# Quarterly Market Review

First Quarter 2019

# Asset Class Performance

First Quarter 2019

After a volatile end to 2018, U.S. stocks generated the largest quarterly gains since the third quarter 2009. Easing trade tensions between the U.S. and China and a more patient Federal Reserve that is delaying future rate hikes supported gains across many asset classes. Higher oil prices and lower bond yields benefited income oriented assets such as Energy Infrastructure and U.S. Real Estate , which outperformed almost all equities. Developed markets outperformed emerging markets while smaller cap stocks in both the U.S. and abroad outperformed larger-cap equities. The rebound in equity prices also had positive contributions in fixed income markets as high-yield bonds were the top performer during the quarter. Investment grade corporate bonds also had strong returns during the quarter and outperformed U.S. Treasuries. A larger decline in long-term rates (compared to short-term rates) led longer-maturity debt to outperform shorter-term bonds.

| Asset Class | First Quarter 2019 | Past Year | Past 10 Years* |
|---|---|---|---|
| Energy Infrastructure | 21.7% | 20.6% | 15.5% |
| U.S. Real Estate | 17.2% | 20.5% | 18.8% |
| U.S. Small Growth | 17.1% | 3.9% | 16.5% |
| U.S. Large Growth Stocks | 16.1% | 12.7% | 17.5% |
| Commodities: GSCI | 15.0% | -3.0% | -3.4% |
| U.S. Small Stocks | 14.6% | 2.0% | 15.4% |
| U.S. Large Stocks: S&P 500 | 14.6% | 9.5% | 15.9% |
| Foreign Large Growth Stocks | 12.0% | -1.3% | 9.7% |
| U.S. Large Value Stocks | 11.9% | 5.7% | 14.5% |
| U.S. Small Value Stocks | 11.9% | 0.2% | 14.1% |
| Foreign Small Stocks | 10.7% | -9.4% | 12.8% |
| Foreign Large Stocks | 10.0% | -3.7% | 9.0% |
| Emerging Market Stocks | 9.9% | -7.4% | 8.9% |
| Foreign Small Value Stocks | 9.0% | -9.9% | 12.3% |
| Foreign Large Value Stocks | 7.9% | -6.1% | 8.1% |
| High Yield Bonds | 7.3% | 5.9% | 11.3% |
| Long-Term U.S. Govt. Bonds | 4.6% | 6.3% | 5.0% |
| Municipal Bonds | 2.9% | 5.4% | 4.7% |
| Corporate Bonds | 2.9% | 5.2% | 3.5% |
| Foreign Hedged Govt. Bonds | 2.7% | 4.8% | 3.6% |
| U.S. Intermediate Govt Bonds | 1.6% | 3.8% | 2.0% |
| Short-Term U.S. Govt. Bonds | 1.0% | 2.7% | 1.0% |
| U.S. T-Bills / Cash | 0.6% | 2.1% | 0.4% |

*Annualized

Source: Morningstar Direct. Data as of March 31, 2019

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# World Stock Market Performance [1]

First Quarter 2019

With selected headlines from Q1 2019

260
250
240
230
220
210

"US Indexes Close with Worst Yearly Losses Since 2008"

"Strong US Job and Wage Growth Provides Assurance on Economy"

"OECD Sees Further Slowdown in Global Economy"

"China's Annual Economic Growth Rate Is Slowest Since 1990"

"US Stocks Post Best January in 30 Years"

"Economy Notches 100th Straight Month of Increased Employment"

"Consumer Sentiment Hits Lowest Level in More Than Two Years"

"Eurozone Economic Forecasts Slashed"

"NASDAQ Exits Bear Market as Stocks Rally"

"Oil Rises Sharply on OPEC Production Cuts, Falling US Stockpiles"

"US Economy Grew 2.6% in the Fourth Quarter"

"Small Business Hiring Breaks Record"

"US Posts Record Annual Trade Deficit"

"Manufacturing Pullback Flashes Signs of Economic Slowdown"

"Fed Keeps Interest Rates Unchanged; Signals No More Increases Likely This Year"

"May's Brexit Deal Is Rejected for a Third Time by Lawmakers"

January February March

[1] MSCI ACWI Index [net div.]. MSCI data © MSCI 2019, all rights reserved. These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

Source: DFA Quarterly Market Review. Data as of March 31, 2019

# World Stock Market Performance [1]



With selected headlines for the past 12 months

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Source: DFA Quarterly Market Review. Data as of March 31, 2019

# Fixed Income Performance & Yield Analysis

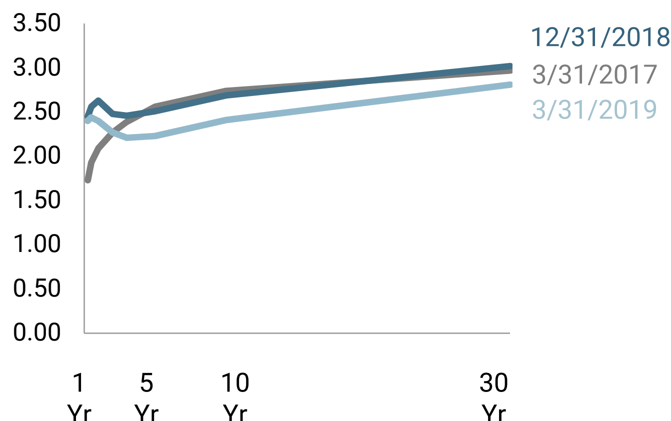
First Quarter 2019

Concerns over slowing economic growth during the quarter impacted U.S. Treasury yields. The Federal Reserve acknowledged the slowdown in economic activity and delayed the pace of further rate increases to avoid leading the U.S. economy into a potential recession. The Fed lowered its growth and inflation outlook but reiterated that the economy continues to show signs of growth.

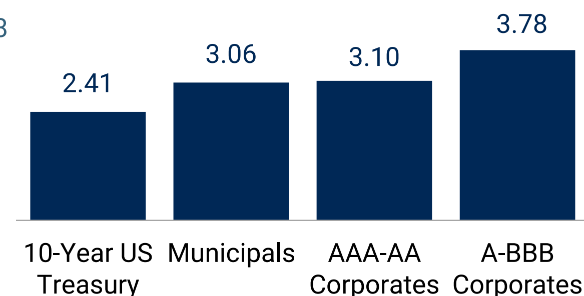
Because of the Fed's shift in sentiment, longer-term bond yields, which reflect inflation and growth expectations, declined more than short-term rates. This caused the 10-year Treasury yield to fall below 3-month Treasury yields, inverting the yield curve. Historically, yield curve inversions have provided an early signal of future weaker economic conditions, but given the unusual monetary policies implemented over the last ten years, the past may not be a reliable guide for the future.

Returns were positive across all fixed income segments with longer maturities outperforming shorter-term bonds. Strong demand for investment grade and high yield corporate bonds after last quarter's sell-off drove those sectors to outperform government-issued debt.

## US Treasury Yield Curve (%)[2]




## Bond Yields across Issuers (%)[3]




## Period Returns (%)[4]

*Annualized

| Asset Class | QTR | 1 Year | 3 Years* | 5 Years* | 10 Years* |
|---|---|---|---|---|---|
| Bloomberg Barclays Municipal Bond Index | 2.90 | 5.38 | 2.71 | 3.73 | 4.72 |
| Bloomberg Barclays US Aggregate Bond Index | 2.94 | 4.48 | 2.03 | 2.74 | 3.77 |
| Bloomberg Barclays US Government Bond Index Long | 4.64 | 6.20 | 1.54 | 5.43 | 5.19 |
| Bloomberg Barclays US High Yield Corporate Bond Index | 7.26 | 5.93 | 8.56 | 4.68 | 11.26 |
| Bloomberg Barclays US TIPS Index | 3.19 | 2.70 | 1.70 | 1.94 | 3.41 |
| FTSE World Government Bond Index 1-5 Years | 0.34 | -2.04 | 0.40 | -0.95 | 0.71 |
| FTSE World Government Bond Index 1-5 Years (hedged to USD) | 1.16 | 3.13 | 1.59 | 1.65 | 1.73 |
| ICE BofAML 1-Year US Treasury Note Index | 0.82 | 2.44 | 1.21 | 0.85 | 0.70 |
| ICE BofAML US 3-Month Treasury Bill Index | 0.60 | 2.12 | 1.19 | 0.74 | 0.43 |

One basis point equals 0.01%. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). FTSE fixed income indices © 2019 FTSE Fixed Income LLC, all rights reserved. ICE BofAML index data © 2019 ICE Data Indices, LLC.

Source: DFA Quarterly Market Review. Data as of March 31, 2019

# Quarterly Market Review



After an abysmal fourth quarter of 2018, US stocks rebounded to their best quarterly gain in nearly a decade. Fear around diminished growth prospects, trade, and a Fed monetary policy mistake faded as the quarter progressed, allowing stocks and bonds to gain and interest rates to fall.

At the forefront of the equity market decline in late 2018 was the Federal Reserve. After years of near 0% interest rates, the Fed moved short-term interest rates to a range of 2.25%-2.5% after a 0.25% increase in December. Initial forecasts from the Fed showed they expected additional rate increases in 2019. As economic data weakened, both domestically and abroad, capital market participants became concerned that monetary policy was becoming too restrictive too fast putting growth prospects for 2019 in jeopardy. Beginning in January, the Fed's language and forecasts for interest rates suggested Feb members knew about the slowing rate of economic growth and planned to put the brakes on the pace of expected interest rate increases. By March, the Fed indicated it expected no additional rate hikes in 2019. The Fed also laid out a plan to stop reducing the size of its balance sheet. These actions imply monetary policy is less likely to cause a recession, abating many fears.

Once it became clear the Fed was not going to raise interest rates, equity markets responded positively, as this removed a risk to growth going forward. Importantly, while economic growth had slowed in the fourth quarter, it was still positive and our outlook for 2019 includes a low likelihood of a recession. It would appear a more patient Fed will allow economic growth to continue albeit at a slower rate.

Besides monetary policy, the uncertain economic relationship with China has been a source of angst and volatility in the capital markets. The US and China represent the two largest economies in the world. An adversarial trade relationship would be an economic negative not only for the US and China but also for the rest of the world. Our view of this process is that the leaders of both countries have a vested interest in finding a successful outcome. As the first quarter progressed, positive messages emerged about the trade negotiations and there were no new tariff actions taken by either side. As of this writing, the countries have not reached a final agreement, but hopes remain high for a positive resolution. It is hard to know how much, it at all, the global equity markets might move upon this agreement, but it could remove a major potential headwind to the global growth outlook.

Domestic bond markets also enjoyed positive returns for the quarter as the shift in monetary policy by the Fed allowed interest rates to fall and credit spreads to narrow. It is becoming more apparent that there is a reduced probability that interest rates will increase significantly or too quickly, based upon slowing growth and low inflation. Within this environment, the Federal Reserve has little to fear from an economy that overheats from excess activity or rising inflation expectations.

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In the last weeks of the first quarter we saw the Treasury yield curve briefly "invert". An inversion occurs when short term interest rates (three month Treasury bill) trades at higher yields than longer term Treasury notes (ten year Treasury note). For a few days, the three month Treasury bills yielded about 4-6 basis points (0.04%-0.06%) more than the ten year Treasury note. Past occurrences of inversions have, at times, been telling indicators of future economic weakness and even recessions. Not surprisingly then, this event got a lot of attention in the financial press. While we are sensitive to the history of these types of events, it is important to note the unique circumstances of this period when compared to past periods. Doing so does not mean this event doesn't matter, but it may be the "message" from this inversion is a bit different.

What are these unique circumstances? We know that interest rates are much more global today than in the past, and the global economy is much more interconnected. While international economies have always had central banks, doing much of what our Federal Reserve does, the impact of those international monetary policies is much greater today. Globally, there is about $16 trillion dollars of foreign debt trading at negative yields. In that environment, a 2.5% US Treasury note looks very inviting to non-US investors. Absent this "global" demand keeping yields low, domestic interest rates could potentially be higher, as US growth and inflation are higher than corresponding global growth and inflation. Global bond demand therefore has the effect of holding longer term US rates down; so the "inversion" we saw of 3 month Treasury bills and ten year Treasury notes might indicate something different than in the past.

It would also be important to note the inversion did not last long. As of the end of the quarter, three month Treasury bills were yielding less than the ten year Treasury note, and the spread between the two of them remains positive today. Also, the spread between two year Treasury notes and the ten year Treasury note did not invert, at any time.

Overall, we continue to expect economic growth to be positive. A more cautious Federal Reserve and an anticipated trade agreement with China provide an environment in which capital market returns can remain positive. As always, our decisions are driven by holding client interests first, and working hard to manage risk while prudently pursuing returns. We thank you for your continued trust and confidence.

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# Disclosures/Endnotes



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# Disclosures/Endnotes



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ENDNOTES:

1 MSCI ACWI Index (USD) [net div.]. MSCI data © MSCI 2019, all rights reserved.

2 Federal Reserve

3 State and local are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated.

4 Bloomberg; US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook ™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Citi fixed income indices copyright 2017 by Citigroup. The BofA Merrill Lynch Indices are used with permission; © 2017 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Merrill Lynch, Pierce, Fenner & Smith Incorporated is a wholly owned subsidiary of Bank of America Corporation. The S&P data are provided by Standard & Poor's Index Services Group.

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