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FINANCIAL MARKET SNAPSHOT

Better Than Expected

May 3, 2019

A better-than-expected Q1 U.S. GDP reading and some early above-consensus earnings reports have helped lift stocks for a fourth straight month.

To-date, the strength of global equity markets has outpaced our expectation, but our multi-factor allocation models are still flashing the need for only modest overweight exposure to risky asset classes.

In April, global equity investors continued to applaud the investment backdrop provided by accommodative central bankers and the U.S. economy. While economic conditions in non-U.S. countries are less dynamic, data on domestic conditions remain somewhat constructive. A preliminary +3.2% U.S. GDP reading for the first quarter and a notable lift in productivity, all in a low inflation environment, has left investors feeling good about the investment landscape so far.

Meanwhile, Q1 U.S. corporate earnings have been somewhat better-than-expected, with 54% of S&P 500 companies yet to report as of April 26. So far, the aggregate S&P 500 Index earnings decline, according to FactSet, has been 2.3%, but that number is above the –4.0% estimate as of March 31. The stability in earnings, versus expectations, has help prop up risky asset prices to-date. However, company management teams have, in aggregate, delivered some cautious business outlooks for the quarters ahead, so this will be something to watch.

Table 1: Notable Returns / Yields / Spreads - January-April 2019

Source: Bloomberg

Note: BBG Barc = Bloomberg Barclays; 10Yr Treasury Yield figures as of the end of the month
High Yield Corp Spreads = Yield-to-Worst differential vs. 10Yr Treasury (end of month)

	Jan '19	Feb '19	Mar '19	Apr '19
S&P 500 Index	8.01%	3.21%	1.94%	4.05%
MSCI EAFE Index	6.61%	2.58%	0.72%	2.89%
MSCI Emerging Markets Index	8.76%	0.22%	0.83%	2.12%
BBG Barc U.S. Aggregate Bond Index	1.06%	-0.58%	1.92%	0.26%
10-Year Treasury Yield	2.63%	2.72%	2.41%	2.50%
U.S. HY Corp Spread (10Yr)	4.27%	3.82%	4.03%	3.62%

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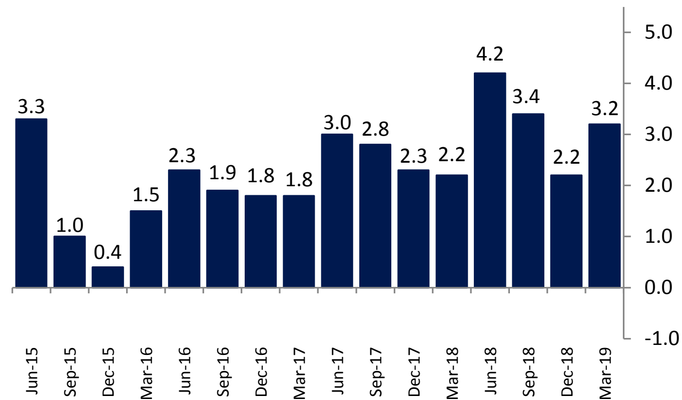
As we have stated in other research pieces, the steady growth and low inflation environment has been a panacea for stocks year-to-date. Even foreign equity markets, where the investment backdrop is less sanguine, have ridden the tailwind of relative U.S. strength. Brexit issues, for now, have been pushed to the back-burner as parties extended their next "end-date" to October 31. U.S./China trade talks seem to be progressing and some semblance of a deal appears forthcoming. We expect, however, that any real trade resolution will be a process, rather than a point-in-time

solution, despite any pomp-and-circumstance that may come with a near-term announcement. And finally, investors do not appear deterred by the political firestorm in the U.S. in what should be an increasing partisan dust-up as we begin our approach the 2020 election.

Figure 1: U.S. Real GDP YoY % Change
Source: Bureau of Economic Analysis

The preliminary Q1 GDP number (or "advance" estimate) was + 3.2% for Q1. This number may be revised by the Bureau of Economic Analysis in an announcement on May 30, and the third and final GDP reading for Q1 will not be made until June 27.



In terms of our research and portfolio management work, our models are picking up some of the improved fundamental and technical conditions we have seen. However, indicators we follow do still tell us to act with a note of caution. Economic, valuation, and price-action inputs we model are steering us to only modestly overweight equities versus bonds at this juncture, and we are leaving some cash in reserve. We believe the potential for some profit-taking following this four-month rally is material.

According to our models the investment outlook has indeed improved, but indications to materially overweight risk-based assets remain muted. Said differently, our work calls for taking a steady approach to equities and non-core bond assets..

Globally, we are favoring U.S. and emerging market equity exposure and underweighting foreign developed markets. This is primarily driven by relative economic conditions and price trends in key markets. However, we are cognizant that foreign developed market valuations are at substantial discounts, which is a variable we are monitoring closely. Currently, the catalyst for us to get more constructive on foreign developed equities is lacking. A Brexit resolution could have been that catalyst, but the decision timeline here has been pushed out.

Finally, our bond allocation remains focused on a "core-plus" construct. That is, we are maintaining strict core-bond exposure (Treasuries, Investment Grade Corporate and Mortgage-Backed securities), but allowing for a modest non-core (global bonds, high-yield) allocation. This bond structure may create some opportunity for enhanced return while still positioning the bond allocation as the primary equity downside buffer.

Risks

Investors should be aware of the risks associated with all portfolio strategies, and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance, our macroeconomic theories, and the effectiveness of strategic and tactical portfolio approaches.

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There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

Stock investing involves risk including loss of principle.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Precious metal investing involves greater fluctuation and potential for losses.

Government bonds and Treasury bills are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities and are subject to higher interest rate, credit, and illiquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

The MSCI EAFE Index is a free float –adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

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The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing the major sectors of the U.S. economy.

The 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.

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