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1st Quarter 2018 – Market Commentary

THE QUARTER IN BRIEF

Stocks rallied in January, corrected in February, and slumped in March as volatility and economic policy changes took some of the enthusiasm out of the market. The Trump administration announced tariffs on foreign steel, aluminum, and assorted products from China; China soon said that it would reciprocate with excise taxes of its own. The Federal Reserve adjusted the federal funds rate upward and welcomed a new chair; the White House appointed a new chief economic advisor. An orderly process was outlined for the Brexit. The Nasdaq Composite advanced for the first quarter, but the Dow 30 and S&P 500 did not; most major Asian and European benchmarks also retreated. Among commodities, bitcoin declined notably, while oil and gold improved. The placid market climate of 2017 vanished, giving way to trading sessions marked by significant ups and downs.[1]

DOMESTIC ECONOMIC HEALTH

A protectionist trade strategy emerged from the nation's capital in March. The Trump administration declared that a 25% tariff would be instituted on imported steel and a 10% tariff on imported aluminum. Some countries were given short-term exemptions from these excise taxes: Argentina, Australia, Brazil, Canada, Mexico, South Korea, and members of the European Union. Additionally, up to $60 billion in Chinese imports would soon face excise taxes. China retaliated at the end of the quarter, imposing import charges of either 15% or 25% on 128 U.S. products, including pork and fruits.[2]

Elsewhere in Washington, the Janet Yellen era gave way to the Jerome Powell era at the Federal Reserve. Weeks after Powell took over as Fed chair, the central bank made its first interest rate adjustment of the year, a 0.25% hike that set the target range for the federal funds rate at 1.50%-1.75%. The Fed's updated dot-plot forecast, reflecting the consensus opinion of its policymakers, projected two more hikes this year: three in 2019 and two in 2020. All that would leave the benchmark interest rate around 3.4%, according to the dot-plot. The Trump administration hired former Reagan administration official and CNBC commentator Larry Kudlow as its new chief economic advisor, following the resignation of Gary Cohn.[3,4]

Business growth looked good in the first quarter; correspondingly, so did hiring. The Institute for Supply Management's factory PMI went from 59.1 to 60.8 to 59.3 across three months; ISM's service sector gauge was also very high at readings of 59.9 in January and 59.5 in February. January saw a net job gain of 239,000 hires by the Department of Labor's estimation, and February brought an even more impressive net gain of 313,000. The headline jobless rate stayed at 4.1% in January and February, and the U-6 rate, counting the underemployed, remained at 8.2% in both those months.[5]

Inflation became a worry during the quarter, but fears that it was running away subsided. There was a half-percent spike in the headline Consumer Price Index in January, plus a 0.3% gain for the core CPI. A month later, both the headline and core CPI moved but 0.2%. By February, annualized consumer inflation was running at 2.2%, core inflation at 1.8%. Wholesale inflation pressure was greater: the year-over-year advance in the Producer Price Index through February was 2.8%. Speaking of production, industrial output was up 4.4% in the 12 months ending in February; durable goods orders rose 3.1% in February after a 3.5% January decline.[5]

Consumer incomes rose 0.4% in both January and February, paralleled by consecutive 0.2% gains in consumer spending. Another indicator from the Department of Commerce seemed to show consumers were saving rather than buying: overall retail sales fell 0.1% in February following a 0.1% January increase. The Bureau of Economic Analysis showed real consumer spending at 4.0% in the fourth quarter, a major factor in the 2.9% expansion of the economy. (That number was an upgrade from the BEA's second estimate of Q4 GDP, which was 2.5%.)[5]

Speaking of the central bank, it started unwinding its vast securities portfolio and hiked the federal funds rate another quarter point in December, resulting in a new target range of 1.25%-1.5%. Among the economic indicators that likely fostered that decision was the final federal government assessment of Q3 growth: a strong 3.2%. The Fed also raised its projection of 2018 GDP to 2.5% from its previous forecast of 2.1% and its latest dot-plot indicated three rate hikes for the new year.[3,8]

GLOBAL ECONOMIC HEALTH

While Spain grappled with the Catalonia region's desire for independence and the United Kingdom contended with European Union demands involving its Brexit, there was much good news concerning the overall E.U. economy. The jobless rate across its 28

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"Gratitude is not only the greatest of virtues, but the parent of all others."

- CICERO

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member countries continued to descend, falling to 7.4% in October. Inflation, barely above 1.0% at the end of 2016, increased to 1.8% in November. The European Central Bank kept interest rates steady in the quarter and announced it would buy fewer bonds per month; its monetary stimulus is expected to last through Q3 2018. In December, the ECB projected 2.3% growth for the E.U. economy in 2018.[9,10]

Economic data streams from the Asia-Pacific region offered plenty of positive news this fall. While the Caixin/Markit manufacturing PMI for China reached a 5-month low of 50.8 in November, manufacturing PMIs in Asia's leading electronics producers were up. Japan's factory PMI hit a peak unseen since 2014 in November, while manufacturing PMIs in South Korea and Taiwan respectively displayed their best readings since mid-2013 and mid-2011. South Korea's Bank of Korea raised interest rates in Q4, becoming the first major central bank in Asia to hike in three years.[11]

LOOKING FORWARD

As a tough quarter for stocks becomes history, signs of a trade war have surfaced. What could the second quarter hold? All three major indices (and oil futures) sold off significantly as Q2 began. Investors hope that the March jobs report and the start of a new earnings season will restore some optimism to the market. Housing and retail sales aside, fundamental economic indicators have looked good for the most part. The anticipation (and results) of this coming earnings season could take investors' minds off recent headwinds, but a continuation of the marked volatility we witnessed in the first quarter would not be a surprise. If earnings can distract Wall Street away from concerns about trade, the slump in tech shares, and the Fed's plans for tightening; then, the tone might be set for a better month and quarter than some investors expect. For now, the feeling that a promising year for equities might turn into a poor one persists.[25]

SUMMER OFFICE HOURS:
7:30AM – 4:30PM MAY 1 – AUGUST 31