Towerpoint Wealth
Monthly Market Lookback

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Whataya Want From Me?

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"An Investment in Knowledge Pays the Best Interest"
(Ben Franklin)

Whataya Want From Me?

Just don't give up
I'm workin' it out
Please don't give in I won't let you down
It messed me up, need a second to breathe
Just keep coming around
Hey, whataya want from me? Whataya want from me?

(From "Whataya Want From Me", by Fed Chair Jerome Powell, 2019…er, sorry, it was Adam Lambert, 2009)

We find the global economy and market at an interesting crossroad. Continuing our "noise" versus "signal" theme of the past 2-3 months, here is our take on the current environment:

Noise

1. The Robert Mueller investigation is over and there will be no indictments, and therefore no impeachment proceedings. This is not to suggest there will be no further rancor or partisanship in Washington, DC, only that the focus will shift to other issues, none of which should have any lasting impact on the economy or markets (until at least 2020).

2. The China-US trade negotiations drag on with modest progress. It is clear that both sides want / need to reach a "successful" conclusion, but the devil remains in the details, especially over protection of intellectual property rights and enforcement protocols.

   We still expect an agreement to be reached, but not for another few months. In the meantime, the current tariff regime is hurting both economies, including the politically important farm belt here in the US. We maintain our belief that there will be no winners or losers in the ultimate agreement, but what the market wants above all else is clarity and certainty, so that it can plan and act accordingly. Therefore, any agreement that is even remotely "fair" will be welcomed and rewarded by the market.

3. "Brexit" negotiations remain a mess, but the market has taken a "wait and see" approach and has not over-reacted to a seemingly intractable situation. There seems to be a belief that the issue will be continually "kicked down the road" until some kind of compromise can be reached. The UK economy has suffered, but not to the degree that the actual facts on the ground might suggest.

4. Political uncertainty is high in several European countries, especially France, Germany, and Italy. So far this uncertainty has not overly affected economic activity or market performance, but that could change should the political winds shift further away from the respective current administrations.

Signals

1. In previous months we listed Fed policy as a "hybrid" between noise and signal, but now feel that policy has turned to a signal. The Fed has adopted a decidedly dovish approach, and more or less abandoned its previous "normalization" program. There almost certainly will be no more rate hikes in 2019 (and perhaps not even until later in 2020), and the run-down of the Fed's balance sheet will cease in September (a de facto easing maneuver). In essence, the Fed has acknowledged that the risks to both economic growth and inflation are to the downside, and it is responding accordingly. [Note: We do not ascribe to the notion that the Fed "caved" to Donald Trump's jaw-boning, though we do think there is merit to the idea that, even though it is not part of its mandate, the Fed paid attention to the negative market reaction to its tightening signals last fall.]

   The Fed's reversal is aligned with a more generalized global "resynchronization" of monetary policy. The UK remains accommodative in the face of Brexit, Mario Draghi and the ECB have reversed course and returned to a more accommodative stance after a moderate attempt to "taper" last fall, Japan has been and will remain accommodative into the foreseeable future, and China has moved to a significant monetary (and fiscal) stimulus approach in face of a slowing economy (with positive effect). All of this "easy money" may have detrimental long-term effects, but in the meantime it should be positive for global risk assets.

2. The global economy continues to expand, though with clear signs of deceleration, especially in manufacturing. The US economy is still expanding, though at a much slower pace. The first quarter GDP print is likely to be sluggish (below 2%), due both to seasonality and to the year-end government shutdown. The consensus forecast for the whole year is just north of 2.0% – not recessionary but not overly vigorous. The employment picture remains robust, though it, too, has started to stabilize as we extend the current "full employment" regime.

China is in a slump that has been worsened by ongoing trade tensions with the US, though recent fiscal and monetary stimulus seem to be having a positive effect. Europe continues to slow down, and its manufacturing sector has been especially hard hit by the slow-down in China (to which it is a significant exporter). Japan posted a mildly positive fourth quarter GDP, but also two negative quarters of growth in calendar year 2018 – it continues to "muddle along".

3. Interest rates are no threat, at least not yet. Given the change in Fed "attitude", the lack of inflation, and expected lower growth rates, we forecast US rates moving up only slowly over the course of the year, with very little upward pressure. The global story is similar – there simply is no catalyst for significantly higher rates in any major market.

4. Global inflation is under control. Commodity prices rallied early in the year after being oversold in late 2018, but we do not expect that to continue. In the US, wages are increasing slowly but should not present inflationary pressure any time soon. Oil prices rallied strongly due to supply cuts, but we expect them to stabilize as supply and demand imbalances level out over the remainder of the year.

5. US corporate revenues and earnings remain positive, though both are expected to decelerate as we move through 2019. Financial engineering (stock buyback and dividends) remain in vogue and therefore supportive of stock prices, but the YTD rally will not continue – trees do not grow to the sky.

With that as a backdrop, looking out over the current economic and investment landscapes, here is what we see.

The Current Economic & Market Landscape

The global economy is still expanding but clearly decelerating:

- ***The Q4 GDP growth in the US was 2.6%, bringing 2018 GDP growth to 3.0%. Growth is expected to fall to 1.4% in Q1 2019, and decelerate but remain positive for all of 2019 (2.1%); (source: The Wall Street Journal);***

- ***Ongoing trade negotiations and additional fiscal and / or monetary stimulus could change the economic outlook for the US over the course of the year;***

- ***Both the US manufacturing and services sectors remain in expansionary mode (56.6 and 57.7 in February, respectively; any reading above 50 is considered expansionary), but appear to be slipping (source: Institute for Supply Management);***

- ***The federal debt and deficit are exploding and will at some point create a problem, but neither party is the least bit interested in addressing the issue;***

- ***Modern Monetary Theory (i.e., the idea that deficits don't matter when you can print money) is absolute lunacy and is simply an attempt to justify increased spending and astronomical deficits;***

- ***Inflation is nowhere to be seen and, combined with a slowing economy, is driving the dovish tone at the Fed;***

- ***The Fed is "signaling" no further rate increases in 2019, and perhaps not even until well into 2020. Former Fed Chair Janet Yellen suggests that the next Fed move may well be a rate cut;***

- ***The employment picture in the US remains strong, though showing signs of stabilizing – no surprise given the "full employment" environment;***

- ***With the Mueller investigation behind us (and, theoretically, any impeachment risk as well), the primary threat to continued economic expansion remains trade policy negotiations, specifically with China;***

- ***There are some signals (specifically in the sentiment or "soft" indicators) that the economy is cooling and recession risks are increasing. However, we do not expect a recession in 2019 and perhaps not until the second half of 2020;***

- ***With a more dovish tone from the Fed and a slowing economy, there is little upward pressure on interest rates;***

- ***We maintain our outlook, however, that rates in the US generally will inch steadily higher, with periodic reversals during market disruptions;***

- ***The yield curve remains very flat despite the Fed "backing off," but the long end remains "tamped down" by high demand, a slowing economy, a lack of inflation fears, and periodic "flights to quality";***

- ***Through the third week of March, there is less than 15 basis points difference between the yield on the 2-year and 10-year Treasury. Parts of the curve actually temporarily inverted in recent weeks;***

- ***That said, we do not fear an inverted yield curve – should one occur, we believe it will be because of investment flows and, even should it be a harbinger of recession, we will have 12-18 months of "lead time";***

- ***In the wake of a slowing US economy and the more dovish tone by the Fed, the US dollar stabilized in late 2018, and we believe it is more likely to weaken than strengthen as we move through 2019, even though we anticipate that the US economic growth rate will continue to exceed those of non-US economies;***

- ***Manufacturing all across the Eurozone is slipping and has fallen into non- expansionary territory;***

- ***The Euro area Services index remains expansionary (52.7 in March), but is decidedly slowing (source: TradingEconomics.com);***

- ***Eurozone unemployment is stable at 7.8%, and remains at its lowest level since 2008 (source: TradingEconomics.com);***

- ***Inflation is a non-issue in Europe, and the ECB has changed course from its planned "tapering" of quantitative easing. Deflation is a bigger risk than out-of-control inflation at this point;***

- ***Japan's GDP is back in positive territory, but remains sluggish and sensitive to changes in exchange rates. A slowing global economy and a weakening dollar (should it occur) will not help;***

- ***China's (official) GDP growth in Q4 was 6.4% (annualized), the lowest reported growth rate since the Financial Crisis in 2008;***

- ***The Chinese manufacturing index remains in non-expansionary territory, for the first time since May 2017. There are signs, however, that Chinese fiscal and monetary stimulus is beginning to have a positive effect.***

- ***Should this continue, it will be beneficial to the global economy, especially Europe and other EM countries.***

The Towerpoint Wealth Economic & Market Outlook:

- ***The global economy continues to expand, though there is an expected deceleration of growth, including in the US;***

- ***US economic growth, interest rates, inflation, and earnings are all weakening but remain generally expansionary. Wages and input prices are starting to increase, though slowly, and we do not see them as threats (yet) to continued expansion;***

- ***Outside the US, inflation simply is not a problem, due to slow growth and (still relatively) low oil prices;***

- ***Global central bank policies are once again beginning to "synchronize" around an easing theme, and this should be beneficial for risk assets;***

- ***Market volatility is low but may increase depending on ongoing trade negotiations between the US and China, Brexit, the Italian fiscal discussions, changing political climates in France and Germany, and other geo-political issues;***

- ***US valuations are not cheap. We still like EM and EAFE valuations relative to US valuations (though they are only average relative to their own historical norms). Non- US investments will benefit if we are correct and the dollar drifts lower over the course of 2019;***

- ***The US yield curve remains incredibly flat (there is currently less than a 15 bps difference between the 2-year and 10-year yields), as lower longer-term expected growth rates and investment flows combine with only modest inflation expectations to "tamp down" the long-end of the curve;***

- ***There currently is not a great deal of upward pressure on rates, but we maintain our view that rates will "grind higher" over the course of 2019, with periodic market corrections and a corresponding "flight to quality" response from investors;***
- ***In the wake of the recent rally in spread investments (especially in high yield), the public credit markets once again look very expensive to us. Further, we are concerned about high yield liquidity and refinancing risk and the growing level of "covenant lite" bank loans. We are nearing the end of the current credit cycle and risks are increasing;***
- ***For investors who can access the private markets and handle some degree of illiquidity, we still believe there are better opportunities in the private versus public markets, though investors face compressed premiums versus historical levels, driven by huge investment flows over the past 24-30 months;***
- ***Alternative investments, both Hedge Funds and Liquid Alts, disappointed investors in 2018, and both spaces witnessed extensive investment outflows as a result (as we expected). 2019 will be a litmus test for alternative investments;***
- ***We believe that real assets, after a nice YTD rally, will more or less stabilize and perhaps inch upward as we move through 2019, benefitting from an expansionary global economy and a stable-to-lower dollar;***
- ***While we generally are constructive on the global economy and overall market potential, investors should not expect the YTD performance to continue – the global economy and earnings both are decelerating;***
- ***With that in mind, clients need to have their expectations managed as to what a globally diversified portfolio can deliver over a full market cycle.***

It is perhaps a little bold to suggest *Green Grass & High Tides Forever*, as we did in our selection of one of this month's "theme songs". Nothing is forever and there are few things more dangerous than extrapolating now into the future. There are warning signs out there – consumer and business owner sentiment is softening, the market is not cheap, we are in the late stages of the current economic and credit cycles (neither of which is likely to end "softly"), manufacturing is slowing down, and there are geo-political risks that may generate disruption in the market.

But, *for now*, we should be ok – not as euphoric as the previous 2-3 months, but ok. As we suggested last month, we think *time is on our side*, at least for now, but, as we also suggested, clients need to have their expectations managed as to where we are in the market cycle, and they need to be reminded to keep their investment horizon aligned with their long-term financial objectives.

Warm Regards,

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Towerpoint Wealth, LLC