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FROM THE DESK OF DAN VERU, CHIEF INVESTMENT OFFICER

Market Outlook

My last market update from January 7, 2019 set out a very bullish case for equities for the year from the deeply over-sold levels of year-end 2018. So far, the market rebound has been as historic and unusual as the fourth quarter's year-end collapse. While a pause in the market's advance may occur in the short run, I continue to remain bullish on stocks for the balance of the year for the following reasons:

1. It is clear Federal Reserve Chairman Powell has found his voice and grasped the market-moving influence his words have on the perception of liquidity conditions. Conditions in the U.S. are tighter than in recent history but the accumulated weight of global macro factors, Chairman Powell seems to have reversed course on interest rates and on the size of the Federal Reserve's balance sheet and made it clear that further moves would be data dependent. In my opinion, this is the biggest contributor to the equity rally in the U.S. and around the world, which is a dramatic shift from previous guidance of almost certain two to three rate increases coupled with continued shrinkage of the Fed's balance sheet. Government bond yields have also eased with the 10-Year Treasury yield dropping from 3.24% in November to 2.67% as of February 25th.
2. The stock market's year-end decline hurt confidence, whether it's CEO or consumer confidence, but the rebound has already begun to repair that confidence. The recently released Consumer Confidence index was up nine points–and could continue to recover as the year progresses based on the outcome of easing trade tensions. While corporate earnings for S&P 500® Index[1] (the "S&P") declined by 2.7% year-over-year (with most firms reporting) and guidance was more tepid than previously thought, there is no evidence that this is anything more than a mild slowdown in profits.
3. Valuations on the S&P are up but remain fair, particularly since interest rates have dropped. The S&P ended the year at 14.5x on December 31, 2018 and is about 16.6x on February 26th. The forecast for earnings growth remains 6.0% for 2019, still a greater rate of change than in 2014, 2015, and 2016. Unless some global calamity occurs, I expect earnings will be higher for the S&P in 2019.
4. Significant progress on trade between the U.S. and China seems to have been made. President Xi Jinping and President Trump recently made concurring statements indicating both nations are closer to settling not only current tariff issues, but also indicated progress is being made on nagging longer-term issues, such as intellectual property protection. Both leaders were more specific than in previous communiqués and President Trump indicated further tariff increases would not happen on the March 1st deadline, which is a further indication of progress. On this news, the Shanghai Stock Exchange Composite Index[2] leaped 5.6% on February 25th, which was its biggest daily percentage gain since July 2015.

5. The U.S. economy is slowing but remains on solid footing. U.S. GDP for the fourth quarter came in at 2.6%, above estimates of 2.2%. On the other hand, economic conditions in China continue to deteriorate as tariffs and waning consumer confidence continue to slow the Chinese economy. China's February manufacturing PMI shows further deterioration in factory activity and export orders are now slowing at the fastest pace since 2009. Chinese weakness is also showing up in European economic data. Germany, Europe's biggest economy, has stalled due to the combined effects of China weakness and targeted tariffs by the U.S. on Europe. While the European Union's annual GDP growth rate grew by 1.4%, Germany's growth rate was 0.6%.

CONCLUSION

The recovery in the market has been impressive and more than half of my 2019 target has been achieved. Even with a successful outcome on trade, there could be a modest "sell on the news" and pull-back in equities. However, it is clear the Federal Reserve is now favoring keeping liquidity in place at a time when confidence could be on the rebound.

Dan Veru, Chief Investment Officer