During the first quarter of 2019, equity markets recovered from the steep sell off experienced in the prior quarter. The S&P 500 and Russell 2000 Value appreciated 13.7% and 11.9%, respectively. Despite this strong performance equity markets have not fully recovered the losses experienced since the end of the third quarter of 2018.

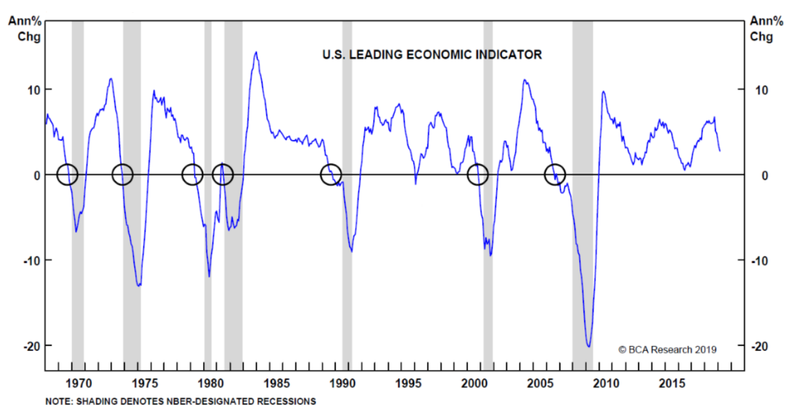
The powerful rally was triggered by global central banks acknowledgement of tightening liquidity conditions and an increase in monetary stimulus by China. Markets are hopeful that 2019 will be a replay of 2016 with China's credit stimulus leading to a broad global recovery in economic growth. In 2016, the global economy was recovering from a broad industrial/energy recession at the time China implemented powerful credit stimulus supercharging the recovery. In 2019, China stimulus is much narrower and is focused on maintaining liquidity within the formal banking system as the shadow banking system continues to contract. Therefore, we expect little more than stabilization in China's economic growth versus a broad reacceleration.

We continue to expect only a modest resolution to tariff/trade negotiations with China and other countries. It is important to note that the global slowdown began prior to the implementation of tariffs and trade negotiations and therefore we do not expect a resolution to result in a sustainable increase in economic growth. Global trade as a percentage of global GDP peaked in 2014 and will remain in a secular decline over the medium term.

Although portions of Europe are in a recession, the U.S. is still in an environment of slowing economic growth, but not a recessionary environment. On the U.S. economic front first quarter GDP looks to be tracking somewhere in the 1.5% area. Our base case for full year 2019 is for GDP to slow from 2018's 2.9% pace to approximately 2.0%. However, if economic growth deteriorates further the U.S. economy could become vulnerable to a recession.

A reacceleration in economic growth is necessary to reach 2019 earnings estimates for the broad market averages. First quarter earnings growth is expected to be negative sequentially before beginning to recover with a sharp year over year increase in the second half of 2019. Unfortunately, the leading indicators we track continue to show slowing industrial activity not just overseas, but also in the U.S **(Chart 1)**. The slowdown is now spreading to the services sector, which will likely cause a softening in employment activity and a reduction in inflationary pressures. Unless these leading indicators improve during the second quarter, 2019 earnings estimates will need to be reduced. In the near-term, economic activity will likely continue to slow, which will further pressure margins and ultimately earnings growth. Equity valuations have risen materially in Q1 2019 as markets recovered, and we expect equity markets to remain volatile until the economic slowdown has bottomed and we return to an environment of sustainable economic growth.

**CHART 1**



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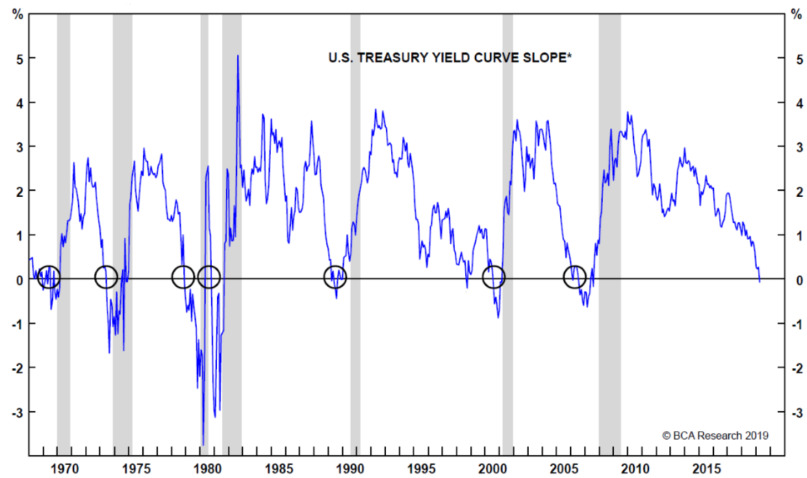
The flattening and inverted yield curve is confirming that despite central banks best wishes economic activity domestically and overseas is still slowing **(Chart 2)**. Treasury yields continued a decline that started in the fourth quarter of 2018. The 10-year Treasury yield declined from 2.69% to 2.41% during the quarter. The fourth quarter sell off in credit reversed course with investment grade credit spreads narrowing 34 basis points to 125 basis points over comparable duration Treasury yields, generating 257 basis points of excess return.

**CHART 2**




*10-YEAR TREASURY YIELD LESS 3-MONTH TREASURY RATE
NOTE: SHADED FOR NBER DESIGNATED RECESSIONS

Another factor impacting yields is the change in Federal Reserve Board policy. At the end of November 2018, Chairman Powell stated they were still a long way from being neutral, a level where rates neither help or hurt economic activity. Additionally, the forward looking “dot plots” dictated that investors could expect four additional 25 basis points Federal Funds rate increases in 2019. Since then, the Fed has signaled a pause on future rate hikes. Interestingly, this shift in policy has led to a flattening of the short end of the Treasury yield curve and a steepening at the long end. Inflation rates and, more importantly, inflation expectations should remain well contained in the 1.5-2.0% area. All in all, the environment remains positive for credit and a stable one for Treasury yields to remain range bound.

Finally, the Municipal bond market continues to enjoy strong demand from investors in the higher tax brackets and supply should remain lower than in prior years, as most states are generating increased revenues. The ten year and longer maturities remain the most attractive area of the curve to invest new cash within a managed portfolio.