From the desk of the CIO
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This month's focus:

1. Presidential Tweets
2. Earnings

He's At It Again

Who would have thought such an innocuous little bird could ruffle the feathers of global market participants?

In February, President Trump delayed the planned increase in tariffs on some $200 billion in Chinese imports, citing "substantial progress" in ongoing talks. Markets were pleased, and despite fears over a global economic slowdown, stocks moved higher. This morning we awoke to the President's renewed threat of higher tariffs in the continuing trade war with China.

I'm sure it's no coincidence that the Chinese trade delegation is scheduled to meet with their U.S. counterparts on American soil this week. Whether we're observing a New Yorker's tough negotiating style, or providing some sort of "cover" for Chinese negotiators to save face at home, is anyone's guess.

The important takeaway from days like today is that the market's reaction to headlines of uncertainty is usually a temporary condition. At the end of the day (or perhaps a few days or even weeks and months), asset prices trade back to their fundamental value.

Stocks have been trading relatively well on positive economic data. Employment conditions in the U.S. continue to be historically positive, U.S. GDP in the first quarter of 2019 was better than most anyone expected, and corporate earnings (which we'll discuss in more detail in a moment) have come in reasonably healthy. It looks like the moderate growth pattern with low inflation will continue for a while longer.

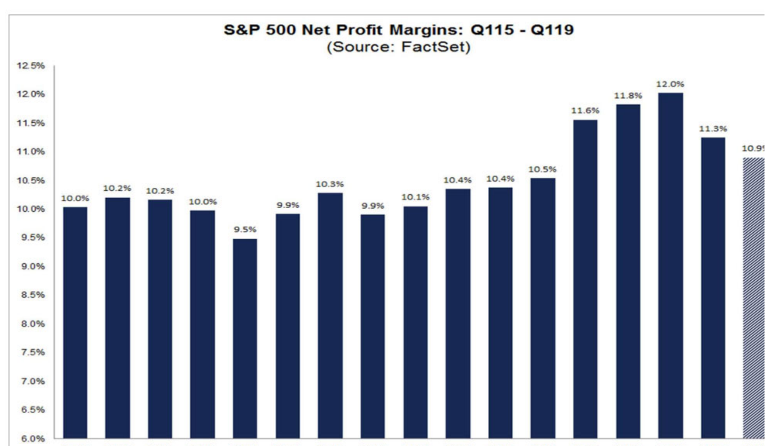
As I write this at 10:30 a.m., Monday morning, the major averages have already recovered nearly half of what was lost at the open of trading. We won't predict what the market will do in the last few hours of today, but the trade deal with China has been a point of uncertainty for markets to factor in, so we have viewed this as a potential threat to near-term stock prices, hence our **"risk neutral"** view (neither too excited or too worried) going into 2019 remains.

Profits, Profits, Profits

In last month's *Market Note* we included a segment entitled "It's All About Earnings" as we headed into the quarterly reporting period.

So far, the results of the first quarter of 2019 have been a pleasant surprise. With about half of S&P 500 Index reporting, 77% have come in with earnings above estimates, and nearly 60% reported above expectations for revenue.

What's more important in determining future stock prices, is whether company profits are increasing compared to prior periods. Over time, stock prices are set by what investors think the future holds for a company. The data point that currently has us in a "risk-neutral" posture is that the first quarter of 2019 is the first year-over-year decline in net profits for S&P 500 companies since 2016. You may recall we entered the first quarter of 2016 in the midst of an "earnings recession", meaning quarter over quarter profits for S&P 500 companies had declined for five consecutive reporting periods. The chart below shows the percentage of net profits relative to gross revenue. We believe that with continued economic growth profit margins may expand over the next few quarters and support higher stock prices. However, there are some risks we should not ignore as mentioned above.



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