



# FULLEN FINANCIAL GROUP

## Quarterly Market Summary – Q1 2019

### Market Results as of the First Quarter of 2019

Selected Index Results for Q1 – 2019

<u>Index<sup>(1)</sup></u>	<u>%Growth For FY 2018</u>	<u>%Growth For YTD 2019</u>	<u>%Growth For Q1 2019</u>
DJIA	-5.63%	11.15%	11.15%
Lehman Aggregate Bond Index (U.S. multi-sector bond)	-2.60%	2.42%	2.42%
S&P 500 (large cap)	-6.24%	13.07%	13.07%
S&P 400 (mid cap)	-12.50%	14.02%	14.02%
Russell 2000 (small cap)	-12.18%	14.18%	14.18%
MSCI EAFE Index (developed international)	-16.40%	10.34%	10.34%
iShares MSCI Emerging Market Index	-17.11%	9.88%	9.88%
iShares Dow Jones US Home Construction	-31.29%	17.31%	17.31%
MSCI US REIT Index	-7.96%	14.59%	14.59%
Amex Oil Index	-13.21%	12.32%	12.32%
Barclays Global Agg ex-US Corp Bond Index	-6.79%	0.64%	0.64%

(1) These results do not include reinvestment of dividends.

### Q1 Quick Summary

- The Federal Reserve moved from a tightening posture to one that is neutral, and introduced plans to end its policy of quantitative easing.
- During Q1, growth in the major indices was strong across the board. The S&P 500 Index added 13.1%, while the MSCI EAFE Index gained 10.3%. Bonds also rose as the Fed signaled an end to near-term rate increases.
- The Bloomberg Barclays U.S. Aggregate Bond Index rose 2.4% in the quarter due to Fed positioning and further signs of a slowing in global economic growth.
- Economically, overall conditions remained soft, as evidenced by weak readings in manufacturing and services activity. Trade and Brexit concerns weighed on economic data, and while they were previously offset by the change in U.S. tax policy, this one-time impact has now largely run its course. The advance estimate for Q1 U.S. GDP growth exceeded expectations, however, with quarter-over-quarter growth of 3.2%.

### Pointing To Improvement?

The Q1 rally in equity prices appears to indicate market participants expect an improvement in economic fundamentals as we move through the year. It is also possible, however, that the Q1 rally was in part a correction of a market over-reaction in Q4, highlighting the notion that market movements are often more severe than the underlying economic data would warrant. Bullish Q1 investors are likely anticipating that



more accommodative policy from central banks could alleviate recent economic pressures in the second half. Meanwhile, the market seems to believe events including the 35-day U.S. government shutdown, weather episodes in Japan, and a hit to European auto production may prove to be one-time issues from which the global economy can recover. And finally, some halting movement toward a U.S./ China trade deal aided sentiment as well. These aggregate issues, in our view, were clearly what investors had in mind in Q1.

**S&P 500 Index Sector Returns – Q1 2019**

Source: Bloomberg

Sector	Cyclical or Defensive	Total Return	Sector	Cyclical or Defensive	Total Return
Consumer Discr.	Cyclical	15.7%	Info Tech	Cyclical	19.9%
Consumer Staples	Defensive	12.0%	Materials	Cyclical	10.3%
Energy	Cyclical	16.4%	Real Estate	Cyclical	17.5%
Financials	Cyclical	8.6%	Telecom	Defensive	14.0%
Health Care	Defensive	6.6%	Utilities	Defensive	10.8%
Industrials	Cyclical	17.2%			

The economy’s moving parts again have market participants trying to judge the current position of the business cycle. Is the global economy just pausing and on the way to further growth, or is this the deceleration typically found in the latter stages of a business cycle? For now, the Goldilocks market environment seems alive and well, but the question remains as to how exposed investors should be to risky asset classes. Indeed, the Fed’s prior policy tightening may have been stopped in time to preserve and thus elongate the current business cycle; however, investors may want to ask how much do global fundamentals have in the tank after 10 years of economic gain? And, how much has the Q1 rally already reflected the renewed improvement in economic conditions some are expecting? In our view, investment conditions are likely not as bad as they appeared in Q4, nor as robust as they seemed in Q1. In today’s conditions, equity prices can still move higher, as we have seen, but the prudent investment strategy, we believe, is still a measured one. Some economic components that usually support sustained growth are not present, while at the same time, U.S. Corporate debt, personal debt and government debt are reaching record levels. Additionally, many equity valuation measures remain at historically elevated levels. No correction trigger appears to be looming at this time, but many possible triggers can be found.

**The Federal Reserve Sets the Table**

In December of last year, the Fed hiked its policy rate to 2.50% (upper bound) and policymakers were indicating “some further gradual increases in the target range”. However, late in the month policymakers began to hint at a change in their tune. In January, such Fed utterances as “the committee will be patient” emerged, and in his January public address, Fed Chairman Jerome Powell indicated policymakers were firmly undertaking a “wait-and-see approach”. New Fed language helped guide the markets from expectations of another 2-3 rate hikes to now some talk of potential rates cuts later this year. While rate cut expectations may be a bit premature, in our view, the Fed is indeed getting little pressure from

inflation as consumer price readings have receded from mid-2018 highs. Meanwhile, the material shift in policy clearly aided in driving equity prices higher and caused a back-up in long-term Treasury yields.

### Market Implied Probabilities for Fed Funds Rate Changes By Date

Date: December 24, 2018			Date: April 11, 2019		
Fed Meeting Date	Probability of:		Fed Meeting Date	Probability of:	
	Hike	Cut		Hike	Cut
5/1/2019	18.0%	5.8%	5/1/2019	0.0%	0.5%
6/19/2019	17.5%	7.9%	6/19/2019	0.0%	10.9%
7/31/2019	24.6%	7.1%	7/31/2019	0.0%	15.8%
9/18/2019	23.8%	9.6%	9/18/2019	0.0%	29.6%
10/30/2019	25.5%	9.4%	10/30/2019	0.0%	35.7%
12/11/2019	22.0%	19.5%	12/11/2019	0.0%	49.3%
1/29/2020	20.5%	23.8%	1/29/2020	0.0%	56.3%

Source: Bloomberg

### Other Central Banks Follow: IMF Warns

Following the Federal Reserve’s policy adjustment, the European Central Bank (ECB) and the Peoples Bank of China (PBoC) took action in Q1 to try and curb recent deceleration in economic activity. After taking down its Eurozone GDP estimate from 1.7% to 1.1%, the ECB changed its forward guidance on its policy rate; indicating the benchmark could stay at 0.0% through the end of the year or longer. Previously, the ECB had been targeting a potential rate increase in the fall of 2019.

Meanwhile, the PBoC again lowered its required reserve ratio for banks to help combat the negative ramifications from the U.S./China trade dispute. The PBOC has taken down the reserve ratio systematically over the last several years to help offset a slowing economy. The added trade issues have prompted more concerted action from the PBoC.

In its latest forecasts, the International Monetary Fund (IMF) highlighted some of the economic worry monetary policymakers have been targeting. The IMF recently moved its 2019 global GDP forecast to +3.3%, down from +3.7%. This implies a year-over-year slowing of the world economy, as 2018 GDP was +3.6%. The IMF also took down its 2020 forecast to +3.6% from +3.7%. Fading impacts from the U.S. fiscal stimulus, reining-in of excessive credit growth in China, tightening of financial conditions in emerging markets, and material slowing in the Eurozone were keys to the IMF’s revised view of the world. Notably, the IMF’s chief economist termed current conditions as a “delicate moment” for the global economy.



## 2016 Redux? – Stepping Forward, But Stepping Lightly

In some ways the current state of the economy may resemble 2016, when conditions deteriorated and earnings fell; only to snap back again. Part of the snapback was likely due to anticipation of changing U.S. tax law and a resurgence in commodity prices (particularly oil). What now? Well, 2019 GDP growth in the U.S. is not expected to be just shy of 1%, as it was in 2016, but the economy today will likely wrestle with the lagging effects of tighter monetary policy. Will it snap back as in 2016? Based on Q1 equity returns, investors don't seem too worried, as many hope current economic and earnings weakness is indeed transitory. Similar to the post-2016 tax and commodity recovery, perhaps the key to 2019 is a necessary catalyst - a U.S./China trade deal perhaps? On the other hand, there is the possibility that the global economy will simply run out of late-cycle steam, and accommodative monetary policy will reach the point of diminishing returns.

Our view is that the U.S. economy is likely to muddle through, with risk of recession remaining elevated versus 2017 and 2018 levels, but still low historically. The more dovish monetary policies from global central banks have alleviated that risk to some extent. That said, however, we struggle to find a near-term catalyst that will allow the global economy and market to re-ignite growth as it did in 2016-2017. We believe some benefit could indeed come from a potential U.S. trade resolution with China, although those benefits may be slow to emerge, and the relative impact may not be as significant as expected. Global economies and markets are already operating at a higher level than they were in 2016; modestly higher in places like the Eurozone and Japan, and materially higher in the U.S. The most immediate benefit could be felt in China's economy, although that market has debt hurdles to cross and equities in China have already priced in some expectation of a deal.

With a modest economic backdrop, limited recession risk, and beneficial monetary policy in mind, we take a positive view on equities and other risk-based assets, although we anticipate Q1 returns have exhausted a material portion of the potential upside. We believe the change in monetary policy has, for the most part, already been reflected in stock prices. Further upside may come if we do in fact get some reacceleration of economic growth in the second half of 2019, but that view carries some amount of risk. As such, we believe investors should wary of possible near-term downward price pressure following the Q1 rally.

Looking globally, equity valuations make the most sense in developed markets ex the U.S. and secondarily emerging markets, but investors have paid little attention to this dynamic so far. In practice, the consistent attraction to U.S. exposure likely has been due to the relative sustainability of the U.S. economy and lingering tax benefits. Absent any material risk of inflation at this time, bond risk-adjusted returns may prove to be competitive with equity returns through the balance of the year.

### Risks

Investors should be aware of the risks associated with all portfolio strategies and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance and the effectiveness of strategic and tactical portfolio approaches.



## Conclusions

Although the market downturn in Q4 of 2018 was significant, market performance thus far in 2019 has offset much of that decline. This is not normal, and we believe the possibility of further correction is certainly there. As mentioned earlier, there is convincing evidence that over the next few years, investment returns will be lower and volatility higher. A moderately rising long-term interest rate environment is hoped for even though it will include some negatives such as lower fixed income yields (compared to what we have experienced over the last couple of decades). Adding to the anxiety associated with a lower yield environment will be higher volatility; unfortunately, investors that choose to sit-out to avoid volatility will likely lose what investment yields are available, even if reduced. While there will be periods of negative returns, history tells us that equity and fixed income yields should still be positive (over time) and are highly likely the best alternative for the vast majority of investors (even at reduced levels).

In periods of higher market volatility, maintaining investment discipline within a lower overall yield environment will be more difficult emotionally. However, we need to remember that market timing as an investment strategy has never worked consistently (and results in lower longer-term yields). Trying to time markets in a lower yield environment has a high probability of creating permanent losses. Avoid the temptation to act in an undisciplined and consequently damaging way—everyone is investing in the same lower yield environment. If someone appears to have found a way around it, be very wary – they are either not showing you all their “cards” or are taking very high investment risk.

Fullen Financial is always available to help sort out false claims so don't be concerned about asking us.

As always – stay with a consistent and disciplined investment strategy – it is the only course of action with any track record of success (in any investment environment). There is no reason to believe, even with the changing economic dynamics, that the disciplined approach to investments will be less effective than in the past at delivering the best possible relative returns.

At the most fundamental level, match your investment time horizon to your spending timeline – if you have short term cash needs then those funds should be in short term investments. These are simple asset/liability matching principles practiced by the most sophisticated investment managers every day (but far too complex to explain in sound bites and not conducive to selling products). Additionally, don't try to solve short-term financial problems with long-term equity exposure. If you try to chase returns, you may get lucky sometimes but, if pursued long enough, it always ends in extreme frustration and often with serious financial losses. The reality is that no one has ever consistently predicted investment markets and they never will - and there is always a consequence to continued unsound financial behavior.

As always, if your personal or family situation has changed (or is likely to), a discussion with us as to how this may impact your financial plan and your overall asset allocation is warranted. Or, if you simply feel a need to discuss any aspect of your portfolio and/or financial plan, or you haven't had a planning update within the last 12 months, please contact us to review your financial plan and investments.

**Your financial plan is the most important financial document that you possess! Keep it updated and use it.**



Please note that you are entitled to receive Fullen Financial's Form ADV whenever you would like to. This document outlines many details of who Fullen Financial is, their investment methodologies and their advisor's education and experience. You may do so by contacting Lisa Bushman at [lisa@fullenfinancial.com](mailto:lisa@fullenfinancial.com) and requesting such. Alternatively, you can go to the Fullen Financial website ([www.fullenfinancial.com](http://www.fullenfinancial.com)), click on "Resources" in the top menu bar, and then on "Client Forms."

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