

STAY INVOLVED

While the last quarter of 2018 turned out to be one of the worst on record, the first quarter of this year will likely be seen as one of the best. Santa Claus showed up right on time, and the January 4th follow-through confirmed that we are still in a major bull market. Perhaps most of the credit should go to Federal Reserve Chairman Powell, who reversed his interest rate tightening campaign and more or less guaranteed no further increases this year. We suspect, however, that the other defining factor was that investors finally realized that business is good and should get better in a low-growth, low-inflation, and low-wage-pressure environment. We think the economic expansion will continue for many quarters to come, a positive backdrop for equities.

To be sure, the business environment was always good with personal income and spending rising, while the core PCE deflator, the Fed's favorite gauge of inflation, is below 2%. With such numbers, the Fed had no choice other than to shift to a neutral policy. We did see a slight inversion of the yield curve on the short end, but this has happened several times in the past without dire consequences. For the moment, we look at it only as a warning sign. A curve that was 25 basis points inverted for roughly a quarter would be more worrisome.

There are still a number of things that need to go right to sound the all-clear signal. We still do not have a U.S./China trade deal. Brexit, while postponed, is still on the horizon, as is the U.S. raising the debt-ceiling and other political considerations. Progress is being made however, and we expect to see more in the future. The most recent economic numbers are the most promising: The U.S. Manufacturing PMI was 52.4 in March—solidly in expansion territory. Though U.S. retail sales took a dip in February, both January and March were higher, with March showing the strongest increase in the past 18 months. Construction spending rose 1% in February. These are all indications of a slow-but-continuing economic expansion.

Since Standard & Poor's started keeping score back in 1926, the index has delivered double-digit returns in the first quarter 14 times. There were only four years when the S&P 500 didn't go on to post a 20% + year, and of those four only 1930 saw a decline. We expect that there will likely be normal pullbacks, particularly after such a strong first quarter and a fairly sloppy earnings season, but we are optimistic for the remainder of the year. We also like what we see in the equity market itself, with broadening participation and some of the more cyclical areas showing strength. These and other data points suggest more economic strength than currently forecast. One of our favorite indicators—copper vs. gold—is telling the right story. Copper, the most widely used industrial metal in the world, is rallying, while gold, the symbol for a safe haven, is not.

April 2019

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