Weekly Capital Market Comments

May 17, 2019

Unintended Consequences

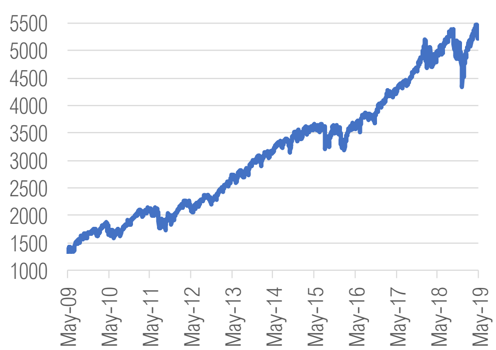
Weekly Review

Another roller-coaster week for equities and fixed-income as markets continue to assess outcome probabilities given a host of geopolitical and economic head-winds; all preceded by the historically worst three-month trading-period in any given year. After a 2% pullback earlier in the week (Thurs-Thurs), the S&P recovered all of its losses, ending the 5-day period higher by 50bps, and now stands higher YTD by almost 16%. The NASDAQ suffered heftier losses earlier on, but had an offsetting bounce as well; lower on the week by 20bps, but up 19% YTD. Bonds remained for bid overall, but exhibited wide disparity as the US Treasuries dipped below 2.4%. While at the same time, we note that credit spreads on non-investment grade and suspect sovereigns are backing up. Large-Cap Growth was higher this week, as FANG-ish equities and technology found buyers, while Small-Cap Growth continues to underperform. Utilities and REITs were higher by 2.6% and 2.5%, respectively, while Financial Services and Healthcare lagged. Regional APAC developed and emerging markets seem to feel the pain from US/Sino trade gyrations, while Developed Europe outperformed, both in local and US$ terms. Oil was for bid, as drone attacks in Saudi Arabia and a US military presence in the Middle East heightened tensions and drove up prices. Gold too, was for bid, perhaps as Reuters published a survey suggesting that the chances of a US recession increased to 40% following the break-down in trade negotiations. Wow – I can't wait for the Memorial Day long-weekend.

The One-Eyed Man

We continue to struggle to find reasons for the recent market resilience; maybe we are just wrong. Maybe Mr. Market believes that China will acquiesce, and not issue reciprocal tariffs or other monetary retaliation (reduce US Treasury holdings). Or possibly cooler heads will prevail at The White House, and offset war hawk National Security Advisor, John Bolton. Perhaps Brexiteers will hold a kumbaya with the EU governors before October elections and provide a win-win outcome for both Europe and the UK. And that Kim Jong-un will simply hand over all his nuclear weapons, begin feeding his people and allow free elections. Then there is the US economy; maybe the deceleration in almost EVERY data point we follow is a head fake, and that technicians no longer need a double-bottom to support higher-highs. And maybe, just maybe, investors really think tariffs are a sound long-term economic strategy (ends to itself, rather than means to an end).

Exhibit: S&P 500 Total Return +15% Per Year Since 2009



Source: FactSet, NEPCG

Like a one-eyed man in the land of the blind, we thought we had it all figured out, and the fate of the market was a foregone conclusion. But recent price action is making us just as blind as everybody else. And trust me, we would like nothing more than to have 10 more years of a robust economic expansion, torrid job growth and 15% annual returns in the S&P 500. But rather than writing a mea-culpa, we decided to simply change the prescription in our monocle (we now need 2.5x vs 1.5x…LOL), double down, and remind investors that it is about the direction note the vector. And as with most things, timing is everything. We also remind investors that "bonds see around corners," and that the data we follow is flashing yellow. For example, the 10Yr Treasury dipped below 2.4% this week, while the German Bund is negative once again (both safe haven currencies). And at the same time, credit yields (Baa/High Yield) and suspect sovereign yields are blowing out.

The concern here is that the POTUS is right, and that tariffs will hurt China more than the U.S. But the unintended consequences to this is that global growth suffers even more in the near-term, slowing even more so than inflation/growth data already suggests; this is what the bond market is telling us. And if market participants are expecting the Chinese Politburo to just roll over, think again. This is high stakes game theory that our politicians are playing, and after moving higher by 15% YTD, it simply makes sense to tack in a more conservative path – just until the gusts subside. **We'd love to hear your thoughts**

	Domestic Indices	1Week
1	US Inter Gov Bd TR Bond	0.4%
2	BBgBarc US Government TR	0.3%
3	BBgBarc US Agg Bond TR	0.3%
4	BBgBarc Municipal TR USD	0.3%
5	S&P 500 TR	0.3%
6	BBgBarc US MBS TR	0.3%
7	DJ Industrial Average TR	0.3%
8	NYSE Composite PR	0.1%
9	ICE BofAML US High Yield TR	-0.1%
10	NASDAQ Composite PR	-0.2%
11	S&P MidCap 400	-0.8%
12	Russell 2000 TR	-0.8%

	Style Stratificiation	1Week
1	US Large Growth	0.8%
2	US Mid Growth	0.7%
3	US Growth	0.7%
4	US Large Val	0.5%
5	US Large Cap	0.4%
6	US Market	0.2%
7	US Mid Cap	0.0%
8	US Mid Val	-0.2%
9	US Large Core	-0.3%
10	US Core	-0.4%
11	US Small Growth	-0.5%
12	US Mid Core	-0.6%

	Sector Stratificiation	1Week
1	US Utilities	2.6%
2	US Real Estate	2.5%
3	US Consumr Dfnsve	1.7%
4	US Energy Capped	1.1%
5	US Commun Svc Capped	0.7%
6	US Dfnsve Sup Sec	0.7%
7	US Basic Materials	0.5%
8	US Snstve Sup Sec	0.2%
9	US Cyclcl Sup Sec	0.0%
10	US Industrials	-0.2%
11	US Technology	-0.2%
12	US Consumr Cyclcl	-0.3%
13	US Financial Services	-0.3%
14	US Healthcare	-0.4%

	Bond Indices	1Week
1	US Lng Gov Bd TR Bond	0.6%
2	US TIPS TR	0.5%
3	US Lng Core Bd TR Bond	0.5%
4	US Inter Gov Bd TR Bond	0.4%
5	US Lng Corp Bd TR Bond	0.4%
6	US Gov Bd TR Bond	0.4%
7	US Inter Corp Bd TR Bond	0.3%
8	BBgBarc Municipal TR USD	0.3%
9	US Core Bd TR Bond	0.3%
10	US Corp Bd TR Bond	0.3%
11	US Inter Core Bd TR Bond	0.3%
12	Mortgage TR Bond	0.2%
13	US Shrt Gov Bd TR Bond	0.2%

	International Markets	1Week
1	FSE DAX TR EUR	2.8%
2	Euronext Paris CAC 40 NR EUR	2.6%
3	FTSE 100 TR GBP	2.4%
4	MSCI Europe PR LCL	2.0%
5	MSCI Europe NR USD	1.5%
6	MSCI World Ex USA PR LCL	1.0%
7	MSCI World ex USA NR USD	0.7%
8	MSCI Pacific Ex Japan PR LCL	0.2%
9	MSCI Pacific PR LCL	-0.5%
10	MSCI Pacific NR USD	-0.8%
11	MSCI Japan PR LCL	-0.9%
12	MSCI EM PR LCL	-1.5%
13	Nikkei 225 Average PR JPY	-1.6%
14	MSCI EM PR USD	-1.7%

Source: Morningstar.com