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Market Perspectives
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Introduction

"They always say time changes things, but you actually have to change them yourself."
– Andy Warhol

You may have already noticed that this looks different than the typical Market Perspectives. The subsequent pages will confirm those differences. To build on Andy Warhol's observation above, times have changed since we introduced Market Perspectives, and we are adapting as well. In doing so, we believe that it's time to make some changes in how we communicate with you. The 2018 Road Ahead provided some hints of what is to come, with a combination of web-based content (that can be easily accessed on mobile devices), video clips, and a supplemental written commentary. The use of multiple communication channels represented a marked departure from our prior efforts and reflected the changing nature of how we all communicate, while providing various options to meet a range of client preferences.

We are confident that you will find these changes to be a step forward, and are excited about bringing relevant content to you more quickly, directly, and through a variety of channels to meet your changing preferences.

In the interim, we wanted to share our current perspectives on a few relevant questions investors have today.

Blog

For other up-to-date economic briefs, visit PMFA's Market Perspectives Blog at **plantemoran.com/market-perspectives-blog**.

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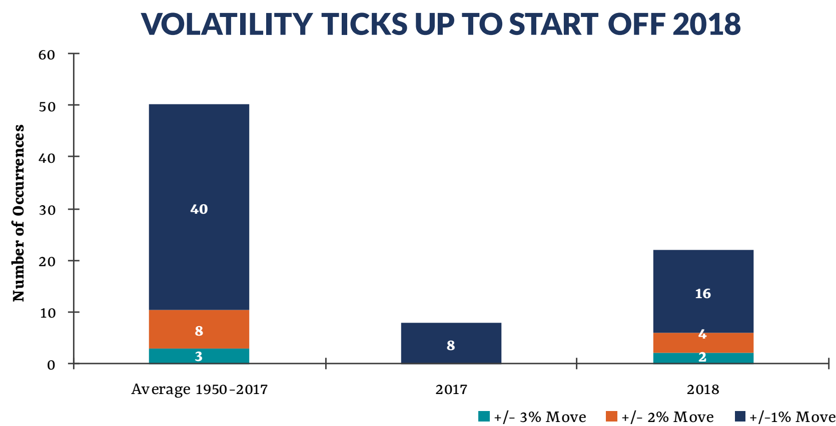
Is recent volatility "normal"?

Volatility has picked up considerably in the first quarter of the year, triggered by an inflation scare (prompted by the unexpectedly strong January jobs report) and fears of a potential trade war. Volatility has easily eclipsed the comparatively limited volatility of 2017; however, that was an unusually calm year by historical standards.



Source: PMFA, Morningstar

Since 1950, the S&P has averaged over 50 daily moves of greater than 1% each year, with about 20% of those exceeding 2%. In 2017, the S&P 500 posted a daily price move of greater than 1% only eight times – a fraction of what would have happened in a "typical" year. As illustrated, 2018 has already given us more moves of 1% or more than the entirety of last year.

As we've noted repeatedly in recent months, investors should be prepared for volatility to return to more normal levels, and should not anticipate a repeat of the placid markets of 2017. That doesn't mean that equity market returns will be negative; against the backdrop of a growing economy, there should still be solid tailwinds for equity markets in the near-term. However, the return to a more typical market environment could mean more volatility for equity investors moving forward.

Will tariffs spark a trade war?

There are more questions than answers today about the true scope and potential effect of the recently announced tariffs. The Trump administration recently announced tarrifs for about $50 billion of imported products from China, representing nearly 10% of China's total exports to the United States. China retailiated with an announcement of an equal amount of tarrifs on the total imports from the U.S. to China, representing nearly 39% of U.S. total exports to China, further raising the trade tensions between the two countries.

On any number of fronts, President Trump has demonstrated a preference for taking an aggressive initial stance for the purpose of creating a framework for future negotiations. Already, the Trump administration has quietly taken steps to blunt the impact of the previously announced tariffs on steel and aluminum, providing waivers to key allies, including the EU, Canada, and Mexico. Talk of a trade war can help to sell newspapers and drive ratings, but it is far from certain that such an outcome is inevitable. If the trade disputes were to escalate, it would pose the potential risk of higher inflation, slower economic growth, and greater overall uncertainty; however, the implications of the current tariffs are unlikely to meaningfully change the economic trajectory today. It's certainly a risk worth watching, but not one that has fundamentally changed the outlook for the economy at this point.

A lengthy expansion, but can it continue?

The expansion that began in 2009 is poised to enter its tenth year. From a historical perspective, the longest expansion on record in the U.S. lasted for 120 months, spanning from 1991 until 2001. Today, incoming economic data paints an optimistic story for continued growth in the coming quarters:

- Trend growth remains solid, despite a likely slowdown in Q1
- Job creation remains quite strong, with layoffs near 50-year lows
- Activity in the cyclically important manufacturing sector is also strong, with new orders (a key leading indicator) still robust
- Despite higher short-term rates, financial conditions remain quite positive
- Inflation and inflation expectations remain well anchored
- Various measures of the consumer mood remain very upbeat
- The global economy has experienced its most synchronized growth since before the onset of the financial crisis in 2008.

While a shock to the economy is always a possibility, given the strong outlook, the current expansion may be positioned to eclipse its previous record length.

With rates set to push higher, why hold bonds?

The inflation scare that was the catalyst behind the February stock market pullback is also the key driver behind bond returns year-to-date, which remain marginally negative. After surging to near 3.0% in the first five weeks of the year, the 10-year Treasury yield has been rangebound (2.8 – 2.9%) in recent weeks. The potential exists for rates to rise further, but consensus estimates are for the 10-year yield to reach 3.5 – 3.75% by mid-2020. If accurate, another 0.75% - 1.0% increase in long-term yields would certainly act as a headwind to bond returns, but a diversified bond portfolio could still provide a modestly positive return over such a timeframe even under those conditions.

Bond investors might find the recent uptick in rates and modestly negative returns unsettling. While most expect rates to continue to rise, the upside appears relatively limited against a backdrop of well-anchored inflation expectations and a global low-yield environment. Income generated by bonds will also help to offset the negative drag of rising rates, providing a floor under returns. In the meantime, bonds still provide an important source of income and act as a strong counterbalance to equity risk in a diversified portfolio.

What does this all mean for investors?

We remain cognizant of "what could go wrong" (and there is always risk), but are generally upbeat in our outlook on the overall economic, policy, and capital markets landscape. As always, it's critical for investors to make decisions that reflect their goals, objectives, and tolerance for risk over their investment time horizon. For most investors, that horizon in measured in decades, not weeks or months. Risks will come and go over time, but a well-conceived plan takes into account such risks (even if they can't be specifically predicted) and the volatility that they create (even if it can't be avoided). Therein lies the strength of having an investment policy and corresponding plan to navigate all phases of the market cycle, allowing you to position yourself to successfully achieve your long-term goals and objectives.

Disclosures

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