clearstead
MARKET MINUTE

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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.

This month's Market Minute reflects the views of Clearstead's Research Team and was composed by Dan Meges, Senior Research Analyst.

US and foreign markets traded cautiously in March, as investors weighed the implications of a slowing global economy along with more accommodative monetary policy. While investors have for several months been wary of a slowing global economy, March brought a steady stream of disappointing economic data. US housing starts and corporate earnings estimates, Chinese industrial profits and exports, and German business sentiment and manufacturing volumes were some of the most notable economic headlines to weigh on global markets during the month[1]. No surprise given these dour headlines, expectations for real GDP growth in 2019, diminished in Europe, the US, and Japan. As a result the US Federal Reserve and the European Central Bank (ECB) both communicated to markets during the month that any further tightening in 2019 was unlikely. Meanwhile the Chinese government detailed additional fiscal and monetary stimulus measures. In fact, markets seem to be expecting more QE from the ECB in latter half of 2019, and potentially a rate cut by the US Fed either in late 2019 or early 2020.

Against this backdrop of anticipated global liquidity easing and weakening economic growth, the US yield curve slightly inverted late in the month as the 10-year yield dropped just below that of the 3-month yield. This mild inversion does not signal an imminent recession—see our Clearpoint article from mid-2018—but it does represent another signal that this historically long US economic expansion is in the ninth inning. As we noted previously, late-cycle investing can be volatile, but it can extend for several months (even years), and provide returns for those with the patience and fortitude to stay in the game.

Domestic Equity

As of March 29, 2019

U.S. EQUITY MARKETS

Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	0.2%	11.8%	11.8%	10.0%
S&P 500	1.9%	13.6%	13.6%	9.5%
Russell 2000	-2.1%	14.6%	14.6%	2.0%
Russell 1000 Growth	2.8%	16.1%	16.1%	12.7%
Russell 1000 Value	0.6%	11.9%	11.9%	5.7%
WTI Crude Oil	5.1%	32.4%	32.4%	-7.4%

Given these uncertainties, market returns did not give way to many clear themes in March. However, one item to note was the steady decline of US small cap stocks. Typically more domestically focused than their larger cap peers, small cap stocks were affected significantly by the weaker-than-expected U.S. data releases in March. Another factor weighing on markets were the sliding expectations for Q1 corporate earnings growth, as the number of S&P 500 firms issuing negative guidance during Q1 was up meaningfully from recent quarters[2].

Balancing out these negative developments were the views that the US-China trade talks were grinding their way towards a trade deal by early summer (May/June) and that some of the current economic weakness had already been priced into the markets in the sharp Q4-2018 sell-off. Similarly, while the US economy is set to slow from its 2018 growth rate, the US labor market, retail sales, and manufacturing sector are poised for steady—albeit not stellar—growth throughout 2019. Overall, the fundamentals that underlie the US economy as well as US corporate sales and profits remain solid. Current valuations are not stretched and the overall environment remains supportive for equities.

International Equity

As of March 29, 2019

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	0.6%	10.3%	10.3%	-4.2%
MSCI EAFE	0.6%	10.0%	10.0%	-3.7%
MSCI Emerging Markets	0.8%	9.9%	9.9%	-7.4%
MSCI EAFE Small Cap	0.2%	10.7%	10.7%	-9.4%

Foreign markets underperformed US markets in March, but this fact was largely a result of the US dollar moving up modestly against most foreign currencies during the month. Despite the disappointing economic data coming out of Europe, Japan, and China, markets generally took heart at the fact that ECB was indicating a renewed dovishness and Chinese officials made it clear that new stimulus efforts would build upon the already enacted growth-oriented fiscal and monetary policies from second-half of last year. Assuming the US-China trade talks make it over the finish-line, non-US equities should have a basis to trade higher over the coming months.

Fixed Income

As of March 29, 2019

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	0.9%	2.9%	2.9%	4.5%
BarCap Global Aggregate	1.3%	2.2%	2.2%	-0.4%
BarCap US High Yield	0.9%	7.3%	7.3%	5.9%
JPM Emerging Market Bond +	1.5%	6.6%	6.6%	3.5%
BarCap Muni	1.6%	2.9%	2.9%	5.4%

The yield on the 10-year moved sharply lower in March given the Fed's pivot at the most recent policy meeting. The Fed's dovishness and the yield curve inversion prompted a flight to quality as fixed income investors moved into long-dated Treasuries and Investment Grade bonds as recession fears creeped in to market psychology. Risk-oriented fixed income investments were positive during the month, but underperformed high-quality fixed income investments. With the Fed on pause for the remainder of the year, the economy slowing to a more sustainable pace and stable corporate fundamentals, we believe fixed income investors should expect coupon income to drive returns for the remainder of the year.

Closing

Late cycle investing can be volatile and investor sentiment can swing quickly from a bullish to a bearish outlook and back again, and potential derailment of US-China trade talks, as well as further weakening to China's economy remain as risks. Nonetheless, these late cycle dynamics may persist for some time as we are in a phase—both in the US and abroad—of slow growth, low inflation, full employment, and stable monetary policy. In light of this, Clearstead is more defensive at present, but we judge the economic fundamentals, low-interest rate environment, and current stock valuations should provide a supportive atmosphere for equities and other risk assets throughout the year.

Sources:

1. US Census Bureau – US Housing Starts in Feb-2019 down 9.9% YoY, FactSet – S&P 500 Corporate Earnings Q1-2019 down 3.9% from Q1-2018; Chinese industrial profits in Dec-2018 fall 1.9% YoY – National Bureau of Statistics, China's total exports fall 4.6% in the combined Jan-Feb period compared to the same period a year earlier; IFO Institute business-climate index falls to 98.5 in February, German industrial production falls 3.3% YoY in Jan-2019.
2. "Largest Cuts to S&P 500 EPS Estimates Since First Quarter of 2016" FactSet, 29-March-2019.