FINANCIAL MARKETS COMMENTARY

MARCH 2019

TELEMUS®

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FIRST QUARTER HIGHLIGHTS

Global markets shapeshifted from ugly fourth quarter declines to exuberant gains across sectors during the first quarter as the Central banks of the world reneged on tightening in the face of a mild countercyclical breeze intimating marginally slower growth than previously expected.

The high correlation between money printing (or even the idea of its resumption) and world markets was evidenced rapidly. Most stock markets saw double digit gains, as did energy, natural resources and real estate. Bonds posted expected annual returns all in the quarter, and precious metals and commodities rose over 6.0%.

Slowing global growth is no surprise and the 0.3% average reduction now forecast results in still comfortable global growth of 3.3% for 2019. We do not think this warranted the 360 from beginning/continuing QT to resumption of QE by the Central banks and see it as unexpected verification that the 'Fed Put' is alive and well. All things equal, this means global markets will again have the tailwind of money-printing behind them for some longer time.

We are clearly nearer the end of this economic cycle than the beginning and continued maturation of the cycle coupled with trade tensions, Brexit fears and China's economic reallocation will serve to heighten uncertainty and perhaps volatility. However, so long as the Central Banks are easily cowed, it is difficult to see global markets falling precipitously.

INDEX RETURNS AS OF 3/31/2019

BASIC INDEX RETURNS

BASIC INDEX RETURNS	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
BALANCED INDEX (50% ACWI, 35% US Gov. Cr 1-5, 5% HFRX, 5% commodity, 5% bill)	0.94%	7.07%	7.07%	19.61%	18.53%	94.54%
HFRX GLOBAL HEDGE FUND INDEX	-0.17%	2.60%	2.60%	5.96%	-1.48%	18.81%
CPI - SEASONALLY ADJUSTED	0.00%	0.15%	0.15%	6.39%	7.42%	19.08%
S&P 500 COMPOSITE	1.94%	13.65%	13.65%	46.25%	67.81%	338.09%
LIPPER LARGE - CAP CORE	1.37%	12.52%	12.52%	43.76%	56.89%	289.32%
WISDOM TREE LARGE CAP DIVIDEND	1.44%	12.47%	12.47%	40.29%	61.49%	328.70%
MSCI ALL COUNTRY WORLD INDEX NET	1.26%	12.18%	12.18%	35.56%	36.71%	210.15%
MSCI EAFE NET	0.63%	9.98%	9.98%	23.44%	12.19%	135.79%
BLOOMBERG BARCLAYS MUNICIPAL BOND 5Y (4 - 6)	0.70%	2.11%	2.11%	5.46%	11.64%	36.02%
BLOOMBERG BARCLAYS US AGGREGATE	1.92%	2.94%	2.94%	6.20%	14.48%	44.72%
BANK OF AMERICA / MERRILL LYNCH US T - BILL 3MONTH	0.22%	0.59%	0.59%	3.62%	3.77%	4.37%

EXTENDED INDEX RETURNS

EXTENDED INDEX RETURNS	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
RUSSELL 1000 GROWTH	2.85%	16.10%	16.10%	58.24%	88.33%	402.25%
RUSSELL 1000 VALUE	0.63%	11.93%	11.93%	34.73%	45.03%	287.97%
RUSSELL MIDCAP GROWTH	1.35%	19.62%	19.62%	52.31%	67.65%	405.99%
RUSSELL MIDCAP VALUE	0.50%	14.38%	14.38%	31.31%	41.69%	356.25%
RUSSELL SMALL CAP COMP GROWTH	-0.73%	18.47%	18.47%	61.06%	61.96%	425.16%
RUSSELL SMALL CAP COMP VALUE	-1.20%	13.49%	13.49%	32.86%	33.00%	298.92%
MSCI EM (EMERGING MARKETS) NET	0.84%	9.92%	9.92%	35.59%	19.80%	135.53%
BLOOMBERG BARCLAYS US TREASURY BILL 6 MONTH	0.25%	0.66%	0.66%	4.10%	4.66%	6.22%
BLOOMBERG BARCLAYS US AGENCY	1.40%	1.81%	1.81%	4.64%	10.59%	25.16%
JP MORGAN EMERGING MARKET BOND INDEX(EMBI) + COMPOSITE	1.10%	6.16%	6.16%	12.62%	24.64%	109.39%
CITI GROUP WORLD GOVERNMENT BOND	1.27%	1.74%	1.74%	2.89%	2.99%	24.34%
BLOOMBERG COMMODITY	-0.18%	6.32%	6.32%	6.82%	-37.31%	-22.83%
ALERIAN ENERGY MLP	3.43%	16.82%	16.82%	18.07%	-21.53%	162.32%
PHILADELPHIA STOCK EXCHANGE GOLD / SILVER	0.67%	8.07%	8.07%	9.85%	-16.27%	-43.22%
LIPPER GLOBL NAT RES	1.24%	13.34%	13.34%	15.01%	-20.23%	49.16%
LIPPER PRECIOUS METAL FUND	-0.45%	7.41%	7.41%	8.61%	-6.49%	-17.47%
MSCI WORLD REAL ESTATE	4.59%	16.02%	16.02%	22.22%	43.69%	268.76%
LIPPER REAL ESTATE FUND	3.35%	15.88%	15.88%	19.16%	49.38%	324.47%

Note: The data is cumulative not annualized. All data in U.S. dollars.

THE GLOBAL ECONOMY

SYNCHRONOUS DECELERATION OF GLOBAL GROWTH CONTINUES

The global economy continues to grow a bit more slowly each year exactly as we have posited. Global growth is expected to drop modestly from 3.6% in 2018 to 3.3% in 2019. Expectations for most of the OECD (developed) countries have been lowered a bit but with larger downward revisions for the Eurozone and the United Kingdom.

Real GDP growth revised down

OECD Interim Economic Outlook Projections

Year-on-year, %. Arrows indicate the direction of revisions since November 2018.

	2018	2019	2020		2018	2019	2020
World	3.6	3.3	3.4	G20	3.8	3.5	3.7
Australia	2.9	2.7	2.5	Argentina	-2.5	-1.5	2.3
Canada	1.8	1.5	2.0	Brazil	1.1	1.9	2.4
Euro area	1.8	1.0	1.2	China	6.6	6.2	6.0
Germany	1.4	0.7	1.1	India[1]	7.0	7.2	7.3
France	1.5	1.3	1.3	Indonesia	5.2	5.2	5.1
Italy	0.8	-0.2	0.5	Mexico	2.1	2.0	2.3
Japan	0.7	0.8	0.7	Russia	2.3	1.4	1.5
Korea	2.7	2.6	2.6	Saudi Arabia	2.0	2.1	2.0
United Kingdom	1.4	0.8	0.9	South Africa	0.8	1.7	2.0
United States	2.9	2.6	2.2	Turkey	2.9	-1.8	3.2

Note: Difference in percentage points based on rounded figures. Dark red for downward revisions of 0.6 percentage points and more. Dark green and dark orange for, respectively, upward and downward revisions of 0.3 percentage points and more but less than 0.6 percentage points. Light green and light orange for, respectively, upward and downward revisions of less than 0.3 percentage points. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.

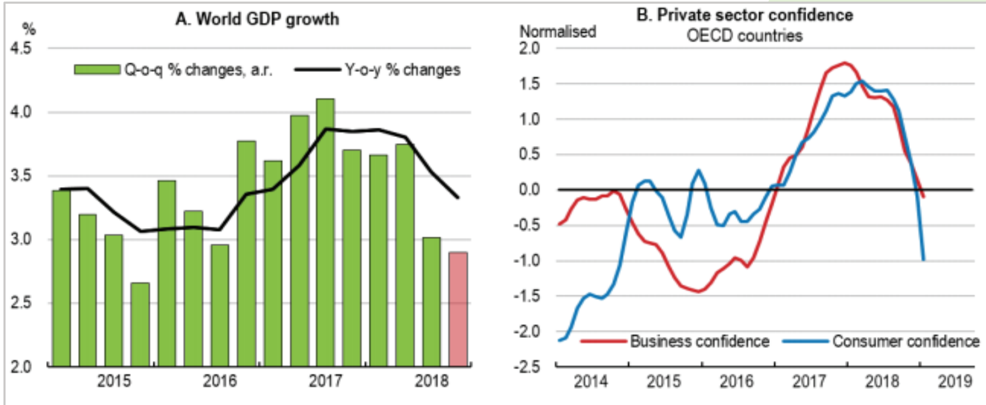
1. Fiscal years starting in April.

Source: OECD, March 2019

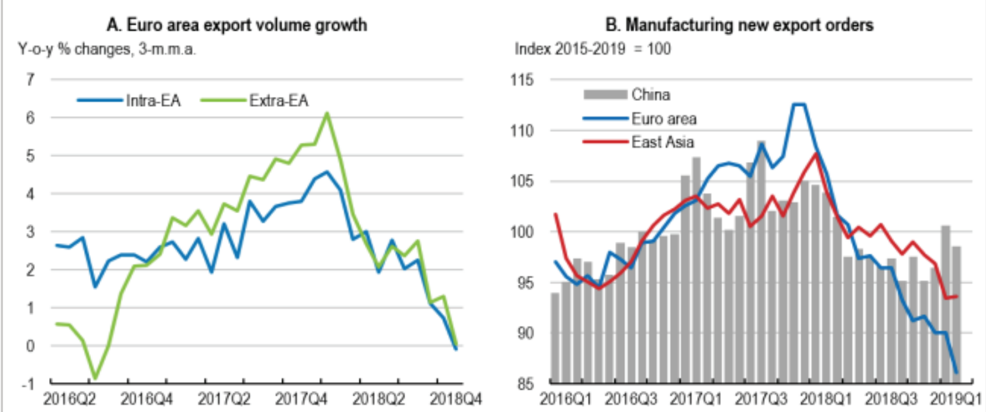
THE GLOBAL ECONOMY

SYNCHRONOUS DECELERATION OF GLOBAL GROWTH CONTINUES

Demographics remain the single largest reason behind the decline and will continue as such. Additionally, however, the world continues to attempt monetary policy normalization more than ten years post the 2008 crisis. This has not proceeded quickly, and the world economy remains distorted, albeit bolstered, by trillions of dollars in various forms of stimulus. Finally, tariff tantrums have significantly slowed trade growth and impacted confidence and manufacturing worldwide.



Note: Global growth in PPP terms. GDP figures for the fourth quarter of 2018 are based on available national accounts data plus estimates for Argentina, Australia, Russia, and Turkey.
Source: OECD Economic Outlook database; OECD Main Economic Indicators database; and calculations.



Note: Seasonally and working-day adjusted merchandise export volumes. East Asia export orders are a PPP-weighted average of Japan, Korea, Malaysia, the Philippines, Thailand, Chinese Taipei and Vietnam.

Source: Eurostat; Markit; and OECD calculations.

THE GLOBAL ECONOMY

SYNCHRONOUS DECELERATION OF GLOBAL GROWTH CONTINUES

North America - U.S. growth is expected to slow a bit in the first quarter and move upward throughout the year, averaging about 2.6% (or about 0.3% less than in 2018). Canada's growth has decelerated recently due to the one-two punch of a drop in oil prices and policy moves designed to slow the parabolic ascent of home prices. These policy moves nonetheless will serve to restrain consumer spending and optimism for a bit. Nonetheless, growth for 2019 is expected at 1.5%, down only 0.3% from 2018, and is expected to rebound to 2.0% by 2020. Mexico is expected to grow 2.0% in 2019, down only 0.1% from 2018 and picking up to 2.3% by 2020 because of boosts in the minimum wage, increases in infrastructure spending and a revival in energy production.

China - China's GDP growth continues to moderate a bit every year, from still robust levels. The decline from 6.8% in the first half of 2018, to 6.0% in the second half of the year was larger than normal and attributable to several factors. First, the trade wars began to bite, impacting China and then rippling to China's trading partners in the Eurozone and Asia. Secondly, the country affirmatively attempted to curtail debt by tightening regulations and reducing the growth of 'gray markets'. Finally, China allowed auto purchase incentives to expire, hurting sales also impacted by tariffs. Recent data indicate a quick recovery as China's PMI leapt to 54.4%, and its exports grew 14.2% in March. China is expected to grow 6.2% in 2019 and 6.0% in 2020.

Japan - In Japan, GDP is expected to continue at a less than one percent rate for 2019 and 2020. However, this is considered a victory as Japan exemplifies the impact of an aging population on growth. Only through the pursuit of "Abenomics" and the Bank of Japan's super accommodative monetary policies has growth stayed 'up' around 1.0%, unemployment stayed low and older and women workers joined or re-joined the workforce. However special immigration rules are being designed because absent some change there will be only about 1.5 workers to support every old person by 2050.

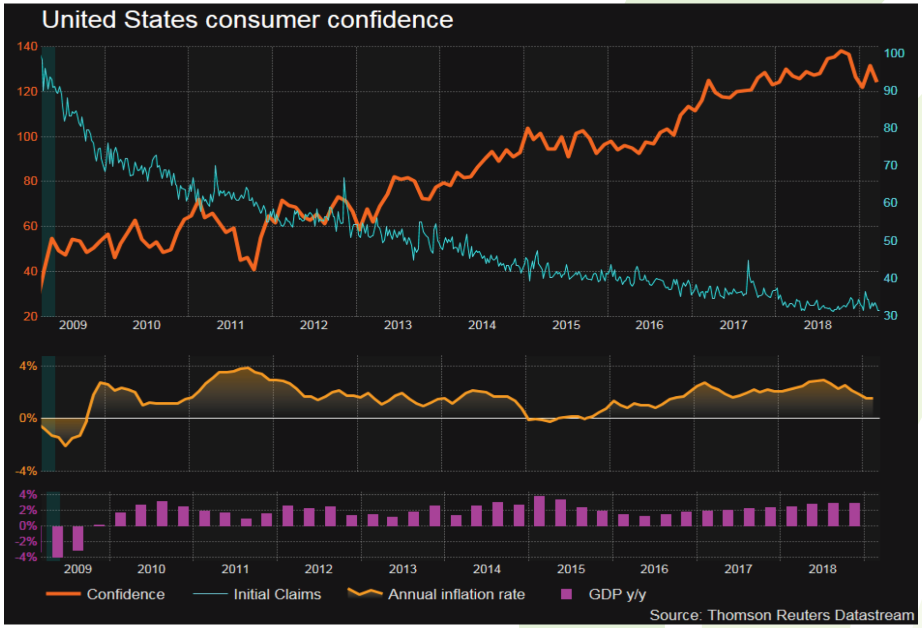
Eurozone - GDP slowed markedly in the Eurozone all during 2018 and is expected to fall further during 2019 to only 1.0%. The ECB, having just halted QE in December of 2018; announced in March, 2019, its resumption via TLTRO III (targeted longer term refinancing operation number 3) to begin in September, 2019. Germany is the largest economy in the Eurozone and is suffering from American tariffs on its steel while its automakers have been caught in the crosshairs of the U.S./China trade war. Exports and imports both fell more than expected in February. Growth should pickup a bit as the temporary problems resolve and the country still has a utopian unemployment rate of only 3.3%. Growth has also fallen in the U.K. and is expected to remain weak at around 0.8% in 2019 and 0.9% in 2020 as Brexit uncertainty wreaks havoc with business planning and investment.

THE U.S. ECONOMY

GROWTH CONTINUES TO MODERATE BUT MAINTAIN A COMFORTABLE LEVEL

As we have forecast, U.S. growth continued to moderate following the boost from last year's tax breaks and mirroring slower world growth. We continue to believe that slower growth is sustainable and not an immediate harbinger of recession. Forecasts for continued slow growth are tightly in line, with the Organization for Economic Cooperation and Development (OECD) forecasting U.S. GDP growth of 2.6% for 2019 and 2.2% for 2020 while the Conference Board forecasts a 2.4% growth rate for 2019 and the identical 2.2% for 2020. While some of the data was weak early in the year, numbers have mostly rebounded or remained comfortably mixed into quarter's close. Recently, estimates of first quarter GDP have risen to over 2% on an abrupt narrowing of our trade deficit in February.

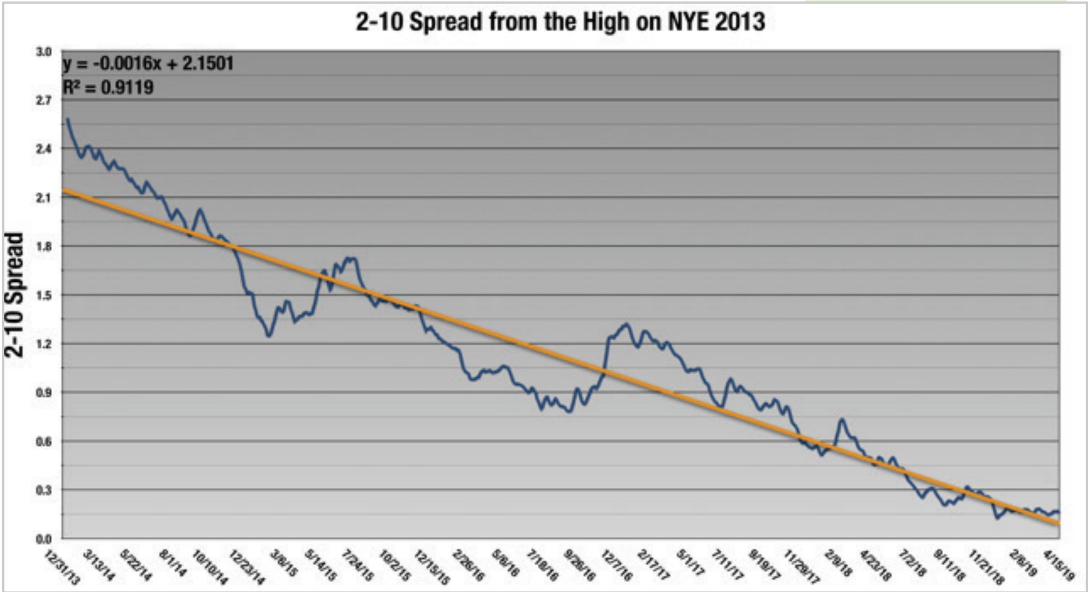
U.S. manufacturing remains in a soft patch which we believe is attributable not just to the slowing world economy, but to supply chain snarls caused by tariffs. This decline is thus reversible if a sensible solution to trade tiffs can be achieved. Consumer confidence, having notched up in February, declined in March, continuing its sideways meandering, but at very high levels. On the other hand, the University of Michigan's Consumer Sentiment Index jumped from 93.8 in February to 97.8 in March. According to Richard Curtin, the Survey's Chief Economist, the March gain was due entirely to households in the bottom two-thirds of the income distribution. This is terrific news on the income equality front. Additionally, while jobs added in February missed expectations, wages grew at a 3%+ rate for the seventh straight month. Retail sales for January were revised up significantly; February was weak but then March retail sales jumped 1.6% led by gains in sales of motor vehicles, clothing, restaurants and bars. The chart below reflects very high, but moderating consumer confidence, very low and falling unemployment, stable prices and steady GDP growth-hardly a recipe for disaster.



THE U.S. ECONOMY

GROWTH CONTINUES TO MODERATE BUT MAINTAIN A COMFORTABLE LEVEL

But what about that yield curve inversion? Doesn't that mean we will fall into recession? First, we usually use the difference between the yield of the 2-year and 10-year Treasuries and that did not invert. The reason for this is that many esoteric banking operations can impact the very short yield but the markets control the 2 and 10 year yields. The yield between the 3-month bill and the 10-year Treasury did invert, for a short time. A chart of the 2/10 year spread since the beginning of 2014 appears below. It has been falling in conjunction with quantitative easing.



Source: Seeking Alpha, April 2019

THE U.S. ECONOMY
GROWTH CONTINUES TO MODERATE BUT MAINTAIN A COMFORTABLE LEVEL

There is an argument to be made that QE has distorted or altered the predictive power of yield curve inversions. That argument has some merit but might distract from the basic points to be made here. Historically, 2/10 yield curve inversions have a pretty good record of pinpointing slowdowns based on a simple occurrence that longer term rates decline when 'the market' does not expect future growth.

So, we are quite close to an inversion but we have not inverted yet. Moreover, this tells us nothing that we did not already know. In July, of this year we will move from the second longest U.S. economic expansion in history to the longest economic expansion in our country's history. Logic dictates that we are closer to the end than we are to the beginning. We have maintained for several years that growth would continue to moderate but noted that QE and its continuation could elongate from historical cycles. We believe that QE has extended the normal cycle or even that it has changed how cycles behave, at the margin. In any event as you can see from the chart, there is usually a 6-18 month lag between first inversion and recession. That is about what we are forecasting without watching inversions.

Data Courtesy St. Louis Federal Reserve

FROM QT TO QE IN MONTHS

The Big Surprise!

We have discussed the impact of quantitative easing on markets in virtually every letter over the past year. There is a high correlation between quantitative easing and rising financial markets.

As some Central banks began to restore monetary normalcy in small steps, the rate of growth of global QE began to ease.

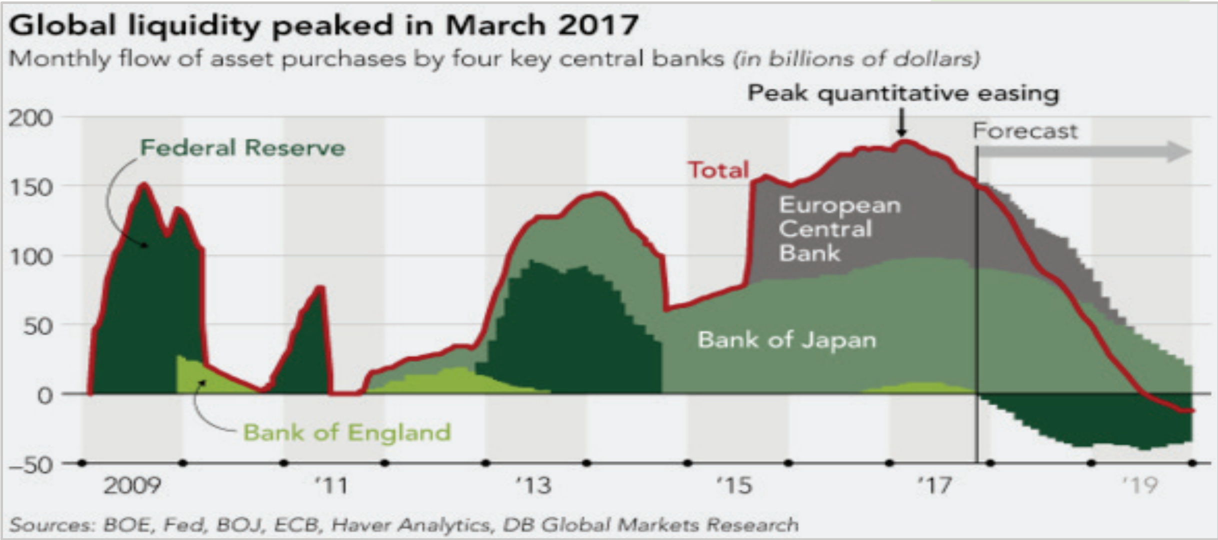
Figure 4.

Note: QE1 (11/25/08) = Fed starts buying $1.24tn in mortgage securities. QE1 expanded (3/16/2009) = Fed starts buying $300bn in Treasuries. QE2 (11/3/10) = Fed starts buying $600bn in Treasuries. QE3 (9/13/12) = Fed starts buying $40bn/month in mortgage securities (open ended). QE3 expanded (12/12/12) = Fed starts buying $45bn/month in Treasuries.
Source: Federal Reserve Board, Standard & Poor's and Haver Analytics.

Source: Yardeni Research | Through March 2018

FROM QT TO QE IN MONTHS

We projected increased market volatility with a downside tendency. This occurred during 2018 and culminated in a downdraft in risk assets paralleled by a rise in bonds and a decline in yields as investors fled to safety. While we modestly reduced portfolio risk, we did not advocate significant shifts in long-term allocations since it was clear that the Central banks would resume loose policies, the elixir of rising markets, in the event of a significant global market decline or crisis.



Well, it did not take a crisis. It did not even take a significant event. A mild breeze carrying some kernels of slowing data stopped the Central banks in their tracks during the first quarter of the year. The U.S. Fed halted previously planned interest rate increases, and the European Central Bank closed the books on quantitative tightening in the first two months of this year. The Fed, which just 6 months ago planned at least two more interest rate hikes, declared a moratorium on rate hikes. The ECB, having just ended quantitative easing in December, 2018, announced LLTRO 3, a new stimulus program.

Interest rates were already plunging into year-end 2018 as bond prices rallied in a flight to safety. Rates plummeted further into the first quarter igniting rallies across global markets. Just as the fourth quarter downdraft was an overreaction, so too was the first quarter rally. What is clear is that the 'Fed put' is alive and well and 'FOMO' (fear of missing out) replaced fear of loss.

INTEREST RATES AND BONDS

At this time last year commentators focused upon what they believed was an inevitable increase in interest rates. We disagreed. "We see possibly two more hikes in 2018 but expect the upward trajectory to slow as world demographics... conspire to limit further increases. Neither the 10 year Treasury nor the 30 year Treasury have decisively pierced and remained above their 2013 taper-tantrum highs. This is our acid test for calling an upward reversal of more than 40 years of falling rates." June 2018 Financial Markets Commentary.

As the charts right reflect, rates have plunged precipitously and the long-term downtrend remains intact for now.

Source: Eikon through 03-31-19

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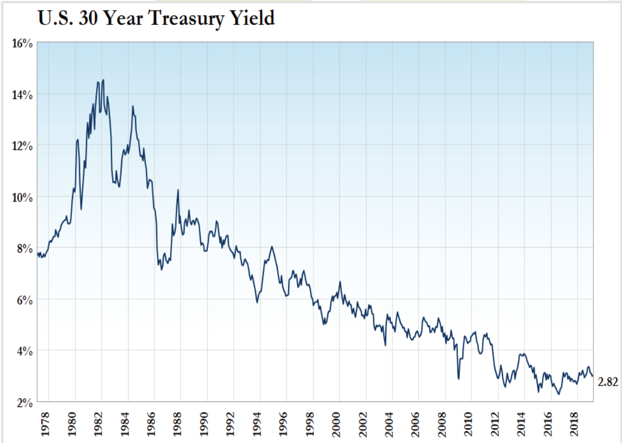


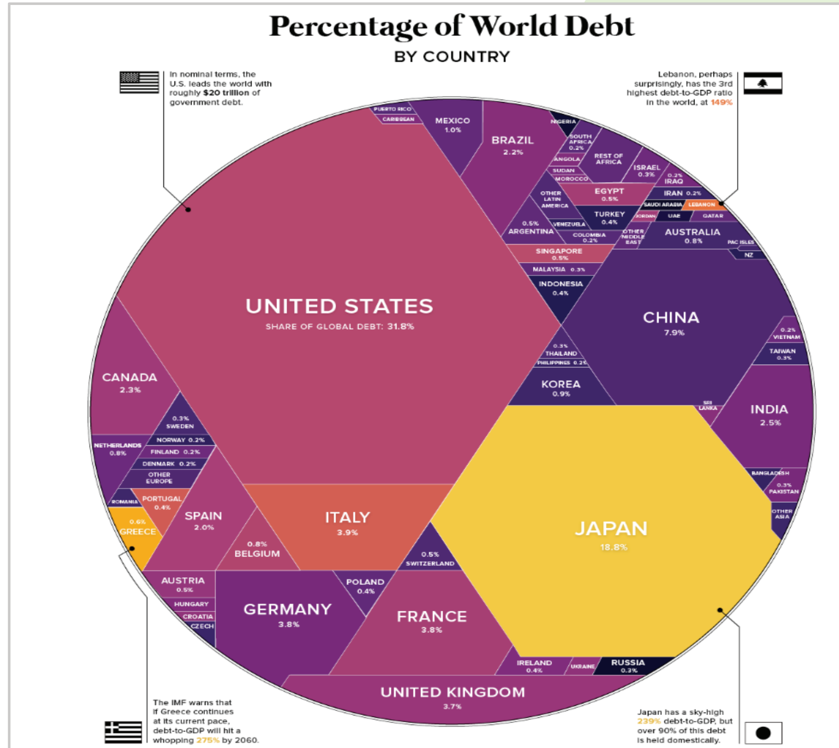
Source: Eikon through 03-31-19

INTEREST RATES AND BONDS

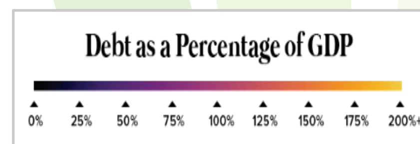
The fixed income rally in the first quarter was eclipsed by the rallies in risk assets but all flavors of bonds performed admirably. Longer maturity paper has outperformed shorter durations, and corporates have surpassed Treasuries and municipals. High yield bond performance has been robust, as junk climbed +7.26%. Specifically, 1-5 year credit has risen +2.39, while 1-5 year municipals are up +1.49% and 3-5 year Treasuries gained +1.59%. The long credit index rallied a whopping +7.86% versus a gain of +3.15% in 10-year municipals and +3.82% in the Bloomberg/Barclays 10-20 year Treasury index. Given the whiff of deflation it was surprising that TIPS rose +3.20%, reflecting their bond but not their inflation, component. World government bonds appreciated 1.74%, in dollar terms, while emerging market debt has been especially strong, gaining +6.16% in the quarter.

Neither strengthening economies nor Central bank tightening will cause rates to rise beyond the levels we have seen in this decade. Rather, a belated recognition of the unsustainable debt amassed across global governments, will create a market induced recalibration just as the excesses of 2005-2007 were ignored until 2008.

Debt in the United States is rising faster than GDP. This means that more and more debt and lower and lower rates are required to service the debt and generate growth. Any interest rate increase will worsen this situation as will any slowdown. While loose monetary policy can buy us more time, eventually investors will examine countries' debt levels and reconsider the interest rates they will accept for the risk-the market will move rates up.



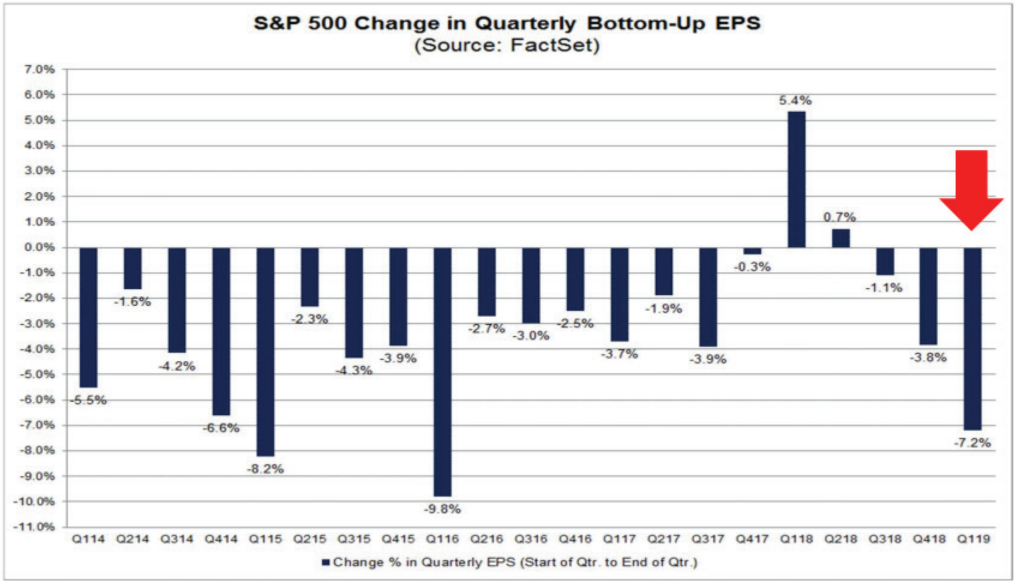
Source: Visual Capitalist



EQUITIES

Global equities delivered a year's worth of returns in the first quarter. They were bolstered by relief at unexpected Central bank easing and bargains generated by an overdone fourth quarter decline. The S&P 500 appreciated +13.65% while the tech-heavy NASDAQ leapt +16.81%. Small cap equities performed a bit better than large caps while 'growth' continued its outperformance versus 'value' across capitalizations. Large cap growth gained +16.10% while large cap value garnered an +11.93% return. Mid cap growth gained +19.62% versus a +14.38% gain for mid cap value. Small cap growth was also strong, returning +18.47% while small cap value was up +13.49%. Collectively, foreign bourses underperformed U.S. with MSCI EAFE up +9.98% and emerging markets up +9.92%. France, Belgium and Hong Kong all rose more than 12%, while the FTSE gained only +4.7%.

It is unlikely that equity returns will annualize at this quarter's pace, and we recommend rebalancing. Earnings season has begun, and expectations are not high. The chart below reflects that while bottom up estimates tend to decline into the quarter's end, the recent downward revisions have been greater than normal.



All eleven S&P sectors recorded declining estimates. However, an earnings apocalypse is probably not in the cards either. Moderate-strong sales growth continues and estimates for corporate sales growth grew 0.7% in February alone. Given the expectations for positive world and U.S. GDP growth, earnings should support an approximate 16x PE on the S&P 500.

REAL ASSETS

Real assets reversed last year's pathetic performance and have skyrocketed year-to-date. Crude oil fueled these results, climbing +33.31% while lean hogs were up +26.90% and global real estate and U.S. real estate climbed +16.02% and +15.72% respectively. Copper on the Comex was up +11.72%, and miners, as measured by the Philadelphia Stock Exchange Gold and Silver Index gained +8.07%. A host of foreign currencies were up in the quarter. The Russian ruble gained +5.34%, the Chinese yuan was up +2.48% and the Canadian dollar increased by +2.18%. The U.S. dollar gained +1.16% so far this year. The rally in real assets reflects lower rates and a 'risk-on' mind set. It is unlikely that gains of this magnitude will continue although a trade deal with China could result in significant real asset volatility.

ALTERNATIVES

Alternatives were muted as the HFRX Equal Weighted Strategies Index rose +0.97% year-to-date. Among hedge fund strategies, the HFRX Equity Hedge Index appreciated +5.95%, as fundamental value and fundamental growth strategies gained +8.10% and +7.23% respectively. Macro driven and market neutral strategies are the notable laggards having declined -0.87% and -0.56%.

INDIA

India's economy is expected to grow 7.2% in 2019 and 7.3% in 2020 on the back of policy rate cuts and strengthening domestic demand. Growth had slowed a bit into 2018 as rising oil prices cut into consumption growth. This is a high and sustained growth rate bolstered by a young and educated workforce, expansion of the services sector and a growing middle-class. Challenges include high tariffs and a web of regulations.

OTHERS

The Commonwealth of Independent States and Georgia are growing at a sustainable 2.0% plus pace. Commodity prices bolster growth structural impediments remain. Russia remains on a low-growth path scheduled to rise from 2.0% in 2019 to 2.3% in 2019. Africa is expected to grow 3.4% in 2019 and 3.7% in 2020 led by strong domestic consumption and significant infrastructure investments. The Association of Southeast Asian Nations (ASEAN) is forecasted to grow close to 6.5% in 2019 led by consumption, infrastructure and government spending.

CONCLUSION

Much has changed in early 2019. Central banks, only recently committed to years of tightening/normalization, have again loosened policy. This has had the predictable result of global market rallies across virtually all asset classes. What had appeared to be a slow, years' long embrace of quantitative tightening (QT) ended abruptly and quantitative easing (QE) resumed, although at a more moderate pace.

What this means is that the current elongated cycle now has some greater chance of continuing. However, we are seeing diminishing marginal utility in QE moves so that it will take more and more to accomplish less. As well, few countries have amassed the tools which might be needed to combat the next slowdown. Hence, additional gains now are probably borrowing from the future. We see setting appropriate asset allocations and rebalancing quarterly as imperative for people to reach their financial goals.

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