



Tom Seay
Managing Director, Research



Anna Rathbun, CFA, CAIA
Director, Research



Joe Boushelle, CFA, CAIA
Managing Director, Research



Daniel MeGES
Senior Analyst, Research



Erin Gray
Analyst, Research



Joe Nitting, CFA
Analyst, Research

For any inquiries about this document please contact marketminute@clearstead.com. For information on our team members, please click on photo.

The fears we encountered in Q4 2018 seem a distant memory as we progress through the winter months. We no longer fear a sudden dive into economic collapse but realize that growth is slowing, not dying. We are closer today to a trade détente with China, with the Trump administration delaying the increase in tariffs due on March 1st. In its search for R-Star, the financial unicorn that would define “normal” interest rates, the Fed has decided to pause in its rate hiking activities and many believe it will last throughout the year. The de-escalation of the drama surrounding the markets provided a perfect tonic, and volatility faded as the month progressed.

Such an environment lifted consumer confidence and the markets’ animal spirits continued the rally we have witnessed since Boxing Day (December 26th). Risk assets have recovered much of Q4’s decline, and what was once cheap may now be considered rich in some enclaves. Late cycle investing often provides such confusion and volatility as investors attempt to determine if the end is near. But, these periods can be long lasting and rewarding for those with the patience and fortitude to remain in the game.

Domestic Equity

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	4.0%	11.6%	11.6%	5.9%
S&P 500	3.2%	11.5%	11.5%	4.7%
Russell 2000	5.2%	17.0%	17.0%	5.5%
Russell 1000 Growth	3.6%	12.9%	12.9%	6.6%
Russell 1000 Value	3.2%	11.2%	11.2%	3.1%
WTI Crude Oil	6.4%	26.0%	26.0%	-7.2%

S&P 500 companies provided pleasant news for Q4 2018 by beating both revenue and profit forecasts¹. Although tepid forward expectations were the norm, nonetheless they were growing. The combination of improving sentiment and solid earnings provided the ingredients necessary for another month of positive returns. With the majority of the earnings season behind us, one must wonder what will capture the market’s attention – Green New Deal, Michael Cohen or our favorite, March Madness – whatever the news headline maybe, the fundamentals continue to be supportive.

International Equity

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	2.0%	9.7%	9.7%	-6.5%
MSCI EAFE	2.5%	9.3%	9.3%	-6.0%
MSCI Emerging Markets	0.2%	9.0%	9.0%	-9.9%
MSCI EAFE Small Cap	2.2%	10.5%	10.5%	-10.5%

The positive momentum regarding the U.S. – China trade talks heartened Chinese investors and provided a strong impetus for a rally². Lackluster growth in Europe and Japan and the ongoing risks of a potential economic disruption related to Brexit weighted a bit on developed markets, but the returns were in the black. As we look ahead we are less optimistic about the growth potential in non-U.S. developed markets and believe the emerging markets provide the seeds for long-term growth that will reward investors. This will not happen overnight and could be a bumpy ride but the potential rewards appear more attractive in China, India and Southeast Asian countries than those in Europe and Japan.

Fixed Income

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	-0.1%	1.0%	1.0%	3.2%
BarCap Global Aggregate	-0.6%	0.9%	0.9%	-0.6%
BarCap US High Yield	1.7%	6.3%	6.3%	4.3%
JPM Emerging Market Bond +	-0.1%	5.0%	5.0%	2.2%
BarCap Muni	0.5%	1.3%	1.3%	4.1%

As a response to very strong employment news on February 1st interest rates rose a bit and then traded sideways for the remainder of the month. Slowing growth expectations, tame inflation data and central bankers taking a more cautious approach to monetary policy implementation once again had bond investors in search of yield. High yield bonds, bank loan securities and emerging market debt all witnessed impressive gains while more conservative investments achieved less impressive results. As valuations now appear a bit rich, the snap back we have witnessed in the year's first two months maybe a bit much; so don't be surprised to experience some choppy waters ahead of us.

Closing

Late cycle investing lends itself to surprises from unknown areas and investors are often jittery and react emotionally. We know that there will be some resolution to Brexit, but we don't know when or the form of the final agreement. The 2020 U.S. Presidential election season is upon us and one thing for sure is that it will be lively and provide plenty of fodder for pundits to pontificate. As often is said, the markets despise uncertainty and in these uncertain times don't be surprised by market volatility. Although our positioning is a bit more defensive, we remain fully invested.

Sources:

- 1 FactSet, 3/1/2019
- 2 MSCI China Indeax returned 3.5% during February of 2019

Disclosures

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