

MARKET & ECONOMIC OUTLOOK APRIL 2019

ON THE RADAR SCREEN

1. April brings corporate earnings announcements that are expected to be sloppy. We're paying especially close attention to profit margins for signs that rising wages are squeezing the bottom line.
2. The spring homebuying season is getting underway. While residential investment makes only a small contribution to economic activity, it tends to be a useful gauge of the general health of an economy.
3. A successful outcome to US/China trade negotiations would go a long way toward reinforcing investor sentiment and encouraging business capital expenditures, so we monitor progress.
4. The partial inversion of the yield curve has caught everyone's attention. We don't view it as a cause for alarm, but it is something of which we are mindful.
5. New unemployment claims have settled back down after a modest but dismaying bump earlier in the year. A more persistent rise would be worrisome.

BARILOTTI WEALTH STRATEGIES IS PLEASED TO PRESENT ECONOMIC AND MARKET INSIGHTS FROM THE MULTI-ASSET SOLUTIONS TEAM.

"There's only one most important thing. Don't fumble the @%~\$*#! ball!"

– Barry Switzer, head football coach

Turnover? The mandate of the Federal Reserve seems relatively straight forward: maintain price stability while targeting full employment. Dialing up and down overnight interest rates is their go-to tool for getting that job done. For a central banker, then, setting rates is arguably the "one most important thing" – fumbling rate policy can have severe consequences for an economy. There are indications that the Fed may have done just that.

As the economy has grown steadily at or near potential growth rates in recent years and unemployed workers continue to find new job opportunities, the Fed has gradually tightened monetary policy through a series of nine rate hikes while additionally allowing their balance sheet to contract. The most recent move came in December, and in retrospect appears as though it may have been one hike too many. The challenge lies in the fact that there is a long lag between the implementation of a change to policy and the point at which its impact is visible in actual economic activity – Fed Board members must enact policy based upon where they expect the economy to be several quarters down the road. That's no small task.

It's increasingly evident today that the economy is already slowing. The cumulative policy tightening of the past three years is constraining growth and the pricing of Treasury securities implies that the Fed has lifted rates just a little too far and will be forced to lower them again at some point in the next year or two. The stress seen in equity pricing in December following that fateful FOMC meeting was also a clear indication that investors were concerned a policy mistake has been made.

Our view is that while the Fed likely did err in December, they've now recovered their own fumble by acknowledging the economic soft patch we've hit and by providing forward guidance of a lower or even flat trajectory for rates. The Fed may have stabbed the expansion in the back, but by our lights it appears to be a mere flesh wound, not murder.

Insights from the Multi Asset Solutions team

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“The markets are better economists than economists.” Jason Trennert, Strategas. Reflecting the input of all participants, markets embody the wisdom of the crowd. Messaging from the market can be catastrophically wrong on occasion, but many nevertheless consider it the best available guide to the direction of the economy. What, then, is it telling us today? Well, that depends on which market you follow.

Equity pricing has rerated sharply, bouncing hard off the Christmas lows while volatility gauges have fallen precipitously from their fourth quarter readings. Stock investors seem to be complacent regarding the current soft patch in activity with analyst earnings expectations pointing to a reacceleration later in the year. Fixed income practitioners have a somewhat less sanguine outlook. The sharp decline in Treasury bond yields and the inversion of segments of the yield curve implies a challenging economic environment moving forward.

So, if the market is not sending a consistent message, what are we to think? As things stand today, we are inclined to side with other equity investors. Tighter monetary policy, trade concerns, and the anniversary of the new tax law are likely to produce some sloppy profit reports for the first quarter, but conditions thereafter look favorable. Real rates are still quite low, consumer confidence is rebounding while household income continues to expand, fiscal stimulus is ramping up outside the US (most notably in China), further progress on a trade agreement seems likely, and businesses continue to invest in themselves through both capital expenditures and buybacks. Our approach is to lean gently into equities with plans to add to risk positions if and when the market reacts badly to weak earnings reports through April and May. It’s hard not to be suspicious of the move lower in yields, so we have our duration a little bit short compared to our benchmarks in anticipation of seeing the 10-year Treasury bond drift back toward 3% as the year wears on.

“Fear and greed are stronger than long-term resolve.” – Doug Kass. The hair-raising ride on which markets have taken investors the past two quarters speaks to the importance of maintaining discipline and abiding by a long-term investment plan. Prices can be volatile in the short term and chasing performance by selling when markets are in decline or buying as they ascend can destroy wealth. We are fully cognizant of the fact that we could hit an air pocket this spring as corporate earnings reports could be quite messy. If so, we beseech our readers to stay the course! Find your resolve and remain committed to your investment plan through these bouts of turbulence. When all is said and done, you’ll be glad you did.



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