THE DANA VIEWPOINT

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Round Trip

And then some. Most equity indexes are down for the year between five and ten percent. The stock market does not go in one direction, although some would be tempted to believe that is the case due to the almost decade-long bull market we have been experiencing. The S&P 500 has not had a negative year since 2008. Corrections also seem more painful when they happen in a short period of time; remember early February? When the stock market declines in more of a stair-step manner, investors have time to re-anchor their expectations based on a more gradual downward slope. Now that we have experienced a drop of almost 17% in the S&P 500 in less than a quarter, it is natural to ask, what has changed in twelve weeks?

We have a hard time recalling a time period where market sentiment had such a wide divergence from economic reality. Many of the events driving increased market pessimism are somewhat “self-inflicted,” including the Federal Reserve’s interest rate policy, trade frictions, and dysfunction on the political front, both within the White House and Congress and abroad.

The Fed and its potential for overdoing its tightening program is one of the most frequently mentioned culprits. If low inflation and unemployment are its goals, what war are they fighting? The unemployment rate has been at the low of 3.7% for the last three months, and CPI (inflation) is at 2.2%, down from a high of 2.9% in July. The Fed is both raising rates and letting maturities roll off of its balance sheet. This second event is referred to as “balance sheet tightening,” but is it really tightening if long rates are going down as new Treasuries are being issued? Much is made of the flattening yield curve, and we do think this is a market signal that the Fed should heed. Even with the Fed rate increase, the two-year Treasury yield is down 18 basis points this quarter, and the ten-year Treasury yield is down 27 basis points.

Based on the FOMC statement, they do not think they are done raising rates, but considering the market-based indicators for prices and economic activity, we would have seen no harm in pausing. The market dropped about 6% in the second half of the week following the Fed announcement and press conference. Higher interest rates have also begun to impact incremental demand for some key “interest -sensitive” industries, such as housing and autos. Do you get the market’s message, Chairman Powell?

Tariffs have also continued to be an issue, and while there appears to be a détente and progress

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towards some sort of an agreement, this may be the biggest uncertainty impacting the markets and corporate earnings visibility. A timely resolution would likely buoy stocks by removing corporate uncertainty and freeing global trade.

Political dysfunction both here and abroad is also having an impact on market sentiment. The shift in the balance of power in Congress raises the potential for further “gridlock,” and also the likelihood of further Presidential investigations. The current government shutdown and the revolving door amongst the President’s Cabinet appointees and other key advisors also increases uncertainty.

While there are reasons for concern, there are also a number of reasons to be optimistic about the economy and financial markets in 2019. GDP growth has averaged 3% for the last four quarters. Corporate earnings growth has been strong in 2018, and further growth is anticipated in 2019, albeit at a more modest pace. Unemployment remains near 30-year lows, and strong employment figures are helping to fuel strong consumer spending. For example, MasterCard recently issued a report noting that holiday sales from November 1 through December 24 increased 4.9% while online sales grew 18.1%. This was the strongest year-over-year growth rate since 2011, resulting in a new record for dollars spent.

This news helped fuel a strong market reaction on the day after Christmas, yet the P/E valuation of the market remains near a five-year low. If some of the macro uncertainties are removed from the landscape, there could be a significant further rally. In the fixed income markets, yields have moved above 3% on many securities, and investors in corporate and mortgage securities have seen their yields move higher as the spreads to Treasuries have widened.

As another year passes, we wish all the best for you, your families, and your portfolios. We respect the trust you have put in us, and will always strive to exceed your expectations.

We buried our 41st president this month, and he was a treasure trove of quotes, some very famous. Here are two that are less well known:

> *"We don't want an America that is closed to the world. What we want is a world that is open to America."*
>
> *“Never ask anyone over seventy how they feel, they’ll tell you.”*

-George H. W. Bush

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