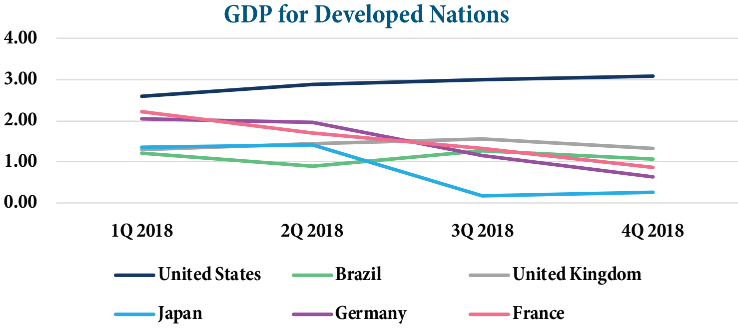
Economic and Market Outlook

Second Quarter 2019

Concerns regarding the strength of the global economy are increasingly dominating the thoughts and actions of central bankers worldwide and, by extension, the financial markets. Bankers, investors, and politicians are pulling out the stops to avoid a global recession. Their goal is made more difficult by continuing trade disputes highlighted by U.S. and China discord and protracted Brexit negotiations. Government actions aside, the U.S. consumer may be the most important factor in determining how the global economy fares over the next six months.

Anecdotal evidence is piling up that global economies have slowed. Interest rates in Europe have plummeted, highlighted by the German 10-year Bund sporting a negative yield in late March. Europe's malaise is bigger than just Brexit concerns. Manufacturing reports indicate that Germany and others are teetering on a manufacturing recession. Gross Domestic Product for most of Europe and other developed nations has stalled. Much of Latin America remains a quagmire with Brazil's fitful progress and Venezuela's socialism-induced depression plunging the country into prolonged periods without electricity.

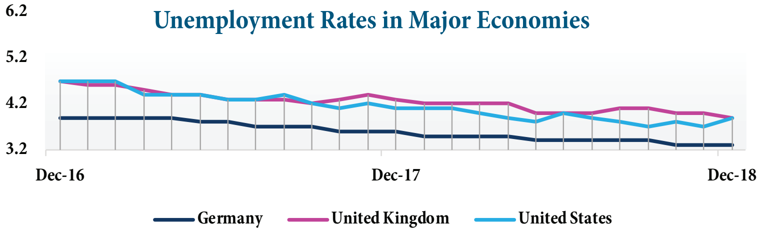
GDP for Developed Nations



Source: Factset

Recognizing the growth challenges and the lack of inflation, the European Central Bank (ECB) essentially ruled out any interest hikes this year. Offsetting the negative headlines, European employment has improved with unemployment rates in most economies trending down. It is at multi-decade lows in Germany and the U.K., yet both country's rates are still above U.S. levels.

Unemployment Rates in Major Economies



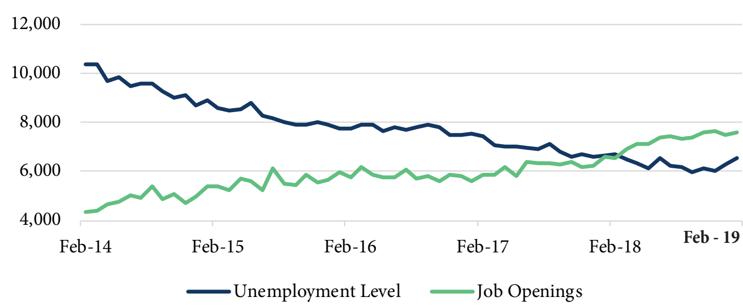
Source: Factset

China's central bank has been more aggressive. The candor with which the U.S. has attacked China's penchant for stealing technology has roiled China's export machine. In response, China has eased lending standards, lowered individual tax rates and the Valued Added Tax, and increased infrastructure spending. Perhaps anticipating prolonged negotiations with the U.S., China has increased contacts with the European Union, hoping to make inroads as U.S. policy has turned more inward and nationalistic.

The world's struggles have dented confidence in U.S. growth. Concerns surrounding trade, capital expenditures, and housing sales have mounted. The federal government's extended shut down dampened sentiment as January began. December stock market action was dismal, casting a shadow as 2019 dawned.

As negative economic reports increased, U.S. employment belied the trends and remained robust. The strongest employment economy in a generation is a powerful elixir for the slowdown in business investment. Low unemployment is a central reason we are confident that the U.S. consumer will continue to drive the economic expansion as 2019 progresses.

Jobs Remain Plentiful in the U.S.



Source: U.S. Bureau of Labor

The consumer represents 70% of domestic spending and is now the primary growth driver of the U.S. economy and the global economy. The employment situation remains the most important element for consumers. Job openings breached the 7.5 million mark in the latest report. Wage growth is hovering around 3.5% which helped create a new high in personal savings. Consumer debt relative to incomes is at lows not seen since the early 2000's. While consumer spending patterns can be inconsistent, the supporting data indicate that the consumer has the financial wherewithal to spend as the year continues.

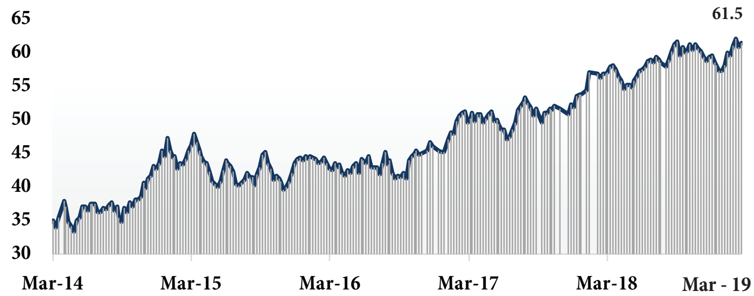
Indeed, the stock market's remarkable first quarter recovery likely reflects the strong employment trends and the Federal Reserve's (Fed) recent pivot in strategy. After raising short term rates in December, the Fed has deferred further rate increases and announced a more gradual plan to shrink its balance sheet. The new path indicates the Fed is concerned about the strength of the economy. In addition, inflation remains stubbornly below the Fed's preferred 2% target. The lack of inflation is noteworthy – it implies that the Fed has leeway to keep rates lower for longer, even if we are at full employment.

Economic expansions typically grow at inconsistent rates. What is unique to the current expansion is its length of 10 years and its relatively subdued level of growth. Notably, we have yet to experience robust growth in consecutive years. With the Great Recession still in our short-term memory, investor sentiment is fragile. Recognizing this, the Fed acted quickly and decisively, assuaging investor concerns.

Government support for the economy extends beyond the Fed. Federal government spending is up 9% over this time last year. This fiscal stimulus, while not as efficient as private sector spending, should help boost economic growth. However, it is deficit financed, demonstrated by the government outspending tax receipts by 30% in the current fiscal year, a large amount that seems to increase each year. The bi-partisan nature of federal spending suggests that this practice will continue pushing payment to future generations.

The decline in market interest rates (the yield on the ten-year Treasury has fallen to around 2.5%) reflects the lack of inflation, tempered growth expectations, and negative yields in much of Europe. U.S. fixed income securities offer rates and safety not available elsewhere. We view the low rates as an inducement to invest in U.S. assets more than a sign of an imminent economic collapse. The quadruple combination of a strong consumer, a responsive Fed, increased government spending, and low interest rates should help the economy overcome this global slowdown.

Bloomberg U.S. Consumer Comfort Index



Source: Factset

The U.S. remains the preferred investment destination as growth, albeit slower than a year ago, is faster than most of the developed world. Stocks are valued near historical averages with interest rates and inflation at generational lows. The fits and starts aspect of the global economy is likely to continue, but U.S. companies have proven to be agile and are poised to respond as the economy regains momentum.

Investment Oversight Committee
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