

# Market Insights

Economy | Capital Markets

Q1  
2019

## Economy

After a very volatile and unrewarding year for investors in 2018, the new year started with a bang. Through March, the major stock market indices from around the world have posted very strong results. The S&P 500 Index is up 13.65 percent, the Dow Jones Industrial posted a 11.81 percent return and the MSCI All World Index returned 12.65 percent. Bonds have also bounced back from their lackluster performance last year with returns of around 2 percent for core bond strategies and 4 percent or higher for riskier bond allocations. While several of the economic trends remain intact and serve as a ballast amidst uncertainty, several “other” pressing geopolitical and global issues can potentially either help or derail the markets and economies of the world, depending on their outcome.

First on the economic front, record low unemployment, healthy consumer spending and modest business activity remain the main drivers of growth. Although the most recent monthly employment report showed a gain of only 20,000 new jobs, the three-month average is still quite vibrant at about 186,000 per month, and the nation’s unemployment rate is hovering near a 50-year low. Further, employee wages are growing at their fastest pace in about 10 years, a positive sign for an uptick in consumer spending. On the business side, the latest Institute for Supply Management (ISM) report on manufacturing activity indicated a modest decline, but it is still in expansionary territory. Sixteen of the 18 manufacturing industries reported growth, the most in six months. The latest report on the services industry showed an even brighter picture. Economic activity grew for the 109th consecutive month in the non-manufacturing sector and is approaching its cyclical peak. While the report was mostly optimistic about the near-term outlook, concerns linger about the uncertainty surrounding tariffs, capacity constraints and tight labor markets.

Other sectors of the economy illustrate some volatility, yet modest strength overall. For instance, the housing market took a nosedive at the end of last year as construction plummeted across all building types and regions. However, a sharp rebound in the National Association of Home Builders (NAHB) index so far in 2019 suggests housing activity will recover in the spring. Housing permits, a barometer of demand for new construction, have increased, which suggests the recent volatility may be short-lived and due to supply and labor constraints. On the consumer side, retail sales rebounded after a surprisingly weak December that was likely due to the government shutdown and seasonal factors. Employee wage gains are beginning to push higher, which is a good sign for consumer spending, the largest part of our economy.

While the economic fundamentals appear solid, pockets of weakness and instability have caught the attention of the Federal Reserve.

After raising interest rates nine times over the past three years, the combination of severe market volatility and weaker-than-expected economic data at the end of last year forced the Fed to alter its path to any further rate hikes. In early January, amidst softer economic data, Fed chairman Jerome Powell indicated he was willing to be flexible on policy and was in no hurry to increase interest rates further. This reassurance sparked a rebound in the capital markets during the first quarter. At the Federal Reserve’s meeting in March, it not only left interest rates unchanged, but also indicated a high probability that further rate increases were unnecessary through the remainder of the year.

The Federal Reserve is keenly aware that recent indicators point to a slowing economy. The tricky part is determining whether it is a temporary blip in the long-running economic expansion, or a more sustainable slowdown that could eventually cause a recession. For starters, Treasury yields are nearly the same for short and medium-term bonds. This is termed a “flat” yield curve, and should longer rates decline further, the yield curve would invert. If this occurs, it tends to be an early indicator that a recession is nearing. Next, the Fed’s own recessionary gauge, which has often foreshadowed a recession in the past, has jumped to an uncomfortable level. While a bit unnerving for investors, the many positives still tend to outweigh these early economic warning signs. Growth remains positive and is expected to hover around 2.0-2.5 percent for the year. The employment picture is one of the best on record, with the Bureau of Labor Statistics reporting the highest job openings rate of all time. Over 7 million jobs are available, and wages are rising. Further, inflation is tame and corporate balance sheets appear sound.

Amidst a bit more economic uncertainty and with the Federal Reserve on hold, investors have taken notice. The capital markets have bounced back so far in 2019 after a dismal performance last year. With equity markets up double digits in the first quarter, we are tempering our expectations for the remainder of the year, particularly since corporate earnings are expected to weaken. In bonds, the combination of lower interest rates and the Federal Reserve pausing on any further rate hikes should cause returns to continue to trend higher for the rest of the year. In this environment, we may make modest changes in client accounts in response to economic and market conditions.

As always, investing in capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser.

## Capital Markets

The yield on the U.S. 10-year Treasury bond drifted lower during the quarter amidst signs the economy was slowing and the Federal Reserve would be on hold. High-yield and investment-grade bonds performed reasonably well during the quarter. Global equities rebounded from the fourth quarter rout and produced very strong results for the first quarter.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

## Market Index Performance (%) As of March 31, 2019

	1st QTR	YTD	1 Year	Annualized 3 Year
<b>S&amp;P 500</b>	13.65	13.65	9.48	13.52
<b>Dow Jones Industrial</b>	11.81	11.81	10.03	16.39
<b>Nasdaq Composite</b>	16.81	16.81	10.66	18.06
<b>Barclays Aggregate Bond</b>	2.94	2.94	4.48	2.03
<b>FTSE USBIG Corporate</b>	5.07	5.07	4.93	3.67
<b>MSCI World</b>	12.65	12.65	4.61	11.35

## Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
<b>U.S. Unemployment Rate</b>	3.80%	6.09%	Represents the number of unemployed persons as a percent of the labor force	Near historic lows
<b>Consumer Price Index</b>	1.50%	2.20%	Represents changes in prices of all goods and services purchased for consumption	Trending modestly lower
<b>U.S. Capacity Utilization</b>	79.13%	80.26%	The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime	Trending slightly higher
<b>Gross Domestic Product*</b>	3.00%	2.80%	Total value of all goods and services produced indicates strength or weakness of the economy	Trending higher
<b>10 Year Treasury Yield</b>	2.44%	6.33%	Yield on the current 10 year treasury bond	Trending lower recently
<b>Annual Housing Starts</b>	1,162,000	1,433,000	New privately owned housing unit starts annualized rate	Modestly lower

\*Average from 1966 to Present

\* Annualized

Source: Bloomberg

Disclosures: Investments are not insured, and may lose money. Client should be prepared to bear the risks associated with investing.

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