BFS Wealth Management
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PERSPECTIVES

APRIL 2019

Market Recap

What a way to start the year! The 1st quarter was the best quarter for the S&P 500 in nearly 10 years and it could not have come at a better time - following the 4th quarter of 2018 - which was the worst 4th quarter since the Depression. And, that is why one does not try to time the market! More on that in "Portfolio Management", below.

It was a bit unusual that it was a terrific quarter for both stocks and bonds. The S&P 500 index gained 13.1%, and the Barclays Aggregate Bond index gained 2.94%, as investors fled to bonds for safety on the heels of the Q4 2018 stock market swoon. The S&P 500 now sits 3.3% below last September's all-time high.

What caused the sudden change in investor sentiment? Part of the rebound was due to the fact that stocks were oversold in December, before bottoming out on Christmas Eve. The stock market surge in early January was a "dead cat bounce" (an old stock market term so-called because even a dead cat will bounce if it falls from a great height!). However, there were other factors that contributed to the Q1 stock market rally.

Commenting on the 2018 4th quarter swoon and the surge in the 1st quarter of 2019 is like commenting on the same movie with two different endings. In the first movie, the Chairman of the Federal Reserve, Jerome Powell, comes on screen and says in spite of indications that the global economy is slowing a bit, the Fed will continue to raise interest rates and sell off its bond portfolio, making no modifications to its plans at all in light of the deteriorating economic data. That does not sit well with U.S investors and the movie ends with them selling off equities in spades.

In the second movie, the Chairman once again comes on screen and instead of a dour, resolute look on his face, he has a big smile and says the Fed recognizes that there are signs of global slowing and, therefore, the Fed is not going to raise interest rates anytime soon. They are also not going to continue to sell bonds into the market, to reduce its balance sheet, at the same rate as it has in the recent past. Investors in that movie rush to buy stocks and there is a ticker tape parade on Wall Street!

Well, the turnaround in the stock market happened because both these "movies" came out within months of each other. Powell basically said, "No change, no how", on October 3rd to initiate the sell off, and, confirmed that position with a rate increase on December 19. Then, on January 30, he reversed course and basically shouted "all is good, and we have your back". As a result, U.S. stock markets continued their run and ended the quarter strongly.

But, why did bonds do so well, also? It is simple. U.S. interest rates are some of the highest in the developed world right now, our economy is growing, inflation is tame, the U.S. still has a strong rule of law, and our Treasuries are backed by the strongest country in the world. That creates global demand for our government bonds, which increases the prices of our bonds and decreases yields (the government does not have to pay as high an interest rate on money it borrows when demand for its bonds is strong).

Bottom line, we had a terrific quarter all around. But that is in the past. What is next? Read on....

Forecast

Let's start with interest rates. In a nut shell, if you are thinking about re-financing your home – do it now! Call us - we can help. Rates have fallen in part because investors have been anticipating the Fed might cut interest rates a bit. We don't think so – especially since they just raised the Fed Funds rate in December. We think they would look silly if they reversed themselves now, and we think the economy is solid in the U.S. and may soon get better globally.

We think bonds have been over-bought and, rather than falling more, interest rates will begin to rise again. The 10-year U.S. Treasury rate bottomed last week at 2.37% after falling 28 basis points in the quarter. We think that over the rest of their year it will rise to 2.75%, or more. If rates rise that much, it will put some pressure on bond prices, but it won't be too bad.

The Score Board

	3/31/19	YTD (Change)
Dow Jones Industrial Average*	25928.68	11.2%
S&P 500*	2834.40	13.1%
NASDAQ Composite*	7729.32	16.8%
MSCI EAFE (USD)*	1875.43	9.0%
Bloomberg Commodity Index	81.09	-5.7%
Barclays Aggregate Bond Index	2106.83	2.9%
10 Yr U.S. Treasury Bond Yield	2.42%	-28 bps
30 Yr Fixed Mortgage Rate	4.06%	-54 bps
Prime Rate	5.50%	UNCH
Crude Oil ($/barrel)	$60.14	32.1%
Gold ($/oz.)	$1,293.00	1.1%
U.S.$/Euro	$1.12	-2.2%
Core Inflation (ex food/energy)		2.1% **
Inflation (with food/energy)		1.5% **

* Without dividends
** Unadjusted 12-mos. ended February 2019
bps (1 Basis Point = 1/100%)

UNCH (Unchanged)
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

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Forecast (continued)

We think that year-to-date gains in client bond portfolios will hold up and may even increase a bit over the balance of the year.

With respect to U.S. stocks, we caution clients to avoid confusing "a decrease in earnings" with "negative earnings." TV commentators are talking about Q1 earnings probably decreasing from a year ago (S&P 500 companies are expected to report a nearly 4% drop in Q1 earnings from a year earlier according to Factset), but they are talking about a decrease in earnings as a percent of revenue, which is not to imply that overall corporate earnings will go negative with most companies posting losses instead of earnings. Not at all! U.S. corporate earnings are going to be solid once again this year, however, they may not grow much over a terrific 2018. We think U.S earnings will be better than expected though, and that they may surprise to the upside. For the stock market, it is always all about earnings. Given that, where do we go from here?

The U.S. stock market could very well go sideways for the rest of the year as gains in the stock market to-date are digested. It depends on what corporate earnings each quarter look like compared to investor expectations. The wild cards are what happens with trade negotiations in China, can the re-negotiated NAFTA agreement get approved by Congress, and whether any major policy errors are made by our Congress, the Federal Reserve, or our president. It also depends on whether China can continue to make progress in their economy, if Europe can re-start their growth, and the outcome of Brexit. In other words, all the usual suspects. We certainly do not believe a recession is in sight. It may be around the corner, but we believe that corner is so far away off that we should not be making changes in portfolios now in anticipation of it!

Portfolio Management

As ugly as Q4 2018 was, we largely stayed the course, as we strongly believed the sell-off in the stock market was way overdone and exacerbated by the holiday calendar (traders taking time off) and computer algorithms (still a potential problem). Our patience paid off, as we were able to fully participate in the Q1 2019 stock market rally. Our bond portfolios kept up with the market, despite being positioned for rising interest rates, not the falling interest rates that we experienced in Q1. We are positioned well for a rising interest rate environment and we believe that is what we will see between now and year end. At the end of the year, we will reassess the situation and will adjust our portfolios as necessary.

One of the bright spots in portfolio management is rising interest rates on short term deposits. For example, money deposited in regular savings accounts at Wells Fargo pay only .01% per year (per their website on 4/1/19). Money invested in a 90-day Wells Fargo CD yields only .10%. For clients wanting to hold a stash of cash and not invest it, we can buy 30-day U.S. Treasury Bills with that cash, which are currently earning about 2.40%! They are backed by the U.S. Treasury Department and considered to be the risk-free rate of return. We can roll them over every 30 days into new Treasury bills. We can also buy a Schwab money market mutual fund, which currently has an effective yield of about 2.34%. These funds are not FDIC insured. Both sure beat the next-to-nothing rates that Wells Fargo and other big banks are paying!

Talk With Us!

The very best part about being in the investment management/financial planning business is YOU! We love working with our clients. By and large, you are good hard-working people who saved well, lived within your means and entrusted everything you have accumulated to us for growth and safekeeping. Taking care of and building your wealth is an awesome responsibility that we all take very, very seriously. We talk about this responsibility all the time. It is our job to put your interest even before our own. It is our responsibility to make sure that we don't invest your money in anything we wouldn't or don't invest in ourselves. We are totally dedicated to helping you with all your financial needs so that you can meet your goals in life. Our purpose is to take care of your financial well-being.

One of the things that really pains us is when we see clients worrying about market drops, recessions, bear markets, yield curve inversion, the effects of government policies on earnings, and various geo-political crises, etc. We know that worrying is natural, and even healthy to a point, especially if it causes one to prepare by having a financial plan in place, an emergency cash reserve, and a diversified portfolio, etc. However, part of what you are paying us for is to take a great deal of that worry off you. Our team here has literally decades of experience and a whole slew of experts who support our efforts. We have a pretty good feel for who to listen to and who to ignore; for what matters and what doesn't. If financial worries are keeping you up at night, please let us help and **Talk with Us!**

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