Congress Asset Management Company

Economic and Market Outlook

First Quarter 2019

Fear and uncertainty gripped the financial markets as 2018 drew to a close. The litany of concerns seemed to grow longer as the quarter progressed. Investors reacted to repeated interest rate increases enacted by the Federal Reserve, trade policy negotiations, uncertainties over the federal government shut down, and foreign policy by de-risking their portfolios.

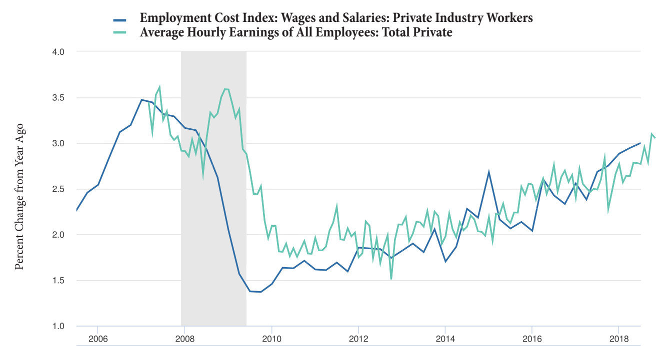
As we witnessed, global stock markets fell with the S&P 500 recording its worst quarter in a decade, down 13.5%. Oil was another casualty, dropping to lows not seen in four years. The bond market provided some solace as intermediate bond prices rose and the ten-year Treasury yield ended the year close to where it began, around 2.8%.

The depth of the 4th quarter swoon would suggest that the economy was stumbling into a recession. In our view, this is not the case. The case for economic Armageddon ignores strong employment trends, increasing capital investment, low inflation rates, and the benefits of de-regulation.

We remain in the midst of the longest economic expansion on record led by the salutary effects of full employment. More people are working in our country than ever before. Jobs are plentiful – we have more jobs available than unemployed people to fill them. Wages and benefits are rising steadily, putting money in consumers' pockets (fig. *1*). On an annual basis, income, spending, and savings all increased more than 4% in November, an unusual trifecta. Early indications of holiday spending suggest a robust season for retailers and gift recipients alike.

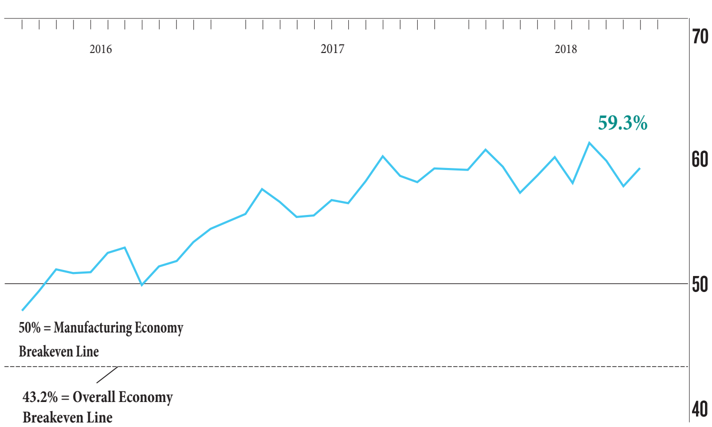
The consumer is supported by business spending. Through November, broad measures of economic health remained in expansionary territory. The Institute for Supply Management's (figs. *2 & 3*) two main readings remain solidly above 50. Business investment has been bolstered by last year's tax cuts and overseas cash repatriation. This is likely to continue as strong corporate profits and the tight labor market combine to encourage corporate spending, in turn enhancing productivity. Companies may be nervous regarding uncertain trade policies but the need to invest outweighs the rhetoric around tariffs. Forward looking measures, such as the leading Economic Index are at cycle highs (fig. *4*).

fig. *1* **Wages & Benefits** November 2018



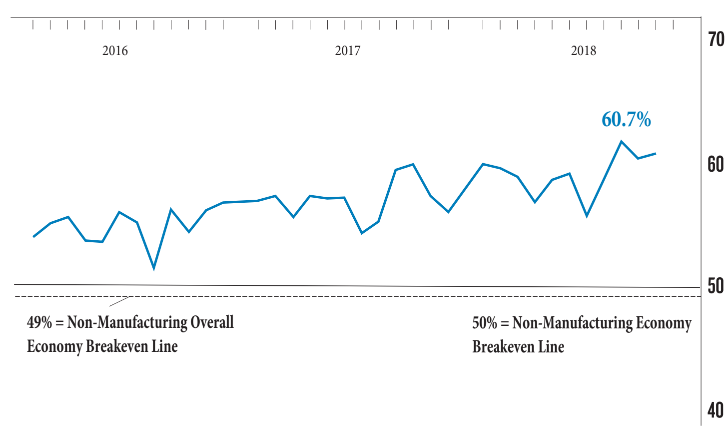
Shaded areas indicate U.S. recessions Source: U.S. Bureau of Labor Statistics

fig. *2* **ISM Purchasing Managers Index** November 2018



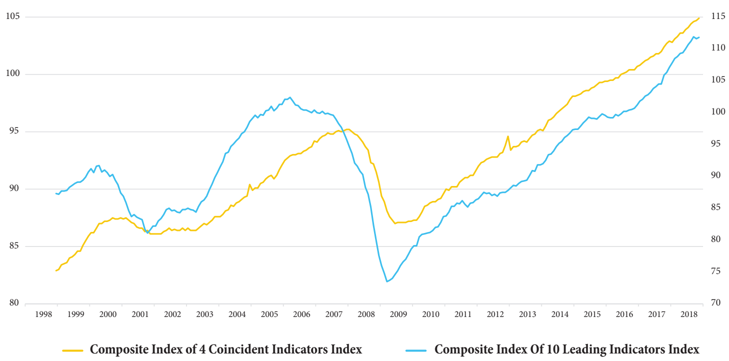
Source: FactSet

fig. *3* **ISM Non-Manufacturing Index** November 2018



Source: FactSet

fig. 4 **U.S. Leading Economic Index (LEI)** November 2018



Source: FactSet

Strong statistics aside, it is not difficult to discern the reasons for investors' confusion. Front and center are the actions, and in some cases commentary, from the Federal Reserve. Inflation, one of the Fed's two primary objectives, remains under 2%, and with oil prices falling, is unlikely to reach that mark in the near term. Still, the Fed forecasts more interest rate increases in 2019, potentially curtailing consumer and business spending as investment costs increase. The housing and automobile markets, both reliant on low interest rates, have already slowed.

Another proximate cause of market unrest is the ongoing negotiations to our trade policies. Bi-lateral agreements are taking precedence over broader, regional agreements. Negotiations with China are dominating the news and are as much about intellectual property protections as they are about tariff rates. The seminal movement to global trade began after World War 2 and accelerated with China's admittance into the World Trade Organization (WTO) in 2001. Increasingly, China has flaunted WTO guidelines and rulings to pilfer intellectual property at the expense of the U. S. and its allies. By introducing new trade restrictions now, the U.S., with the support of many allies, is forcing Beijing's hand to level the playing field. As the world's second largest economy, China is being held to its commitments. China's growth has clearly slowed, and a resolution would ease concerns about a broader global economic slowdown.

We are cognizant of the extreme volatility experienced in the financial markets. After a long bull market in stocks, investors are skittish. The economy remains on a solid path, however, and much of the consternation can be tied to policy uncertainty. But, as with most policy changes: trade, tax, fiscal stimulus packages, or interest rates, American businesses' will adapt and respond. The current expansion is unlikely to be derailed by headlines. Volatility will not go away but the consumer is stronger financially than at any other time this century and strong business trends should continue. Stocks are reasonably valued while bond rates offer a real return over inflation.

Investment Oversight Committee
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