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After a strong start to the year, the stock market as measured by the S&P 500, continued higher in March by 1.8%, bringing the year-to-date rally to 13.1%[1]. This is almost a complete inverse of the 14.0% decline experienced in the fourth quarter[2]. I believe that the two main reasons for the January and February market rally that continued into March are a Federal Reserve that backed off from further monetary tightening and optimism that the US will reach a trade deal with China. Both factors have also lit a fire under international stock markets. In contrast to the optimistic message that global stock markets sent in March, global bond markets sent the opposite message. Another leg lower in bond yields, yield curve flattening, and in some cases yield curve inversions, are possibly reflecting worries about the pace of global economic growth[3]. If only markets could talk we'd be better able to immediately reconcile this behavior.

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The Fed and Interest Rates

We heard from the Federal Reserve Board on March 20th and not only did they reiterate that they will not be hiking interest rates again anytime soon, they laid out a plan to end the shrinking of their balance sheet, aka quantitative tightening[4] (QT). Rate hikes and QT were ongoing simultaneously all of last year and were considered a double barreled pace of monetary tightening. That worry has now been eased. Additionally, at the European Central Bank meeting on March 7th the ECB extended the time frame at which they will maintain a negative interest rate policy[5]. Combining both Central Bank meetings with the economic data releases throughout the month, which reflected a slowing economic back drop, resulted in a sharp drop in sovereign bond yields, globally.

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The US 10 year note yield fell from 2.72% to 2.40% by March end[6]. This yield was below where the 3 month Treasury bill stood on March 29th, at 2.39%, hence the yield curve inversion conversation[7]. The German 10 year bund yield dropped below zero to -.07%, from .18%, where it started the month[8]. The Canadian yield curve also inverted with its 10 year yield falling below its benchmark rate[9].

1. – 3. Bloomberg
4. Federal Reserve
5. European Central Bank
6. – 9. Bloomberg

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Stocks

Looking at individual sectors of the stock market didn't help us figure out who is right on the state of the economy, as we got mixed messages here too. As seen with these diverging groups, stock and sector selection are becoming more important, but with a well-diversified equity portfolio, one may be able to get through months like March in a much more tolerable manner.

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We've previously mentioned the importance of investing in international markets, which has paid off this year, as many have rebounded after a tough 2018.

The Economy

Sifting through all the economic data points in March has left us with a very mixed picture. Global trade has slowed when looking at trade data from key industrial power houses like Germany, South Korea, Japan, China and the US[10]. On the other hand, domestic news, with respect to employment, consumer spending, and services, has been much better[11]. At the end of March, we saw some better economic data from China which was spurred by more rounds of monetary and fiscal easing, which at least for the day of this writing, has boosted hopes that if China's economy stabilizes, it could help the global economy[12]. Let's hope so.

The US economy has been mixed. Economic growth forecasts for Q1 are trending around 1.5% according to the Atlanta Fed and NY Fed[13]. Manufacturing and exports have moderated and consumer spending has been uneven[14]. Hopefully, we'll get a 2nd quarter rebound, which tends to be the case.

10. – 14. Bloomberg

Earnings

With the first quarter of 2019 coming to a close, we are on the cusp of receiving first quarter earnings releases. Expectations for Q1 earnings is for a decline of about 3.5% year-over-year[15]. This year-over-year decline is in stark contrast to 2018, where year-over-year comparisons were favorable. We entered the year with the consensus S&P 500 earnings estimate at $172 per share and ended the first quarter with that forecast at $166 per share[16]. The pace of earnings might very well be the driving force in stocks for the rest of the year.

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Trade Tariffs

We remain hopeful that we will see a US/China trade deal by the end of April, as both sides are highly incentivized to come to an agreement. The remaining question should therefore be; how to enforce the deal. The US wants some tariffs to remain in place, only to be removed if China adheres to the deal, while China wants all tariffs removed immediately. Treasury Secretary Steve Mnuchin and Trade Representative Robert Lighthizer spent a few days in Beijing at the end of March, and Vice Premier Liu comes to Washington, DC in early April.

After a China deal is hopefully announced, attention will shift to a trade deal with Europe, and Congress, at some point, will vote on the new trade deal with Canada and Mexico. In the meantime, the steel and aluminum tariffs remain in place and are causing issues for both those that produce them and for sure those that consume them. We look forward to seeing all of these tariffs removed as quickly as possible.

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Conclusion

It was quite a quarter for markets, both bonds and stocks. The sharp drop in global interest rates has us suspect about the pace of global economic activity, while the amazing rally in stocks has us optimistic. We're trying to square that circle by keeping a close eye on all the economic data and we'll be watching closely the upcoming earnings season, where not only will we hear about the 1st quarter, but companies will also give guidance for the remainder of the year.

The S&P 500 ended the month of March at about the same level it was at the end of January 2018. Thus, there has been 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.

15. – 16. Bloomberg

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