as measured by average hourly earnings, grew by 3.2%, slightly below forecasts but still a solid reading. With signs of growth slowing elsewhere, from the Eurozone to Korea and Japan, the U.S. economy is providing at least a temporary ballast.

Against a relatively stable economic backdrop and tame inflation, the Federal Reserve has continued to signal a patient "wait and see" approach as it applies to moving short-term interest rates. Fed Chairman Jerome Powell indicated that current conditions point to a prolonged period of neither raising nor decreasing rates. For a market that has now convinced itself that there will be a rate cut this year, the Fed's most recent stance was a modest disappointment.

With all of the angst and market sensitivity to the path of interest rates, we think it is important to put in perspective where interest rates are relative to history. The chart above shows both the Federal Funds Rate (gold) and the 10-Year Treasury (blue). While it is clear that interest rates have gone up, they are climbing out of the proverbial basement. 10-year yields were rarely as low as they are today before 2008. The Fed funds rate was only modestly lower during the *recession* of 2001 and thereafter. Rates remain historically low and the economy seems to be exhibiting resilience and strength. This is the type of Goldilocks environment that seems just right for the time being. It would be nice to think that the economy and markets can handle higher rates than "historically low", but we may not find out anytime soon. The market is currently pricing in a 0% chance of a rate hike before the end of the year, and a 54% chance of a rate cut. Low rates are the new norm, or as bond management behemoth PIMCO now describes it, "the new neutral."

April & YTD Market Performance

Global Stocks

Market Returns		Returns (%)	
Index	Description	April	YTD 2019
S&P 500 TR USD	US - Large Company	4.05	18.25
Russell 2000 TR USD	US - Small Company	3.40	18.48
MSCI ACWI Ex USA NR USD	All International, excluding US	2.72	13.44
MSCI EAFE NR USD	International, excluding Emerging Markets	2.81	13.07
MSCI Emerging Markets NR USD	Emerging Market Stocks	2.11	12.23
Bloomberg Barclays US Agg Bond TR USD	High Quality US Bonds	0.03	2.97
ICE BofAML US High Yield TR	Lower Quality US Bonds	1.40	8.90
XAU Gold Spot $/OZ	Gold	-0.68	0.08
*Through April 30, 2019 Source: Morningstar, MSCI, Bloomberg			

The S&P 500 continued its recovery from the late 2018 swoon, delivering a +4.05% return in April. Investors continued to place a premium on names that provide steady growth as opposed to lower-priced value stocks. The positive performance for the market continued despite modest earnings growth of less than 1% year-over-year in the first quarter. Gains were once gain broad-based, led by technology, financial services and cyclical consumer stocks. More defensive sectors, such as utilities and healthcare have not fared as well in an environment of stronger growth. Energy stocks have also suffered as of late but remain in positive territory year-to-date. International Stocks also gained as the MSCI EAFE Index (Developed Markets) and the MSCI Emerging Markets Index, gained 2.81% and 2.12%, respectively in April, but continue the trend of lagging their U.S. counterparts. A proportion of the lag is due to the relative strength of the U.S. dollar, which has gained in value versus a basket of global currencies.

Bonds

The yield on the benchmark 10-year U.S. Treasury note increased by 0.10% in April, but remain at a low level of around 2.5%. The Barclays Aggregate US Bond Index increased barely budged in April, eking out a 0.03% for the month after a solid March. The yield curve, the difference between short and long maturity Treasuries continues to be quite flat as inflation remains tame while the Fed continues to assess its next move. Lower credit quality bonds, often referred to as “High Yield”, continued their strong performance as credit spreads declined once again in April. Credit spreads are the market’s way of betting on the probability that a bond will default. When spreads are low, the market believes that the chance of default is small. Currently, high yield credit spreads are well below their 20-year averages. Typically, this has led to lower returns in the sector going forward. If High Yield spreads begin to increase, it could signal concern to the broader stock and bond markets about the health of the economy. Currently, that concern is low.

The Key Takeaway

Stock and bond markets continue to benefit from a low interest rate environment and the current perception that the Federal Reserve is more likely to reduce interest rates, rather than increase them from here. Recession indicators for the US are not forecasting an imminent slowdown in 2019, but more modest growth is expected domestically and abroad. The stock market has now recovered all of its end of 2018 losses and continues to probe new highs. Interestingly, the most recent rally is happening in the face of a slowdown in corporate earnings growth and has been a function of “multiple expansion” – when markets decide to pay a higher price for a certain level of earnings. It seems that markets are happy in the state of a growing, if not slowing global economy, as long as rates remain low. However, if persistently low rates are an indicator of economic fragility that emerges in more concrete ways – or is driven by a policy misstep such as a trade war gone awry – the market may struggle to justify higher valuations in the face of more modest earnings growth. Given the uncertainties embedded in the outlook, we think portfolio diversification remains a necessary means of participating in the positive performance of the markets while having a cushion against the potential for a negative shift in sentiment and market fundamentals like we witnessed late last year.

If you have any questions regarding this report, please contact us at info@today2b.com or 914.302.3233

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Index and Category Definitions

The S&P 500 Index** is a capitalization-weighted index of 500 U.S. stocks. **Russell 2000 TR USD** is a market cap weighted index* The Russell 2000 measuring the performance of approximately 2,000 smallest-cap American companies ***The MSCI All Country World ex-USA Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI All Country World ex-USA Index consists of 22 developed and 24 emerging market country indices. **The MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. & Canada. **The MSCI Emerging Markets (EM) Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of 24 emerging markets countries. **Bloomberg Barclays U.S. Aggregate Bond Index** is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds. **ICE BofAML U.S. High Yield Index** is an unmanaged index of below-investment grade U.S. corporate bonds. **XZU Gold Spot $/Oz** reflects the exchange rate of **Gold** against the US dollar **index

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