Weekly Capital Market Comments

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NORTHEAST | SEQUOIA
PRIVATE CLIENT GROUP

Wait A "FED" Minute, I Thought Things Were Good

Weekly Review

Equities ended the week (Thursday-Thursday) in the green once again, as positive follow through from a potential China/US trade deal looms, helped by – in our opinion – by overly dovish Fed Minutes. The S&P 500 was higher by 1.1% this week and is now up 11% YTD, while the Russell 2000 (small caps) is higher by 2% and17%, respectively. Value names staged a come-back this week, higher by 2%, while Growth names occupied the bottom of the table. Basic Materials and Communication Services were Sector winners, while Healthcare and REITs lagged. Bonds finished the week down overall, but HY continues to outpace the pace. The 10yr finished the week up about 4bps at 2.68%.

What Does A Fed Pivot Really Say About the Economy?

A lack of inflation, fallout from a government shut down and a slowing global backdrop all contributed to the dovish release by the Fed (Minutes) this week. What wasn't expected, from our perspective, was the FOMC slamming on the brakes on additional balance sheet run-off/reductions. Basically, this implies that the FED is intent on holding greater than expected assets (bonds) on its balance sheet. Further, <u>any</u> reinvestment of longer-dated/duration assets will most likely be reinvested into the front-end of the curve, increasing demand and placing downward pressure on short rates (prices ↑ = yields ↓); effectively forcing a steeper curve. In our opinion, the Fed is doing this to temper any further economic weakness equity market volatility. **Wow ! And just two months ago, President Powell was lauding the strength of the US economy**. What the recent move by the Fed, now being coined **<u>The Fed Pivot</u>**, is telling us, is that the recent market rebound (from the Christmas Eve lows; higher by ~18%) should be viewed with caution. Readers of this weekly should have noticed our gradually more cautious stance toward equity valuations since the beginning of the year. As of Thursday (2-21-19), the S&P is higher by 11% YTD, and is trading at roughly 16.3x forward earnings, or about 1x wider than its long-term average dating back through 2007. We expect limited upside in equity valuations from here and believe the S&P will be range-bound through the remainder of 2019. From our perspective, any significant upside will be tough to come by as: 1) earnings growth continues to decelerate, and 2) the case for multiple expansion is a tough sell. First let's discuss earnings. In our opinion, despite the continued strength of the job market, the broader economy is losing steam. Just this week, we saw a miss in durable goods, continued weakness in capital equipment orders, downside in the Philly Fed, lower manufacturing PMI, continued weakness in housing and a modestly downside surprise to Leading Economic Indicators (LEI). While some weakness can be attributable to the recent government shut-down, the consensus estimate for 2019 S&P500 earnings growth, according to I/B/E/S, is now only 4.0%, down from 10% from October '18, and below the long-term run-rate of 7.0%. While this is certainly not cataclysmic, it should garner attention given the lofty returns the broader equity market has posted YTD and the elevated multiples at which it currently trades. Next, let's tackle multiples. Earnings multiples rarely expand during the tail-end of economic cycles, and we are now less than six months away from recording the longest economic expansion since 1945. Simply put, despite no inflation, low interest rates, and relative economic strength here in the US, we have becoming increasing skeptical of the sustainability in the recent rebound. Add to this, a whirlwind of real and potential negative geopolitical headlines including: a polarizing political environment, BREXIT uncertainties, revelations surrounding the Mueller investigation/report and a potentially toothless China/USA trade agreement, all has us suggesting to clients a more conservative asset allocation is warranted in the near-term.

We'd love to hear your thoughts.

	Domestic Indices	1Week
1	Russell 2000 TR	2.0%
2	DJ Industrial Average TR	1.6%
3	NYSE Composite PR	1.5%
4	S&P MidCap 400	1.4%
5	S&P 500 TR	1.1%
6	ICE BofAML US High Yield TR	0.4%
7	NASDAQ Composite PR	0.4%
8	BBgBarc Municipal TR USD	0.1%
9	BBgBarc US MBS TR	0.0%
10	BBgBarc US Agg Bond TR	-0.1%
11	US Inter Gov Bd TR Bond	-0.1%
12	BBgBarc US Government TR	-0.2%

	Style Stratification	1Week
1	US Large Val	2.0%
2	US Mid Val	1.5%
3	US Mid Core	1.4%
4	US Core	1.2%
5	US Mid Cap	1.1%
6	US Market	1.1%
7	US Large Core	1.1%
8	US Large Cap	1.0%
9	US Mid Growth	0.5%
10	US Growth	0.4%
11	US Large Growth	0.2%

	Sector Stratification	1Week
1	US Basic Materials	3.4%
2	US Commun Svc Capped	2.5%
3	US Utilities	2.2%
4	US Financial Services	2.1%
5	US Cyclcl Sup Sec	1.6%
6	US Consumr Dfnsve	1.5%
7	US Industrials	1.4%
8	US Consumr Cyclcl	1.0%
9	US Snstve Sup Sec	0.9%
10	US Dfnsve Sup Sec	0.8%
11	US Energy Capped	0.7%
12	US Technology	0.3%
13	US Healthcare	0.1%
14	US Real Estate	-0.1%

	Bond Indices	1Week
1	ICE BofAML US High Yield TR	0.4%
2	US TIPS TR	0.1%
3	BBgBarc Municipal TR USD	0.1%
4	Mortgage TR Bond	0.0%
5	US Shrt Gov Bd TR Bond	0.0%
6	US Inter Core Bd TR Bond	0.0%
7	US Inter Corp Bd TR Bond	0.0%
8	US Inter Gov Bd TR Bond	-0.1%
9	US Core Bd TR Bond	-0.1%
10	US Gov Bd TR Bond	-0.2%
11	US Corp Bd TR Bond	-0.2%
12	US Lng Corp Bd TR Bond	-0.4%
13	US Lng Core Bd TR Bond	-0.4%
14	US Lng Gov Bd TR Bond	-0.5%

	International Markets	1Week
1	SSE Composite PR CNY	4.5%
2	FSE DAX TR EUR	3.0%
3	Euronext Paris CAC 40 NR EUR	2.6%
4	MSCI Europe NR USD	2.5%
5	Nikkei 225 Average PR JPY	2.5%
6	MSCI World ex USA NR USD	2.2%
7	MSCI Pacific NR USD	1.5%
8	MSCI Japan PR LCL	1.5%
9	MSCI World Ex USA PR LCL	1.5%
10	MSCI Pacific PR LCL	1.5%
11	MSCI Pacific Ex Japan PR LCL	1.5%
12	MSCI Europe PR LCL	1.4%
13	MSCI EM PR USD	1.1%
14	MSCI EM PR LCL	0.9%

Source: Morningstar.com