2019: 1st Quarter Summary

"Whenever you find yourself on the side of the majority, it is time to pause and reflect." ***Mark Twain***

As we review market returns each quarter to prepare this missive, it seems that we frequently want to write something along the lines of, "This quarter/year was the exact opposite of the LAST quarter/year." We finished 2018 with a holiday bear market, something that hadn't occurred in decades. As a New Year's gift, investors enjoyed the second-best monthly price return of the S&P 500 in five years during January (+7.87%). In contrast, December and October 2018 were the index's two worst months in the past five years. Whatever Spirits of Markets Yet to Come spooked investors at Christmas were chased way by discounted global-equity valuations and the U.S. Fed's announcement of a suspension in its rate-hike program. U.S. and international stocks posted exceptional Q-1 rebound results. Investors in high-yield bonds, commodities and REITs also were quite pleased, as the 'risk on' trade led to a rebound in all markets. Quality investment-grade taxable and municipal bonds earned almost all their yearly coupon in the quarter, and nearly matched the full-year returns of 2017.

Index Returns

as of 3/31/2019

Index	Q1 2019	Q4 2018	YEAR 2018	YEAR 2017
FIXED INCOME				
BbgBarclays US HY 2% Issuer Cap	7.26%	<4.54%>	<2.08%>	7.50%
BbgBarclays Municipal	2.90%	1.69%	1.28%	5.45%
BbgBarclays Global Aggregate	2.99%	1.74%	1.76%	3.04%
BbgBarclays US Agg Bond	2.94%	1.64%	0.01%	3.54%
U.S. STOCKS				
Russell 1000 [Large-cap Stocks]	14.00%	<13.82%>	<4.78%>	21.69%
Russell 2000 [Small-cap Stocks]	14.58%	<20.20%>	<11.01%>	14.65%
S&P 500	13.65%	<13.52%>	<4.38%>	21.83%
INTERNATIONAL STOCKS				
MSCI ACWI Ex USA NR [All Stocks]	10.31%	<11.46%>	<14.20%>	27.19%
MSCI EAFE NR [Developed Markets]	9.98%	<12.54%>	<13.79%>	25.03%
MSCI EM NR [Emerging Markets]	9.91%	<7.46%>	<14.57%>	37.28%
REAL ASSETS				
U.S. Dollar	1.06%	1.09%	4.40%	<9.87%>
Morningstar US Real Asset Index	6.67%	<6.94%>	<3.33%>	3.41%
Bloomberg Commodity	6.32%	<9.41%>	<11.25%>	1.70%
S&P GSCI Crude Oil Spot	32.44%	<38.01%>	<24.84%>	12.47%
S&P United States REIT	15.77%	<6.09%>	<3.79%>	4.33%
S&P Global Ex US REIT	11.99%	<4.46%>	<6.52%>	16.72%

Source: Morningstar, Inc. USD data with dividends and interest

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"The pause that refreshes" *Coca-Cola slogan, 1929*

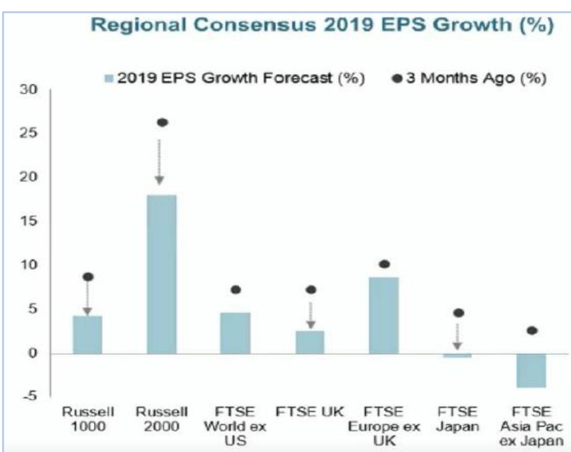
Prognosticators and pundits have been devoting considerable blog and media space to advance their theories on the timing and severity of the next recession and 'the end of the (U.S.) bull market.' Stripping away some of the fear-mongering and bloviation, we find that the data indicates some concerns are warranted. More important, though, is the concept that future policy changes and macroeconomic management are the real keys to prolonging the U.S. expansion and the bull market. That's why the Fed's announcement of a pause in its tightening policies is so significant.

There's a familiar market adage that says, "Bull markets don't die of old age." If investors were playing the classic board-game *Clue*, the most common culprit would be the Fed using monetary policy in the bond markets. While there are elements of truth to this analysis, the Fed has a very difficult job of guiding a long-term, low-inflation expansion at full employment. Its monetary adjustments usually create a 'hard landing,' which cause asset bubbles and the recessions and market crashes investors are familiar with. Their decision to ease-up on rate hikes has us considering the Fed may, in fact, engineer a 'soft landing,' a slow-down without a classic recession. Their current focus on the 'natural rate of interest' is a key to their thinking.

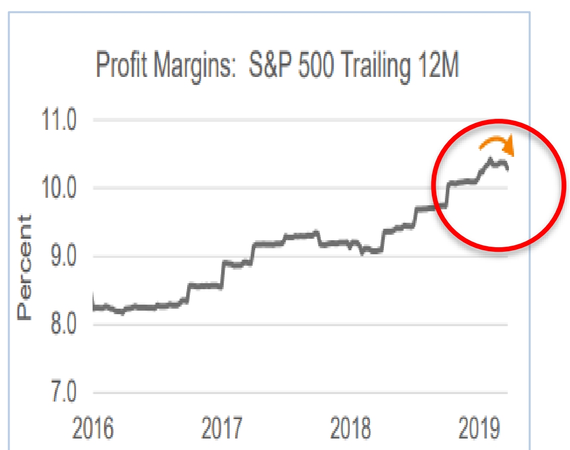
The natural rate of interest is, broadly, the rate that maintains stable economic growth absent economic shocks. It is usually defined as a long-term interest rate plus an inflation premium. The current Fed Funds rate is targeted in the 2.25%-2.50% range, which is consistent with the Fed's current estimates of a neutral rate. This estimation is crucial to corporations and their financial planning; it's also an important global policy and investment consideration, given the dominant roles of the U.S. economy and its Treasury bond market in the world economy.

"In bullfighting there is an interesting parallel to the pause as a place of refuge and renewal… called [the bull's] querencia." *Tara Brach, psychologist and author*

So, what are the risks to the U.S. and global markets now? They are primarily future policy errors. These include: Brexit, China's economy, the global trade wars, the rise in and level of global debt, and the rising U.S. deficit (fiscal policy). These risks are not easily measured, and some have outcomes that may take years to manifest. Here are two issues that policy can affect and that we believe are important to near-term market psyche and dynamics going forward – earnings and debt:



FTSE Russell



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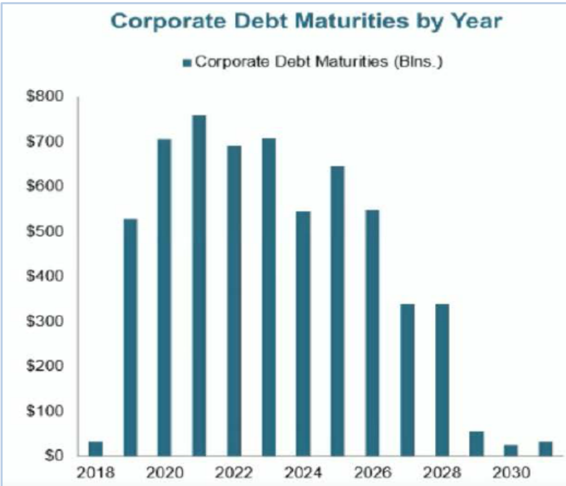
In the left graph, we can see that global earnings estimates for 2019 have come in considerably during the first quarter. This is a result of a slowing global economy, macro policy concerns and some uncertainty about the direction of the U.S. dollar. In the right graph, we can see that profit margins for the S&P have reached a 3-year high and may experience some roll-over. This may be due to wage-inflation pressures, higher borrowing costs and commodity-price increases. Ending the trade wars, allowing for some higher wage growth and a weaker dollar may lessen these pressures.



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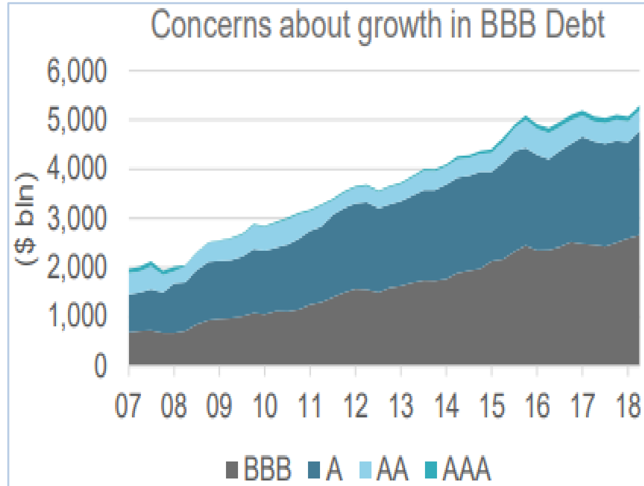

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With respect to debt, the left graph above estimates that corporations will roll ~$5 trillion in debt in the next eight years. If rates remain where they are now or drift slightly higher, the volume of refinancing and the possible upward reset in coupons will affect corporate cash flows and balance sheets. The right graph reflects the huge amount of debt financing that has occurred in the lowest ‘investment grade’ tranche (BBB) over the past 10 years. Previously a sweet spot for investors, this tranche is now a key to corporate-debt financing. Higher interest rates or economic disruptions will impact this crucial market segment. We have noted that some larger corporations are moving to shore-up balance sheets, sell assets and lower leverage ratios while the markets still afford cheaper financing options. A Fed pause may avoid negative shocks to the BBB market, which will affect bond indexes and investment mandates for mutual funds and institutional investors.

“Sometimes all it takes is a subtle shift in perspective, an opening of the mind, an intentional pause and reset…to see new options and new possibilities.” ***Kristin Armstrong, Olympic athlete***

At times it seems difficult to comprehend that the U.S. expansion still seems to have some legs. We think the Fed’s pause will be a big boost to maintaining low-inflation growth. An added benefit is the Fed’s consideration of their policies’ effects on the global economy, as no country is an economic island and U.S. policy repercussions have global knock-on impacts.

While we expect some year-over-year comparative weakness in earnings, we still expect earnings growth in the U.S. and positive market returns. We also expect more value-hunting in international markets, particularly in select ‘emerging’ markets. Our original expectation of a rise in the U.S. 10-year Treasury to a level over 3.00% is less likely, but we still expect muted returns for bonds for the rest of the year.

Our final comment is to be prepared for more pronounced market fluctuations. The result of policy-driven market moves, as opposed to strictly data-dependent ones, is more volatility and uncertainty, not less. Useless noise and emotions, specifically fear, are heightened in this type of environment.

Please take a brief pause to review your financial plan and circumstances, and contact us with your comments and questions.

-Your Wealth Management Team at JJ Burns & Company

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Past performance is no guarantee of future results. This information is provided for educational purposes only and should not be considered investment advice or a solicitation to buy or sell securities.

Investing risks include loss of principal and fluctuating value. Small cap securities are subject to greater volatility than those in other asset categories. International investing involves special risks such as currency fluctuation and political instability. Investing in emerging markets may accentuate these risks. Sector-specific investments can also increase these risks.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed-income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, and other factors. REIT risks include changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and creditworthiness of the issuer.

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The Barclays US Corporate High Yield 2% Issuer Capped Bond Index is an issuer-constrained version of the flagship US Corporate High Yield Index, which measures the USD-denominated, high yield, fixed-rate corporate bond market. The index follows the same rules as the uncapped version, but limits the exposure of each issuer to 2% of the total market value and redistributes any excess market value index wide on a pro rata basis. The Barclays U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The Barclays US Municipal Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed tax-exempt bond market. The index includes state and local general obligation, revenue, insured, and pre-refunded bonds. The Barclays Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. Returns hedged to various currencies are published for multi-currency indices.

The Morningstar® US Real Asset Index is a diversified portfolio of four different asset classes that have historically displayed high sensitivity to inflation. Real assets are defined as TIPS, commodity futures-based strategies, real estate investment trusts, and inflation-sensitive equities such as upstream commodity stocks and master limited partnerships

The S&P U.S. REIT Index defines and measures the investable universe of publicly traded real estate investment trusts domiciled in the United States. The S&P Global ex US REIT index is a comprehensive benchmark of publicly traded equity REITs listed in both developed and emerging markets, excluding the United States. The S&P 500® index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. The S&P GSCI is designed as a benchmark for investment in the commodity markets and as a measure of commodity market performance over time. It is also designed as a tradable index that is readily accessible to market participants.

The MSCI ACWI ex USA Index captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 23 Emerging Markets (EM) countries. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. The MSCI Emerging Markets Index captures large and mid-cap representation across 23 Emerging Markets (EM) countries.

The Bloomberg Commodity Total Return index is composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM. The index currently represents 20 commodities, which are weighted to account for economic significance and market liquidity.