Market & Economic Commentary: Drinking Water Out of the White House Fire Hose

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Jim Scheinberg CIMA® AIFA ®
Managing Partner
jim.scheinberg@npier.com

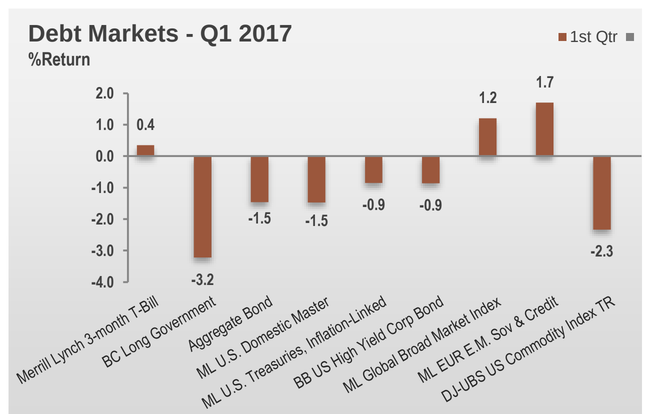
(800) 403-7065
www.npier.com
www.northpiersearch.com

THE NORTH PIER*spective*

Drinking Water Out of the White House Fire Hose

The first days of the Trump presidency have proven to be as unconventional as the election cycle. With a flurry of Executive Orders, President Trump has rolled back regulations, challenged immigration from Middle Eastern countries, attempted the replacement of ACA (AKA Obamacare) not once but twice, and had several high profile firings - including his own new appointment to head the NSA. Controversy didn't stop at his dizzying pace of policy objectives. Several members of the Trump camp have been alleged to confer with high ranking Russian authorities during the transition of power, lending credibility to the Democrats' claims that the Russians intervened on Trump's behalf to influence the 2016 election. Regardless of the actual truth behind the partisan clashes on Capitol Hill and in the media, the news cycle has been a blur. Amidst all this drama, U.S. and European stock markets have steamed ahead at a pace rivaled Washington's. With expectations that lower taxes and pro-business reforms will lead to growth in GDP and corporate earnings, Walls Street is betting on big wins across the board. The question is, will economic realities match these lofty expectations. So far, the early results are mixed.

How the Markets Fared



The debt markets weathered the second Fed interest rate hike with little fanfare. The intermediate and long-end of the yield curve was virtually unchanged during the first quarter of the year. Yields for the 10 and 30-Year Treasury Bonds fell a few basis points, generally staying where they started in the year, close to the two and a half and three percent levels, respectively. This led to fractional gains in the high quality - intermediate end of the market, as bonds generally earned their modest coupons plus a tad of price appreciation. Credit spreads tighten further with the continued expectation of a stronger domestic (and global) economy. This benefitted the credit sensitive end of the aggregate bond market a tad, but had its most impact on the high yield sector. Junk bonds tagged on gains of nearly three percent after 2016's impressive seventeen percent run. The U.S. Dollar gave back some of its lofty Q4 gains, which enabled the debt of developed market and emerging market bonds to outperform domestic debt indexes. Lastly, with inflation flaring up a bit in Q1, there was renewed interest in inflation protected securities, resulting in TIPS gaining modestly during the quarter.

Stocks around the globe surged ahead at the start of 2017. In the U.S., the technology sector led the way, helping the NASDAQ reach all-time highs. Large capitalization stocks gained over six percent with growth names leading the value indices by over five percentage points. This was a reversal to 2016's ten-percentage point dominance from the value side of the spectrum. Value indices were held back during the quarter by declines in the energy sector, as oil prices faded back below the $50 a barrel mark. In fact, commodities generally declined in the first quarter, which hurt resource names in the small cap sector as well. Though small cap growth indexes advanced over five percent, the Russell 2000 Value Index was virtually unchanged during Q1. That area of the market was due for a pause after 2016's robust 30%+ gain. Developed market international equities also saw attractive increases, with growth leading value there as well. Unlike the U.S., where large caps outperformed smaller companies, internationally, it was small stocks that saw the greatest gains. Ultimately though, it was the resurgence in the emerging markets that stole the show. Manufacturing and resource based EM equity markets generally saw double digit appreciation in the first quarter. This was despite the slight declines in commodity prices. The pull-back in the U.S. dollar added to local market appreciation to make this the best place to be so far in 2017.

PIER*ing* Ahead

There is little doubt that a global economic resurgence is afoot. Europe is showing more promise than many had expected, as GDPs rise and unemployment falls. With all of last year's hubbub over BREXIT, the EU economy may be the biggest surprise of 2017. Here at home, regardless of how the plethora of changes spewing out of Washington play out, our economy is on solid footing. With a strong labor market, growing home values, and potential tax cuts on the horizon, consumer and business optimism is likely to continue. It is highly doubtful that economic conditions will falter in the coming months. What lies ahead in the later years of a Trump Presidency may be another story. Recent saber rattling with North Korea may foreshadow a bold and potentially reckless foreign policy style that could come at a cost. If the pre and post-election promises of border taxes take form and lead to trade wars, our young global economic renaissance may be in jeopardy. You simply can't discount the possibility of conflict. If clashes break out, be they financial or military, we may need that White House fire hose we've all been drinking out of to douse the flames.