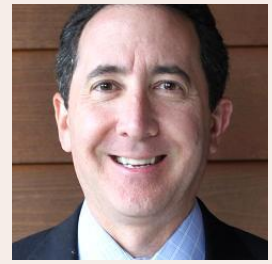
Monthly Update

February 2019

By Peter Boockvar
Chief Investment Officer – Bleakley Advisory Group



The stock market likes symmetry and the fourth quarter of 2018 seems like a distant memory. After January's sharp nearly 8% rally, the S&P 500 followed up with a 3% move higher in February[1]. I say 'symmetry' because after the 20% intraday decline from early October to late December 2018, the S&P 500 has bounced back by 19% through February, since that low[2]. It's not just been US markets that are off to a great start to the year, international markets have rallied sharply as well, particularly China, as the Shanghai composite is up 20% year to date[3]. As stated in the January letter, the stock market continues to celebrate a Fed that is not just likely ending its rate hike cycle but is laying the groundwork for the end of quantitative tightening sometime in the latter part of the year. Also, we are likely weeks away from a trade deal consummation between the US and China and hopefully the economic clouds that a trade battle created can begin to clear.

After January's sharp nearly 8% rally, the S&P 500 followed up with a 3% move higher in February[1].

I say 'symmetry' because after the 20% intraday decline from early October to late December 2018, the S&P 500 has bounced back by 19% through February, since that low[2].

Trade and the Economy

Following the late January Chinese trade delegation trip to the White House, the US sent our high-level trade negotiators to China in February. Led by Trade Rep Robert Lighthizer and Treasury Secretary Steve Mnuchin, progress seems to have been made in coming to an agreement with the Chinese on the important issues of protecting US technology, preventing US companies from being forced to share trade secrets in return for joint venture agreements and further opening up Chinese markets to foreign businesses. What is still uncertain though is the fate of the current tariffs that the US has placed on China, and in turn, those on the US. Will the tariffs immediately go back to zero or will they remain on as an enforcement mechanism, and only come off if China adheres to the deal? That seems to be undecided as of this writing and the difference will matter a lot to the markets. Companies and markets don't like these tariffs, so quickly getting rid of them will be of utmost importance.

The impact of tariffs, and a Chinese economy that has been moderating irrespective of them, has slowed the pace of global economic trade and business activity. The Chinese slowdown has also negatively impacted its close trading partners throughout Asia, has slowed growth in Germany and in turn other parts of Europe. Also, Britain, the world's 5th largest economy, is being weighed down by the uncertainty over Brexit.

1. Bloomberg
2. Bloomberg
3. Bloomberg

Thus, any trade and tariff resolution with China, and hopefully to follow with Europe and our other trading partners, will certainly be well received by the business community and markets. We will then see if this helps to lift economic activity thereafter.

Currently, the US economy is a mixed bag. In 2018, growth finished with a year over year rate of 3.1%, and finished the year with a 2.6% quarter over quarter annualized growth rate in Q4[4]. That growth rate, however, is expected to be less than 1% in 1Q19, according to both the Atlanta Fed and NY Fed's early forecasts[5]. Housing and auto sales have slowed, exports have moderated, and capital spending has lost momentum. The US consumer, outside of their slowing purchases of big ticket items, is thus the main pillar of growth and we'll continue to watch their behavior closely in figuring out where the economy goes from here. The US consumer continues to benefit from a strong labor market and rising wages, but the recent economic data on the US consumer has been inconsistent.

The US consumer, outside of their slowing purchases of big ticket items, is thus the main pillar of growth and we'll continue to watch their behavior closely in figuring out where the economy goes from here.

Earnings

While the stock market has been riding the wave of optimism created by the Fed and the hopes for a China trade deal, earnings expectations have been tempered year-to-date. We entered the year with the consensus full year S&P 500 earnings per share estimate at $172. It is now a tad under $167[6]. A combination of slowing revenue growth and shrinking profit margins are the main reasons for the declining expectations. In 2018, earnings per share ended up around $160, and thus growth estimates have slowed to around 4% for 2019[7].

Interest Rates

While the rallies in global stock markets reflect an optimistic spin on economic growth from here, the world's sovereign bond markets are telling a different story. I say that because global bond markets have traded very well year-to-date and interest rates have remained very low. The German 10 year bund yield is down 6 bps year-to-date through February, while the Japanese JGB 10 year yield fell from 0% to -2%.[8] As yields fall, prices generally rise. If the stock market is signaling appropriately, that growth may likely accelerate from here, then bonds should be selling off and rates should be moving higher. Instead, it seems that sovereign bond markets have a more muted view of the economic landscape.

While the rallies in global stock markets reflect an optimistic spin on economic growth from here, the world's sovereign bond markets are telling a different story.

4. Bloomberg
5. Atlanta Fed and NY Fed
6. Bloomberg
7. Bloomberg
8. Bloomberg

While the S&P 500 is back to where it was in early October, the US 10 year Treasury note yield finished February at 2.72%, well below the early October level of almost 3.25%[9].

Also in February, the Japanese 10 year JGB yield went back below zero and spent the entire month with a negative yield[9]. The German 10 year yield in February vacillated between just .10% - .20%, well below the early October level of .57%[10].

If only markets were able to speak and we could hear their direct messages and thoughts. Until then, we have to acknowledge the diverging performances and watch to see who is right.

If only markets were able to speak and we could hear their direct messages and thoughts. Until then, we have to acknowledge the diverging performances and watch to see who is right.

The Fed

The Fed, in February, continued its messaging that they remain on hold for now with respect to its rate hike cycle. Many members have constantly used the word 'flexible' in describing their approach, which means they will respond to the incoming economic data and implicitly the behavior of markets, instead of being on a one way path to a 3% fed funds rate which they previously wanted. The Fed recently added to this new found dovishness by telling markets that quantitative tightening will likely end by the fourth quarter of 2019.

The Fed, in February, continued its messaging that they remain on hold for now with respect to its rate hike cycle.

Conclusion

The year-to-date rally that has recaptured most of the Q4 stock market selloff has put the S&P 500 at the critical level of 2800. I say 'critical' because this index danced above and below it all through 2018[11]. In determining which way it breaks from here over the coming quarters will likely be decided by a reconciliation between the differing viewpoints on the global economy from the stock markets and sovereign bond markets.

Notwithstanding the year-to-date rally, the S&P 500 is pretty much where it was 13 months ago. Thus, there is a lot of running to stand still, but to state again, this highlights the importance of having a plan for your capital in terms of meeting liquidity needs, being appropriately positioned, and understanding that opportunities always abound.

9. Bloomberg
10. Bloomberg
10. Bloomberg
12. Bloomberg

Disclaimer

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly.

The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Bleakley Advisory Group and Peter Boockvar are not affiliated with LPL Financial. Securities offered through LPL Financial, Member FINRA/SIPC.

Investment advice offered through Private Advisor Group, a registered investment advisor. Private Advisor Group and Bleakley Financial Group are separate entities from LPL Financial.

973.575.4180
Bleakley.com