RDM CAPITAL ASSOCIATES

WEALTH MANAGEMENT

FIRST QUARTER 2019 MARKET COMMENTARY

April 2019

STATE OF THE MARKETS

Equities rebounded in the first quarter with the strongest first quarter performance since 1998 after one of the worst fourth quarters in recent history. The S&P 500 rose 13% as fears over an imminent global recession and endless global trade wars subsided somewhat. While the S&P closed the quarter approximately 4% below its 52-week high, most of the late 2018 market correction losses have been recovered.

Domestic economic data supports continued economic expansion in the near term, albeit at a slower rate than 2018, while foreign economic data reflects relatively weaker conditions in Europe and emerging markets. Investors concerned that global trade wars would lead to further economic deterioration were calmed somewhat by apparent progress in U.S.-China trade talks with a comprehensive trade agreement under negotiation during the quarter. It remains to be seen whether the parties will be able to close the deal in the second quarter and markets could deteriorate on any collapse in talks during the quarter.

Politically, much of the recent theater in the U.S. has passed with the mid-term elections now in the rear-view mirror and the Mueller report on Russian meddling in the 2016 election concluding. Investors should not get too comfortable, however, with the 2020 election cycle ramping up as the year goes on. We expect largely political stalemate for much of President Trump's remaining term, particularly regarding his economic agenda, as the parties do not appear to have much interest in bipartisan cooperation with the possible exception of infrastructure legislation. As the presidential campaigns kick into high gear, the parties will only dig in further.

Looking ahead, we expect equities to follow the lead of economic conditions, both domestically and abroad, and any developments in U.S.-China trade talks. As the Federal Reserve has essentially taken a breather from any further rate hikes in 2019, investors should focus on corporate earnings releases, as well as fiscal policy and trade developments. While interest rate trends are still obviously relevant for fixed income investors and to the extent they portend any under-currents in the economy, e.g. continued yield curve flattening or inversion, Fed policy should be less of a concern during the rest of the year. We expect U.S. economic conditions to remain strong relative to the rest of the world and markets to stabilize further if/when the U.S.-China trade agreement is finalized.

Review of the First Quarter

Equities Recover as Recession Fears, Global Trade Wars Dissipate

As 2018 drew to a close, equity markets were dominated by volatility arising from investor fears of an imminent recession. These fears were born primarily from three sources: 1) the inversion of the treasury yield curve and Fed interest rate policy; 2) the persistence of global trade wars; and 3) weakening economic data, particularly in Europe and China. In the first quarter, the first two sources of market fears were alleviated somewhat while the third source remains.

Historically, an "inversion" of the treasury yield curve – meaning that interest-rates on short-term U.S. treasury debt uncharacteristically move higher than rates on long-term debt – precedes the occurrence of an economic recession. The indicator is fairly reliable and instances of yield curve inversions without a recession within a two to three-year time period are unusual. In the fourth quarter, the yield on 2-year treasuries surpassed the 5-year treasury and sent markets into a panic that a recession was near. In late March, the 3-month treasury moved higher than the 10-year treasury, lending further credence to investors' fears. As we discussed in our Fourth Quarter Market Commentary, we believe that much of the inversion story is due to the unorthodox interest rate policy of central banks in the U.S. and abroad to stimulate the recovery from the Great Recession. Additionally, yields in the U.S. are currently substantially higher in the U.S. than other developed countries like Germany and Japan where 10-year interest rates are still negative. Consequently, foreign investors looking for mid to long-term safe-haven investments in government debt are more inclined to buy U.S. treasuries than foreign government debt which thereby suppresses yields in the longer-end of the yield curves that have inverted.

We are cautiously optimistic that the yield curve inversion trend will ease somewhat in the coming months as the Fed has put a halt to future interest rate hikes for 2019 and assuming economic data in the U.S. continues to reflect that the economy is on sound footing. Additionally, resolving the U.S.-China trade dispute would be a positive catalyst for confidence in both the U.S. and, more importantly, global economy. With repeated signs of progress in trade negotiations during the quarter, we are optimistic that an agreement will finally occur in the second quarter. Further, an economic rebound in Europe and China after the softness of recent months would support a steepening of the yield curve.

Despite this optimism, we are cognizant of the fact that the economic cycle will inevitably lead to recession. Even though cumulative GDP in this economic recovery has been below average compared to other recoveries historically, the current expansion has also been historically long. Thus, while we believe the yield curve inversion has been impacted somewhat by unusual factors, we do not dismiss it entirely as a predictor of a recession down the road. However, we would like to see further confirmatory domestic economic data prior to putting too much weight on the yield curve. Currently, growth, employment, inflation and other key indicators point towards continued economic expansion over the near term.

Political Uncertainty Abates for Now; Eyes on 2020 Election Cycle

With the release of the Mueller report on Trump campaign collusion with Russia in the 2016 presidential election, and the subsequent lack of new indictments, much of the political uncertainty that investors faced in 2018 has passed. While there will likely be continued Congressional probing into the Trump campaign in the months to come, the odds of a serious threat to the Trump presidency emerging have diminished. Nevertheless, investors should keep a close eye on the 2020 presidential election cycle as rhetoric from Democrats and Republicans alike will intensify causing uncertainty about the future economic policy agenda of the next president. In particular, expect that continued fighting between parties over immigration policy and healthcare reform will only intensify as politicians dig in their heels for campaign purposes.

From an economic policy standpoint, we expect the split Congress and looming election next year to lead to few policy changes that would impact investors and the economy. This is not necessarily a bad thing, as markets often thrive in a political stalemate environment, all else equal. With the passage of the Trump tax reform bill, there is likely little additional fiscal stimulus that would have been enacted to move the needle significantly anyways. Rather, we expect Washington to slowly evolve into full campaign mode during the course of the remainder of 2019.

Conclusion

Given the current late-cycle economic environment, we suggest that all clients and investors revisit their financial plans to ensure their asset allocations and retirement income plans are appropriate. From an investment allocation standpoint, we currently recommend investors emphasize equities that thrive in a mature, growing economy while searching for defensive, higher-yielding investments for retirement income allocations. By reviewing and confirming financial planning, investors should not panic and make rash investment decisions during any future correction or downturn. With the proliferation of passive investing and computer-based trading, we expect continued historically-high levels of volatility when there are negative economic or market developments. Thus, it is even more important today that investors maintain a level head and long-term investment focus given this evolution of market behavior.

As usual, we welcome all comments and suggestions.