

First Quarter 2019 Market Commentary

April 3, 2019

Key Takeaways:

- The markets have settled down after a turbulent fourth quarter.
- The Fed has adopted a more patient monetary policy.
- U.S. growth is slowing down, but a recession is not imminent.
- Uncertainty continues to surround unresolved political issues here and abroad.

Markets Roar Back

The sharp recovery in global equities in the first quarter was not surprising in direction but in magnitude. Most equity markets around the world experienced some form of a V-shaped rebound from last year's steep declines, with many appreciating close to their previous highs. Concerns that had roiled stock markets in the fourth quarter were either resolved or materially reduced in the minds of investors.

- **Fed pivot**

At the end of the year, the Fed signaled it was close to ending the tightening cycle. The Fed further pleased markets with its March statement, which preached patience and announced a September end to the balance sheet reduction process. Market odds are now actually forecasting the next Fed move may be a rate reduction at the end of this year or early 2020.

- **U.S./China trade dispute**

A delay in the implementation of further U.S. tariffs on Chinese products helped mollify markets early in the quarter. The two sides continue to work diligently to structure a deal amenable to both. During the quarter, there was a sense President Trump needed to negotiate an agreement if only to score a political victory in light of the government shutdown. The conclusion of the Mueller investigation may encourage him to adopt a harder line with China around forced technology transfer, intellectual property theft and compliance verification. Negotiations should continue well into second quarter.

- **Chinese policy stimulus**

Similar to 2015/16, the Chinese government has again demonstrated a willingness and ability to rein in the deleveraging process when the resulting economic slowdown puts too much pressure on the industrial and real estate sectors. Large spending and tax-cut initiatives, combined with mild monetary policy expansion, are expected to moderate the economic slowdown and enable China to achieve 6.0% GDP (gross domestic product) growth this year.

- **Domestic politics**

The extension of the government shutdown into late January appeared to have little economic impact, but it did shake consumer and business confidence. Resolution helped improve sentiment at the end of the quarter. However, the looming debt ceiling negotiations will likely be similarly contentious, given the deep partisan split in Congress.

- **Oil prices**

Lower oil prices continue to be a net positive for the consumption-driven U.S. economy. As we saw in the fourth quarter, a steep decline can be damaging to the rapidly growing energy sector of the economy, which is experiencing a renaissance due to technological advances in shale extraction. The stabilization of prices at the beginning of the quarter and the subsequent increase of approximately 30% from December lows seem to confirm the decline was primarily a function of supply issues and not a harbinger of a more serious deterioration of global growth.

- **Brexit**

We saved this for last as it remains an unsettled drama moving into second quarter. Global markets have been rather relaxed about this issue, either from an expectation that it will be resolved with minimal damage to the global economy, or that any severe consequences would be confined to the U.K.

Global Growth Chugs Along

Equity markets rose in the quarter despite concerns about a worldwide economic slowdown. Many European countries and Japan are teetering on the brink of recession and have had agonizingly slow growth through much of the decade. Perhaps low growth rates are to be expected, given the demographic and structural challenges of these countries. The U.S. and China continue to be the main drivers of global growth, and both economies are currently growing near their long-term potential.

The government shutdown delayed the release of key U.S. economic statistics. However, once released, the data revealed an all too familiar pattern of an overall weak first quarter, with certain parts of the economy showing improvement by quarter-end. Over the past six years, this type of late-quarter improvement has often extended into the rest of the year. Sectors such as housing, durable goods and retail sales have reestablished upward momentum to the extent GDP growth for all of 2019 should be above 2.0%.

In addition to the Fed signaling an end to rate increases, central banks around the world remain extraordinarily accommodative. While the effectiveness of these policies in generating the desired growth and inflation can be debated, pending monetary tightening is no longer viewed as a near-term risk to markets.

Just as the U.S. equity market tumbled in the fourth quarter despite strong earnings growth, the first-quarter advance occurred in an environment where corporations were aggressively reducing earnings estimates. Overall Q1 earnings growth may actually be slightly negative, a striking difference from last year's tax-cut fueled growth. Equity markets were likely discounting sequentially better economic and earnings growth rates for the remaining quarters.

International equities in developed markets joined U.S. equities in the recovery. They were able to largely shrug off weakness in their respective domestic economies based on confidence that the global economy will continue to advance. As many of these markets consist of companies that sell their products globally, overall earnings growth should continue to be better than forecasts based solely on domestic sales.

Index Performance Data							
	1Q 2019	1 Year	3-Year Annualized		1Q 2019	1 Year	3-Year Annualized
Equity Index Returns				Fixed Income Returns			
Dow Jones	11.81%	10.08%	16.37%	Barclays Aggregate Bond Index	2.94%	4.48%	2.03%
S&P 500	13.65%	9.50%	13.51%	Barclays 1-10 Year Municipal Bond	2.21%	4.63%	1.99%
Russell 2500	15.82%	4.48%	12.56%	Merrill Lynch High Yield Master II	7.40%	5.94%	8.69%
MSCI ACWI	12.18%	2.60%	10.67%	Citi World Government Bond Index	2.73%	4.78%	2.47%
MSCI EAFE	9.98%	-3.71%	7.27%	JPM Emerging Markets Bond Index Global	6.59%	3.52%	5.20%
MSCI Emerging Markets	9.92%	-7.41%	10.68%	Barclays TIPS	3.19%	2.70%	1.70%
				Citi U.S. 3-Month T-Bill	0.60%	2.11%	1.17%
Other Index Returns							
MSCI US REIT	16.27%	20.72%	6.00%	Source: FactSet *HFRI FoF Index Performance as of 2/28/2019 **Returns are total returns except for the Dow Jones & MSCI US REIT (price returns) ***Citi World Government Bond Index is the hedged index			
Bloomberg Commodity Index	6.32%	-5.25%	2.22%				
HFRI FoF Index	3.70%	-1.25%	3.87%				

Optimism has Ripple Effects

Both the Emerging Debt and Equity markets exhibited strength during the quarter. Chinese fiscal stimulus, the anticipated end to Fed tightening and some thawing of the U.S./China trade dispute appeared to mitigate many of the risks perceived by investors in these asset classes. Commodities also benefited from the growing belief that Chinese growth won't deteriorate sharply. Latin American equity markets also registered strong performance.

Bonds Send Mixed Messages

The fixed-income markets had an interesting quarter. The U.S. Treasury yield curve, which had inverted at the end of last year between the two- and five- year maturities, produced a further inversion at the end of the quarter when the yield of the three-month Treasury bill exceeded that of the bellwether ten-year note. While the media jumped on this phenomenon, the markets have been relatively calm most likely because the more closely watched 2- to 10-year part of the curve began and ended the quarter with an approximately 15 basis point (0.15%) positive spread. For more information, refer to our commentary, [Potential Implications of Yield Curve Inversion](#).

The credit markets signaled to investors that we're not on the precipice of a recession. The interest-rate spread above Treasuries in both the investment-grade and high-yield sectors contracted during the quarter; a sign credit quality may have actually improved, and that default rates might remain at these historically low levels for the foreseeable future.

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First Quarter Market Summary

		2Q18	3Q18	4Q18	1Q19	YTD	Annualized			
							1-Year	3-Year	5-Year	10-Year
US Equity Benchmarks		Price								
Dow Jones Industrial	25,929	1.26	9.63	(11.31)	11.81	11.81	10.08	16.37	12.21	15.97
NASDAQ Index Composite	7,729	6.61	7.41	(17.29)	16.81	16.81	10.63	17.97	14.29	18.93
S&P 500	2,834	3.43	7.71	(13.52)	13.65	13.65	9.50	13.51	10.91	15.92
Russell 1000 (Large Cap)	1,570	3.57	7.42	(13.82)	14.00	14.00	9.30	13.52	10.63	16.05
Russell 1000 Growth	1,521	5.76	9.17	(15.89)	16.10	16.10	12.75	16.53	13.50	17.52
Russell 1000 Value	1,216	1.18	5.70	(11.72)	11.93	11.93	5.67	10.45	7.72	14.52
Russell Mid Cap	2,155	2.82	5.00	(15.37)	16.54	16.54	6.47	11.82	8.81	16.88
Russell Mid Cap Growth	1,092	3.16	7.57	(15.99)	19.62	19.62	11.51	15.06	10.89	17.60
Russell Mid Cap Value	2,002	2.41	3.30	(14.95)	14.37	14.37	2.89	9.50	7.22	16.39
Russell 2000 (Small Cap)	1,540	7.75	3.58	(20.20)	14.58	14.58	2.05	12.92	7.05	15.36
Russell 2000 Growth	997	7.23	5.52	(21.65)	17.14	17.14	3.85	14.87	8.41	16.52
Russell 2000 Value	1,791	8.30	1.60	(18.67)	11.93	11.93	0.17	10.86	5.59	14.12
S&P GICS Sectors		Weight								
Consumer Discretionary	10.1%	8.17	8.18	(16.42)	15.73	15.73	13.19	14.41	13.58	21.11
Consumer Staples	7.3%	(1.54)	5.70	(5.21)	12.01	12.01	10.49	5.15	8.59	13.48
Energy Sector	5.4%	13.48	0.61	(23.78)	16.43	16.43	1.32	4.94	(2.80)	6.39
Financials	12.7%	(3.16)	4.36	(13.11)	8.56	8.56	(4.67)	14.27	9.39	15.70
Health Care	14.6%	3.09	14.53	(8.72)	6.59	6.59	14.89	12.57	11.29	16.35
Industrials	9.5%	(3.18)	10.00	(17.29)	17.20	17.20	3.23	11.67	9.34	17.20
Information Technology	21.2%	7.09	8.80	(17.34)	19.86	19.86	15.44	22.56	18.63	20.02
Materials	2.6%	2.58	0.36	(12.31)	10.30	10.30	(0.43)	9.48	5.30	12.39
Communication Services	10.1%	(0.94)	9.94	(13.19)	13.98	13.98	7.75	1.40	5.20	9.73
Utilities	3.3%	3.74	2.39	1.36	10.84	10.84	19.33	9.19	10.89	12.88
Global Equity Benchmarks		Price								
MSCI ACWI	2,108	0.53	4.28	(12.75)	12.18	12.18	2.60	10.67	6.45	11.98
MSCI AC World x-USA	280	(2.61)	0.71	(11.46)	10.31	10.31	(4.22)	8.09	2.57	8.85
MSCI EAFE	1,875	(1.24)	1.35	(12.54)	9.98	9.98	(3.71)	7.27	2.33	8.96
MSCI EAFE Growth	1,592	0.11	1.53	(13.33)	12.04	12.04	(1.30)	7.61	3.93	9.74
MSCI EAFE Value	2,691	(2.64)	1.18	(11.70)	7.92	7.92	(6.13)	6.90	0.67	8.12
MSCI Emerging Markets	1,058	(7.96)	(1.09)	(7.46)	9.92	9.92	(7.41)	10.68	3.68	8.94
MSCI BRIC	323	(6.71)	(4.12)	(5.30)	13.99	13.99	(3.45)	15.68	6.32	8.54
MSCI Japan	3,102	(2.84)	3.68	(14.23)	6.66	6.66	(7.84)	8.06	5.61	7.96

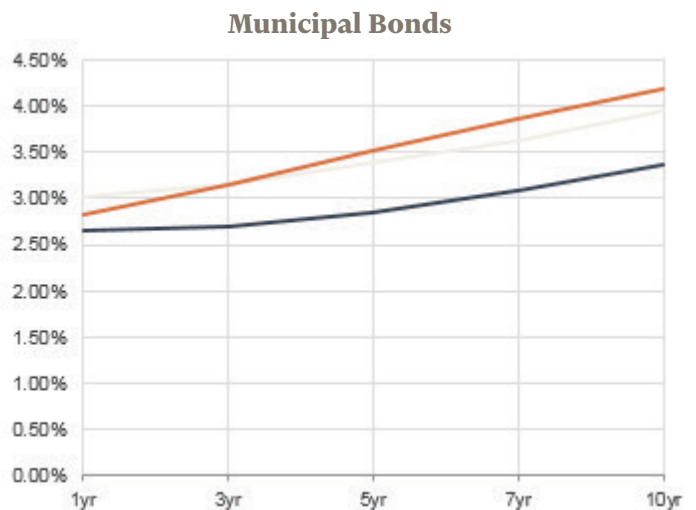
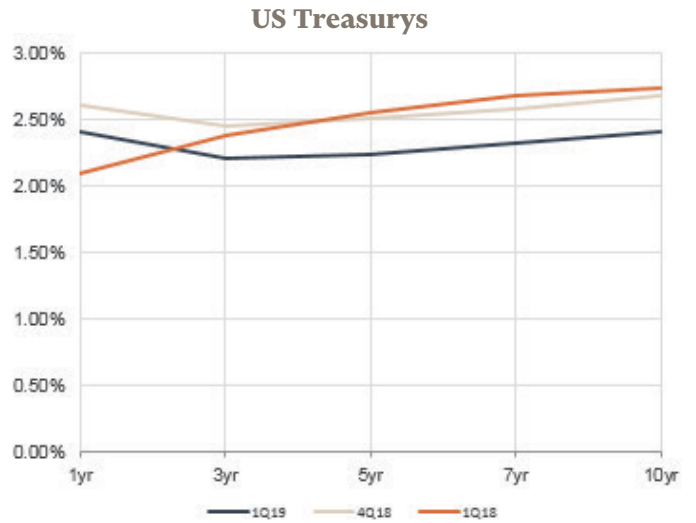
		Annualized								
		2Q18	3Q18	4Q18	1Q19	YTD	1-Year	3-Year	5-Year	10-Year
Interest Rates		Yield								
Prime Rate	5.50	1.17	1.24	1.31	1.33	1.33	5.15	4.33	3.92	3.58
3m Treasury Bill	2.39	0.46	0.51	0.59	0.59	0.59	2.17	1.25	0.77	0.43
US LIBOR 3m	2.60	0.58	0.58	0.66	0.66	0.66	2.50	1.61	1.09	0.73
US Treasury 3m	2.22	0.64	0.68	0.71	0.60	0.60	2.66	1.85	1.50	1.15
US Treasury 10yr	2.42	0.72	0.73	0.76	0.65	0.65	2.88	2.42	2.34	2.50
US Treasury 30yr	2.82	0.76	0.76	0.81	0.73	0.73	3.11	2.89	2.92	3.33
Fixed Income		Price								
Citi 3-month T-bill	645	0.44	0.50	0.57	0.60	0.60	2.11	1.17	0.72	0.41
BC U.S. Gov't & Related 5-7	104	(0.37)	0.42	2.03	3.37	3.37	5.53	2.56	3.02	4.03
BC Municipal Bond 1-10 Year	111	0.81	(0.07)	1.61	2.21	2.21	4.63	1.99	2.54	3.28
BC TIPS	102	0.77	(0.82)	(0.42)	3.19	3.19	2.70	1.70	1.94	3.41
BC Aggregate	102	(0.16)	0.02	1.64	2.94	2.94	4.48	2.03	2.74	3.77
ML High Yield Master II	98	1.00	2.44	(4.67)	7.40	7.40	5.94	8.69	4.70	11.24
Citi World Gov't Bond Index	881	0.19	(0.56)	2.38	2.73	2.73	4.78	2.47	3.73	3.55
JPMorgan EMBI Global	822	(3.51)	1.87	(1.19)	6.59	6.59	3.52	5.20	4.80	8.12
Real Estate		Price								
MSCI US REIT	1,217.06	10.10	1.09	(6.72)	16.27	16.27	20.72	6.00	9.00	18.48
FTSE EPRA/NAREIT Europe	1,852.76	0.09	(1.95)	(10.04)	11.73	11.73	(1.35)	4.58	5.09	12.88
Commodities										
Bloomberg Commodity Index	81	0.40	(2.02)	(9.41)	6.32	6.32	(5.25)	2.22	(8.92)	(2.56)
Energy	37	10.73	4.39	(25.78)	15.93	15.93	(0.55)	7.48	(16.72)	(10.02)
Agriculturals	40	(8.66)	(5.45)	0.15	(3.18)	(3.18)	(16.26)	(7.99)	(12.40)	(2.81)
Livestock	31	5.47	2.88	0.69	4.69	4.69	14.37	0.70	(4.28)	(1.56)
Softs	32	(1.86)	(12.52)	0.73	0.42	0.42	(13.16)	(8.74)	(12.85)	(2.48)
Industrial Metals	123	0.98	(6.88)	(8.69)	12.85	12.85	(3.10)	11.28	0.11	2.37
Precious Metals	162	(4.45)	(6.00)	6.82	0.02	0.02	(4.04)	0.19	(1.90)	2.42
Private Equity / Hedge Funds		Price								
Red Rocks Global Listed PE Index	11	0.64	5.08	(18.56)	14.17	14.17	(1.66)	10.08	4.86	14.61
HFRI FOF Index	6,038	0.46	0.24	(4.96)	3.70	3.70	(1.25)	3.87	1.88	3.46
Currencies		Price								
ICE Dollar Index	97	4.97	0.52	1.09	1.16	1.16	7.91	0.93	3.96	1.31
Euro / US Dollar	1	(5.07)	(0.52)	(1.58)	(1.78)	(1.78)	(8.70)	(0.49)	(4.02)	(1.66)
Pound / US Dollar	1	(5.88)	(1.23)	(2.34)	2.31	2.31	(7.11)	(3.22)	(4.81)	(0.95)
US Dollar / Yen	111	4.15	2.55	(3.41)	0.88	0.88	4.08	(0.51)	1.45	1.15

Source: FactSet

Note: HFRI FOF Index returns as of 2/28/2019

Global Equity Valuation Summary	4Q18	1Q19	QoQ
S&P 500			
Price	2,506.85	2,834.40	327.55
Trailing P/E	16.54	18.35	1.81
Est P/E	14.47	16.49	2.02
Trailing 12m Earnings	143.66	151.37	7.70
Est Forward 12m Earnings	173.23	172.24	(0.98)
Implied 1yr Earnings Growth	20.58%	13.79%	-6.8%
Russell Mid Cap			
Price	46.48	53.95	7.47
Trailing P/E	14.89	18.48	3.59
Est P/E	14.24	16.72	2.48
Trailing 12m Earnings	2.74	2.59	(0.14)
Est Forward 12m Earnings	3.26	3.23	(0.03)
Implied 1yr Earnings Growth	19.21%	24.60%	5.4%
Citi World Gov't Bond Index	881	0.19	(0.56)
JPMorgan EMBI Global	822	(3.51)	1.87
Russell 2000			
Price	133.90	153.09	19.19
Trailing P/E	13.51	16.73	3.23
Est P/E	17.91	20.97	3.06
Trailing 12m Earnings	5.02	4.42	(0.61)
Est Forward 12m Earnings	7.48	7.35	(0.12)
Implied 1yr Earnings Growth	48.86%	66.57%	17.7%
MSCI EAFE			
Price	58.78	64.86	6.08
Trailing P/E	12.41	13.86	1.45
Est P/E	11.85	13.35	1.49
Trailing 12m Earnings	4.60	4.58	(0.02)
Est Forward 12m Earnings	4.96	4.86	(0.09)
Implied 1yr Earnings Growth	7.81%	6.14%	-1.7%
MSCI EM			
Price	39.06	42.92	3.86
Trailing P/E	11.70	12.82	1.12
Est P/E	10.58	12.05	1.47
Trailing 12m Earnings	3.21	3.20	(0.01)
Est Forward 12m Earnings	3.69	3.57	(0.12)
Implied 1yr Earnings Growth	14.91%	11.45%	-3.5%

Source: FactSet



Notes: Municipal yields tax adjusted, assumes a 37% tax rate
Munis use the Bloomberg Barclays Municipal GO indexes and yield to worst



Disclosures:

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