State of the Economy 1st Quarter 2019

The stock market came surging back in the first quarter of 2019. The market is off to its best start since 1998. As I previously mentioned at the end of last year, the majority of the pullback in stocks in 2018 resulted from electronic trading via machines with pre-set trades rather than the behavior of human investors. This reversal of direction is being led by a nice recovery in the technology sector. Investors are looking to buy back into growth companies where stock prices may have been undervalued. The optimism in trade talks with China coupled with the U.S. Central Bank's plan to refrain from raising interest rates for the foreseeable future, have helped buoy the market higher.

In late February, the Federal Reserve affirmed that they will remain patient when deciding to raise rates. The Fed chose to leave their policy rate unchanged for the quarter while indicating that they are unlikely to raise rates again this year. Federal Reserve Chairman, Jerome Powell, cited conflicting signals behind their interest rate determination. Powell stated, “right now, the predominant risks to our economy are slowing global growth.” Since 2015, the Fed has been “normalizing” monetary policy by raising interest rates while shrinking its bond holdings from levels intended for a weak, post-crisis economy. If the Fed’s comments hold true, they may have little ammunition if the economy reverses course in the future.

The stock market may be approaching a crossroads after the strong rebound to start 2019. The positive sentiment deriving from investors and analysts can be partially credited to a potential trade resolution between the U.S. and China. The conclusion to the Mueller report has also lifted a dark cloud that was lingering over investors. However, skeptics may highlight recent data showing negative reports on retail sales, business investment, and job growth. They are pointing to the declining yields in treasuries and mortgage rates as a sign the economy is struggling to maintain continued growth. Generally, bond prices decline and yields rise when stocks rally. But, this has lately not been the case. The yield on the ten year treasury bill recently dipped below the three month treasury bill for the first time since 2007. An investor typically receives a higher yield on a longer-term treasury bill. When this fails to occur, the concept is known as an inverted yield curve and it can be an indication a recession is looming.

As concerns over a global slowdown consume investors, central banks across the world appear to be taking preemptive steps to prevent flagging growth. For example, the European Central Bank ("ECB") surprisingly changed course in early March to stimulate their economy. The ECB, acting less than three months after it phased out a $2.9 trillion bond-buying program, said it would hold interest rates at their current levels at least through the end of this year. Their decision was a few months longer than the ECB previously signaled. Additionally, the ECB will issue a new batch of long-term loans for banks to tap into starting in September. Lastly, the Bank of Canada and Australia's Central Bank each held their rates steady while warning of growing risks to the global economy.

Going forward, there will be an emerging debate on whether central banks are going too far in trying to stimulate their respective economies. Here in the U.S., the underlying numbers are still strong but global concerns are hindering expansion. After years of historically low interest rates, the Fed planned to revert towards a "normal" interest rate environment to prevent asset bubbles. Now that the current federal fund rate of 2.25% - 2.5% is on hold, the Fed may have a limited ability to make future cuts to prevent a recession. However, by global standards, the U.S. is in an enviable position as Europe has not been able to raise interest rates out of negative territory since the economic crisis. Nevertheless, the President and his economic advisor, Larry Kudlow, called on the Fed to cut rates last Friday. They feel increasing rates are threatening this longstanding recovery. It remains to be seen how this will play out through the rest of the year.

It is hard to deny the positive impact central banks played in turning around the stock market from the 2008 recession. Let's just hope they are not the catalyst for the next one.

Sincerely,

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