LongView
ASSET MANAGEMENT

2019 First Quarter Review and Outlook

Financial markets rallied sharply in the first quarter of 2019, despite signs of slowing global growth. Investors responded positively to signals from the US Federal Reserve Bank that the incremental rate hikes of the past several years may be coming to an end, and that going forward monetary policy is likely to be more neutral, and therefore supportive of markets and the economy. The easier stance of the Fed has been echoed by the central banks of the other major economies, and the market rally has extended globally. Investors were further cheered by the apparent thawing of tensions in the US-China tariff dispute and the abatement of other concerns, including President Trump's threat to close the US/Mexico border.

Beyond the short-term relief at the prospect of looser monetary policy, and easing geopolitical fears, the question many investors are asking is whether the deceleration of growth during the past several months is the beginning of a recession, or merely a pause in an expansion which will soon be the longest in US history. The answer to this question seems to depend on who one asks.

In the bond market, yields on long-term bonds have declined, while short-term yields have held up, which is an indication that fixed income investors anticipate slower growth ahead. Such a so-called "inversion" of the yield curve has not always been followed by recession, but the correlation with negative future economic growth is strong enough that investors are well-justified in seeing it as a red flag. Stock markets on the other hand, have risen broadly, suggesting that stable interest rates, low inflation, the best job market since the 1960's and a positive resolution to the trade dispute, could continue to fuel the economic expansion.

We suspect that the markets' mixed signals reflect investors' conflicting sentiments quite accurately.

<u>Portfolio Notes</u>
All in all, the first quarter was a very good start to the year, with all asset classes generating positive returns. In equities, our overweight in US small companies and growth-oriented funds proved advantageous, allowing us to stay slightly ahead of the MSCI All Country World Index which gained +12.18%. Fixed income also had a solid quarter, with the Bloomberg Barclays Aggregate Bond Index gaining +2.94%, and the BofA Merrill Lynch 3-month Treasury Bill Index, a reasonable proxy for cash, returning +0.59%. In spite of the recent bond market rally, we are maintaining our defensive positioning in short-maturity and high-credit quality funds as a safeguard against potential turbulence due to rising rates or a slackening economy. Our alternative strategy funds meanwhile accomplished their purpose of generating bond-like returns well in excess of cash rates, while keeping volatility low.

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Outlook

This will be the longest US expansion on record if growth continues into the summer. At present, none of the cyclical sectors that drive growth in GDP: residential housing, automobiles, business investment and inventories, show signs of an economy tipping into recession. And while the Federal Funds Rate has risen steadily over the past three years from 0.25% to 2.50%, it has been a long and slow process, plateauing well below the average 7.50% at which past periods of tightening ended. In such an environment, slow but sustainable GDP growth of around 2% and mid-single digit gains in corporate profits could continue for several years.

One way or another, it is nevertheless clear that US growth has slowed from its brisk pace of the last two years. While slow but steady growth should benefit stocks more than other asset classes, returns going forward may prove only middling. Moreover, in such a slow-speed scenario, the economy is likely to be more vulnerable to setbacks, whether caused by trade wars, a "hard" Brexit, overly tight monetary policy, or other factors. However, for the time being, the Fed appears to be on hold, so the prospect of a Fed-induced recession is slim. And though the outcome of trade talks is uncertain, what is sure is that it is in all parties' interests to come to a positive resolution.

We see this as a good moment to review your portfolio allocation to ensure that risk levels are compatible with your longer-term goals and that a market downturn, whenever it comes, will not cause more downside volatility than you can tolerate.

On a housekeeping note, we congratulate our partner and colleague Doug Lynam whose book "From Monk to Money Manager" was published in late March. We'll be sharing some of the press that the book has received as it comes out. The renovation of our new building on Grant Avenue continues apace, and in the meantime, we are in temporary quarters in the historic Delgado House on West Palace Avenue just off the Plaza. We also recently received press coverage for launching the first-ever socially responsible 403(b) retirement plan for teachers, the beginning of what we hope will be many more plans that align the ethical values of educators with their investments.

We wish you a beautiful Spring season and we are grateful, as always, for your trust.

Sincerely,

David Cantor

Harlan Flint