Proactive Investment Management & Financial Planning

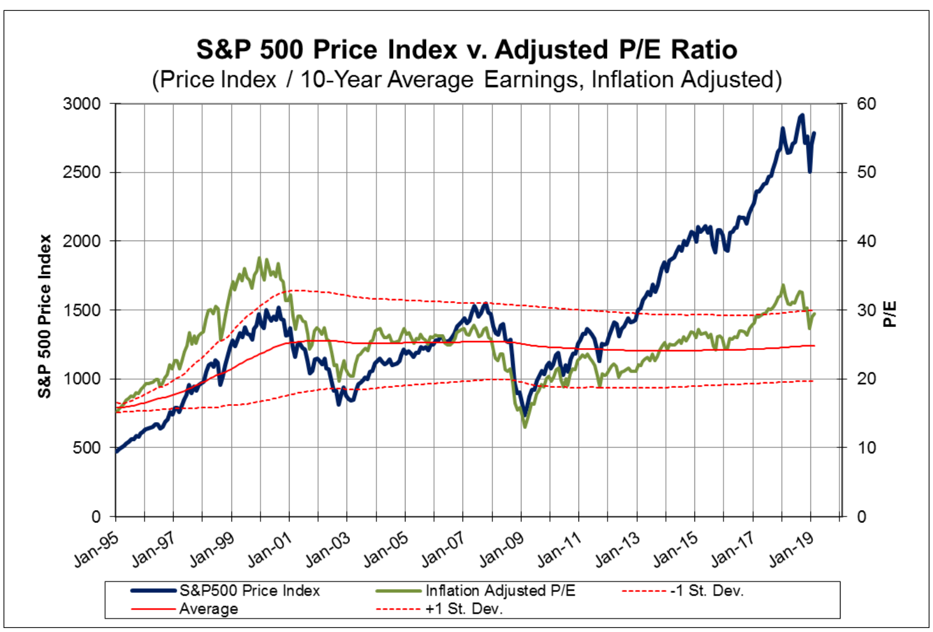
Monthly Market Comment
March 1, 2019

During February, U.S. financial markets continued to recover from their fourth-quarter drubbing. For the second month in a row, all major risk assets appreciated in value, led by stocks and commodities. Bond prices were essentially flat.

Stocks

Investors continued to bid up stocks in February, as they welcomed reasonably good news on economic performance and corporate earnings. There were also signs that the United States and China were getting closer to a trade deal that might unwind some of the protectionist tariffs put in place during 2018. Finally, Federal Reserve policymakers continued to signal they would back off their long campaign of interest-rate hikes. The S&P 500 price index ended the month 3.0% higher than at the end of January and 2.6% higher than at the end of February 2018. Taking into account dividends, the total return on the S&P 500 was 3.2% in February and 4.7% over the last year.

Looking ahead, we still think it's possible that the Fed's stand-down on further rate hikes may have come just in the nick of time. The interest-rate hikes to date have apparently helped bring inflation back down to target, and if rates now remain stable or nearly so, the good momentum in the economy could keep corporate earnings and stock prices on the upswing. That's especially true now that stock valuations have been brought back down to more reasonable levels. However, the Fed has rarely timed things so perfectly. There's some risk that inflation could accelerate again and force further rate hikes, but we think the bigger risk is that the inflation and rate hikes to date have already done their damage and economic growth, profits, and stocks could weaken from here. Just as important, slowing economic growth in China and Europe could be a problem, not so much because U.S. exports might fall, but because foreign production and sales are so important to large U.S. companies. There is also some risk that geopolitical tensions and trade disputes could worsen again.



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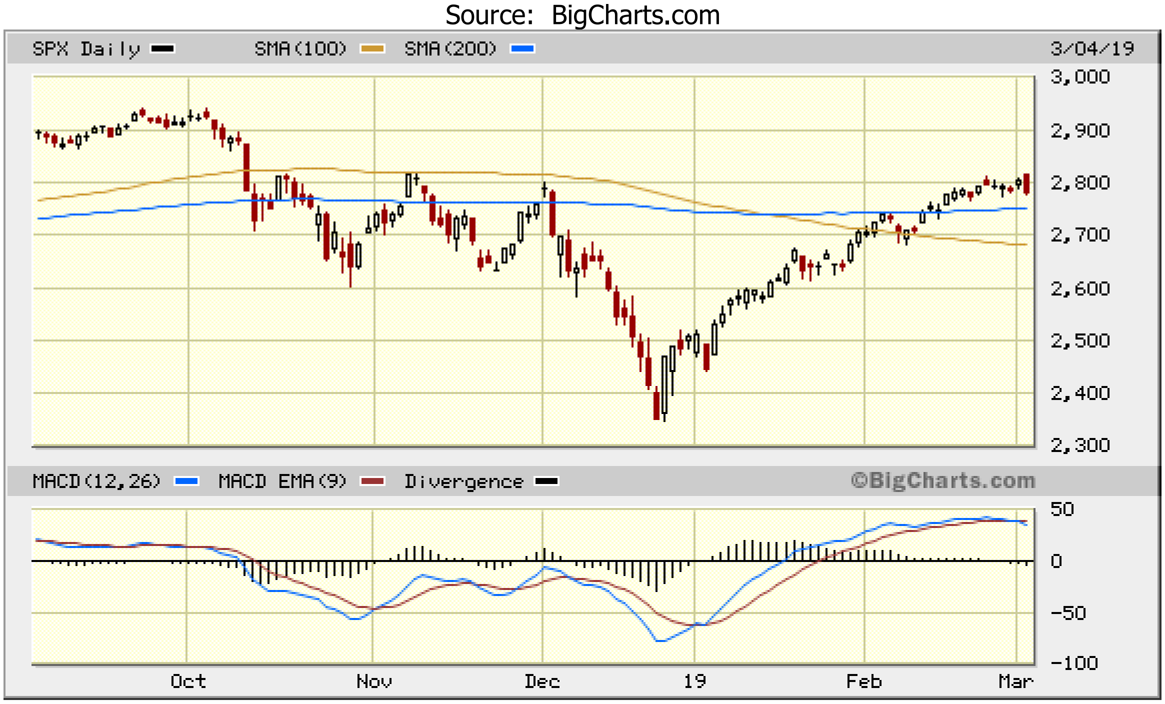
In our view, the various technical indicators are positive, but only modestly so. We do think it's encouraging that the S&P 500 index remains above its 20-day simple moving average (SMA), which in turn has now moved above its 200-day SMA. That's indicative of an uptrend, although we'd like to see the 50-day SMA above the 200-day SMA as well. Meanwhile, the share of S&P 500 stocks trading above their own 200-day SMA has moved up to about 60%, which we consider positive, though not necessarily bullish. A more negative technical indicator is that the Dow Jones Transportation Index has recently been rising somewhat less robustly than the overall market. The clearest reason for caution is that the key short-term momentum indicators (such as the "moving average convergence/divergence," or MACD) suggest stocks have become somewhat over-bought and may therefore be susceptible to a pullback at some point. If the S&P 500 continues to rise from here, we think its next significant resistance levels will come at approximately 2,813 and 2,884. If stock prices instead start to fall again, we think the next significant support levels would be at approximately 2,632 and 2,582.

S&P 500 Stock Price Index + "MACD" Momentum Indicator
Source: BigCharts.com



Bonds

After strong safe-haven buying in the fourth-quarter and a slight sell-down in January, bonds traded in a narrow, flat range throughout February. As a result, bond yields fluctuated in a narrow range as well. The yield on the benchmark 10-Year Treasury Note rose only modestly to 2.71% at the end of February from 2.63% at the end of January. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was 0.0% in February and 2.7% over the last year.

As noted above, we think there is only a small chance that the Fed has stopped hiking interest rates too soon and might have to hike rates substantially further in the coming months or quarters. More likely, we think the policymakers will be able to hold rates steady at their current level or, if the inflation and rate hikes to date have already damaged the economy, their next move would likely be to cut rates at some point. In other words, we now think the balance of risks for bonds is toward flat-to-falling interest rates for the foreseeable future. In that case, the current rich pricing for bonds would seem justified, and it would likely make sense to hold longer-maturity obligations as opposed to the shorter maturities that we were favoring in 2018. Likewise, we think the moderating economy and reduced inflation pressures argue for abandoning inflation-protected securities and favoring conventional, non-adjusted obligations.

Real Estate and Commodities

Publicly-traded real estate investment trusts (REITs) enjoyed favorable conditions in February, as continued economic growth provided reassurance that properties can keep pulling in rents, while the outlook called for stable-to-falling interest rates. At the end of February, the FTSE NAREIT Price Index stood 0.3% above its level at the end of January and 14.7% above its level at the end of February 2018. Reflecting their relatively high dividends, the total return on publicly-traded REITs was 0.5% in February and a whopping 19.6% over the last year. Looking ahead, we believe the continued economic expansion should keep REITs' operational dynamics healthy, while steady-to-falling bond yields will continue to help their price performance.

Physical commodities were mixed in February, though they rose overall. The S&P GSCI Total Return Index rose 3.8% during the month, although it was still down 2.5% from the end of February 2018. The overall increase in February came mostly from a rise in energy and industrial metals prices, reflecting investors' renewed sense that the global economy is still growing and optimism about U.S.-China trade relations. However, prices for precious metals and agriculture products fell. Looking forward, we still see a fairly high risk that the commodity rally will be limited if it turns out the Fed has already hiked interest rates too far or the U.S. economy starts to suffer more seriously from the slowdown in foreign economic growth and the current trade disputes.

Patrick Fearon, CFA
Lead Portfolio Manager

Asset Class	Index	Ending Reading, Latest Month	1-Month Change	3-Month Change	12-Month Change
U.S. Stocks	S&P 500 Price Index	2,784.49	3.0%	0.9%	2.6%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	279.30	1.8%	4.2%	-9.0%
REITs	FTSE NAREIT All-Equity Price Index	702.73	0.3%	2.2%	14.7%
Commodities	S&P GSCI Total Return Index	2,493.11	3.8%	4.4%	-2.5%
Bonds	S&P U.S. Aggregate Bond Index	195.32	0.0%	2.4%	2.7%