Investors Trust
Investment and Trust Services

1st Quarter 2019 Market Commentary

Total Return				
Index	**3/31/2019**	**12/31/2018**	**2019 YTD**	**Q1 2019**
Dow Jones	25,928.68	23,327.46	12.6%	12.6%
S&P 500	2,834.40	2,506.85	13.7%	13.7%
Nasdaq	7,729.32	6,635.28	16.8%	16.8%
S&P 400 Midcap	1,896.27	1,663.04	14.5%	14.5%
Russell 2000	1,539.74	1,348.56	14.6%	14.6%
Yield on 10-Year Bond	2.41%	2.69%		

Source: FactSet

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Overview

In the first quarter of 2019, the **US equity markets posted their best quarterly return since 2009 and the best first quarter return since 1998.** Admittedly, those returns came on the heels of a significant sell-off in the fourth quarter 2018. When we published our *2019 Market Outlook* on December 20, 2018, our call was that the fears that had been ripping through the equity markets in the fourth quarter were unfounded: specifically, we did not believe that the cries of a pending recession in the US made sense, we did not believe that the Federal Reserve would derail the economy with persistent rate hikes, and we did not believe that the US-China relationship would deteriorate into a trade war. As a result, we called for a notable rebound in the equity markets in 2019 based on healthy corporate earnings growth and a solid, albeit slower, underlying economic growth backdrop. So far, so good.

In December, we called for a notable rebound in the equity markets in 2019.

Indeed, the Fed has walked back its expectations of rate hikes, suggesting that they will not raise rates even one time in 2019, down from an expectation of four times as recently as last October. There is a popular adage among the collective firms that make up Wall Street: "Don't fight the Fed." It is popular for a good reason, as history suggests that investing in a manner that is counter to Fed policy is usually a losing strategy. So the Fed's shift in policy stance on rate hikes is potentially a significant positive for risk assets including stocks. It also provides an additional reason for us to be optimistic about the long-term outlook for the markets. At the same time, while no trade agreement has yet been put into place between the US and China, there are numerous reports of constructive progress, so much so that the Street is much less fearful that a trade war is likely. And while the US economy slowed in the first quarter given the myriad obstacles it faced (i.e., the government shutdown, unusually rainy weather across much of the country, a nervous consumer following the fourth quarter decline in the stock market, etc.), recent economic indicators suggest a growing economy for 2019.

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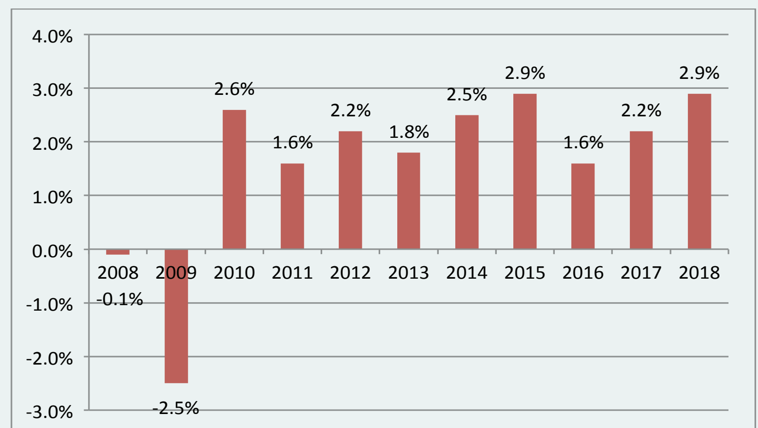
Given the strong start to the year, **our outlook for US equity markets for the remainder of 2019 is more balanced.** Indeed, it would not surprise us if the market experienced a short-term pullback in light of the market strength thus far. During the rally in the first quarter, Street estimates for 2019 corporate earnings growth continued to decline, with expectations now calling for roughly 4.3% growth, down from 8.7% at year-end 2018. We believe that Street expectations have fallen too far, and we are sticking by our view that corporate earnings growth should approximate 6.5% in 2019. If indeed that does occur, that would suggest the equity markets still have room to run. Further, there remain potential positive drivers that could accelerate earnings growth even further in 2019 including positive developments on US-China trade and positive trends in capital spending, which should improve corporate productivity and boost earnings. That does not mean we lack any concerns for the markets; on the contrary, there remain several things that we are watching closely including a sharp rise in oil prices, emerging inflation pressures, some slowing in global manufacturing data, ongoing dysfunction in Washington, DC, among other issues. But our bias remains constructive at present.

From an asset class perspective, we increasingly view International and Emerging Markets as attractive areas. While both of these asset classes have underperformed US equities for several years, China has begun to stimulate its economy through a number of fiscal and monetary actions, which should likely have domino effects that are positive for those asset classes in the quarters ahead. In addition, both asset classes are notably cheaper on a valuation basis.

Economy

While still subject to revision, the US economy grew 2.9% in 2018. As seen in Chart 1, that matches the best level of economic growth for the US since the financial crisis. Economists currently estimate that economic growth in the first quarter should come in around 1.6%, as a number of temporary headwinds negatively impacted first quarter economic activity. Seasonally, the first quarter has often been the slowest growth quarter for the US over the past several years, and it appears that 2019 will be no exception. Current Street consensus for 2019 economic growth is 2.4%, which is consistent with our expectations of 2.0% to 2.5%.

Chart 1:
Annual US Economic Growth – 2008-2018



Source: Bureau of Economic Analysis

On a short-term basis, there are some crosscurrents that suggest a mixed economic outlook. Indeed, some economic indicators have been trending down recently including retail sales, home sales, and measures of global manufacturing activity. Further, we recognize that there is a lagged effect from the eight rate hikes that the Fed implemented over the past couple of years, taking the Fed Funds rate to 2.25% to 2.50% currently from 0.75% to 1.00%. On the positive side, however, US Consumer Confidence remains at very healthy levels,

helped by a 3.8% Unemployment Rate that sits near a multi-decade low. Further, after declining from robust levels in 2018, measures of US manufacturing activity have recently improved. Longer term, there remain several important economic data points that suggest the health of the US economy is well in place. Of greatest significance, **the Fed's decision to pause on further interest rate hikes combined with China's decision to aggressively stimulate its own economy should be notable benefits for the US in the coming quarters.** Just like the lagged effects of prior rate increases could put some pressure on the economy today, the lagged effects of the Fed's decision to pause should result in positive pressure on the US economy in 2020 and beyond.

Equities

US equity markets recovered sharply in the first quarter, with all of the major averages up double digits. In fact, each of the months of the quarter posted positive gains, with the S&P 500 up in January 7.9%, up in February 3.0%, and in March 1.8%. That is noteworthy. As Chart 2 shows, since 1950 the S&P 500 has been positive for each of January, February, and March only 19 times, and the average return for the balance of the year was 9.6%, with all but one year (1987) being positive. It is also noteworthy that the average pullback in such years was 9.4%, reinforcing our view that declines within a broadly higher market are common.

We believe that Street estimates are too low currently, in light of the underlying health of the US economy.

Chart 2:
Performance of the S&P 500 in Years with Positive January, February, & March

Year	3/31-12/31 Performance	Max Drawdown Mar-Dec
1950	18.2%	-14.4%
1954	33.6%	-4.4%
1961	10.0%	-4.4%
1964	7.3%	-3.6%
1967	7.0%	-6.6%
1971	1.8%	-13.9%
1972	10.1%	-5.1%
1975	8.2%	-14.1%
1983	7.8%	-6.9%
1986	1.4%	-9.4%
1987	-15.3%	-33.5%
1991	11.2%	-5.6%
1993	3.3%	-4.0%
1995	23.0%	-2.5%
1996	14.8%	-7.6%
1998	11.6%	-19.3%
2006	9.5%	-7.7%
2012	1.3%	-9.9%
2013	17.8%	-5.8%
2019	???	???
Average	**9.6%**	**-9.4%**

Source: Strategas

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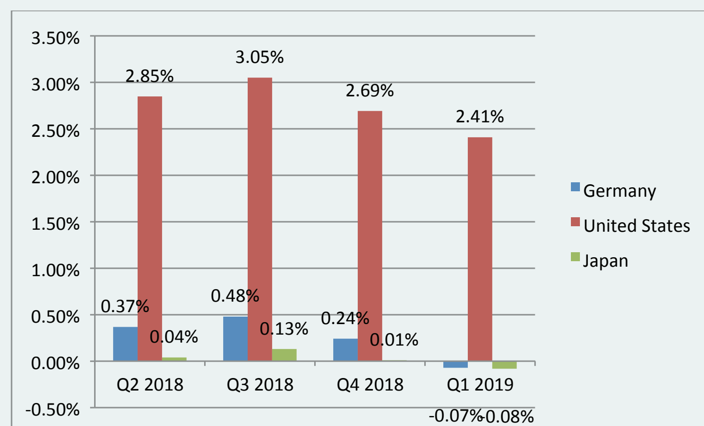
As we have noted on numerous occasions, corporate earnings remains the ultimate driver of equity prices, and estimates for corporate earnings growth for 2019 have declined on the Street to roughly 4.3%. We believe that Street estimates are too low currently, in light of the underlying health of the US economy. Expectations for first quarter earnings growth is flat to down slightly, in part due to the headwinds faced in the quarter. While low expectations have historically been positive for stocks, the fact that equities rallied significantly in the first quarter suggests greater risk to stock prices if earnings results disappoint the Street. Despite near-term concerns, we believe that the positive underlying trends should support a healthy stock market for the balance of the year.

Fixed Income

While the Federal Reserve is always a key player in market activity, **the actions from the Fed in the first quarter were arguably the single biggest factor impacting virtually all asset classes in the quarter.** Specifically, the Fed altered its policy stance on rate increases from the fourth quarter, reducing their expectations in October of increasing rates four times in 2019 down to an expectation of no rate hikes in 2019. That policy shift was viewed favorably by investors, who believed that the Fed would be more accommodative in supporting economic growth going forward. It also resulted in a notable decline in US interest rates in the quarter, as the yield on the US 10-Year Treasury dipped to a 15-month low at 2.41% from 2.69% at year-end. In addition to a more accommodative Fed, the reality of outright negative yields on the other major global bonds, specifically from Germany and Japan, drove global income investors to the relatively attractive rates in the US. As Chart 3 indicates, while the US yield dropped to 2.41% in the first quarter, it is much better than the -0.07% found in German bonds and the -0.08% found in Japanese bonds.

Chart 3:
10-Year Interest Rates for Germany, the US, and Japan



Source: FactSet

In large part due to the policy shift by the Fed, our outlook for interest rates for 2019 has changed. We do believe that the underlying strength of the US economy combined with the potential bottoming of growth internationally could put upward pressure on interest rates from current levels. As a result, we currently expect rates to finish the year in a range of 2.75% to 3.00%