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Market Summary – March 4, 2019

For the week ending March 1

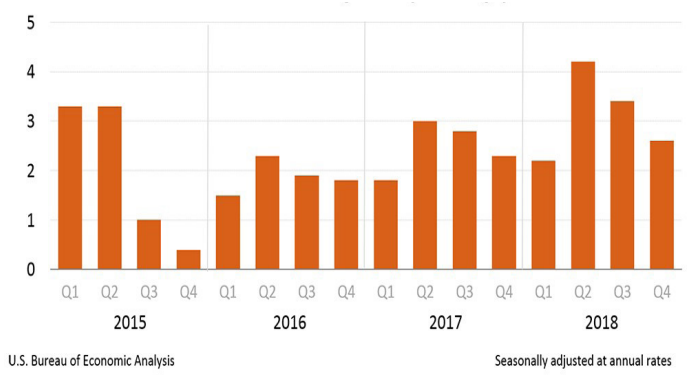
This summary is provided by BMT Wealth Management.

Macroeconomic Overview

Evidence that growth is slowing was further substantiated by last week's round of economic data releases. However, economic reports did not negatively affect financial markets. Housing Starts and Factory Orders missed consensus estimates. In addition, the Institute for Supply Management (ISM®) Manufacturing report released last Friday produced the lowest reading since November 2016.

The U.S. Bureau of Economic Analysis (BEA) released its initial real gross domestic product (GDP) estimate for fourth quarter 2018. While the +2.6% growth rate slightly surpassed consensus forecasts, we believe that peak growth has likely been reached for this business cycle. However, economic conditions have not deteriorated to the extent that makes a recession likely in the near-term.

Real GDP: Percent change from preceding quarter (2015-2018)



Source: U.S. Bureau of Economic Analysis

Coming into this year, we had concerns about an overly hawkish Fed and the pace of rate hikes. More recent comments from the Fed have been much more dovish and have helped to ignite a rally in financial markets. Another risk we cited was concern about further trade-related escalation between the United States and China. While no trade agreement has been finalized, it appears both countries are making progress with trade negotiations. Financial markets reacted favorably last week to news about the Trump administration electing not to raise tariffs on Chinese imports by the self-imposed March 1, 2019 deadline.

Financial Markets:
U.S. Equity Markets Grind Higher

The S&P 500 Index rose +0.46% last week and has now risen by over +12% for the year-to-date period ending March 1, 2019. The rally has been broad but has been more pronounced in higher beta (more volatile) sectors such as energy and industrials which notably lagged in 2018. More defensive sectors, such as utilities, health care and consumer staples, have lagged the broad market by a few hundred basis points thus far.

Another factor behind the stock market rally has been the operating performance of corporations. Earnings growth estimates have been falling but the actual deceleration of profit growth has been more benign than many investors had feared. Nearly all companies (96%) have reported fourth quarter 2018 earnings. Currently, the fourth quarter earnings growth rate, based on data provided by FactSet, Inc., is +13.1%, which marks the fifth consecutive quarter of double-digit profit growth.

Overseas, equity returns were mixed last week. Developed international markets (MSCI EAFE) rose +0.59%, while emerging markets (MSCI Emerging Markets) were the negative outlier, falling -0.65%.

Financial Markets:
10-Year U.S. Treasury Yields Trend Higher

On the fixed income side, U.S. Treasury yields marched higher across the yield curve, which steepened slightly. This helped temper some fears regarding yield curve inversion which has foreshadowed the last several recessions. The 2-year and 10-year U.S. Treasury yields rose seven basis points (+0.07%) and ten basis points (+0.10%) and ended the week at +2.56% and +2.75%, respectively.

High-yield credit spreads have been falling since the end of 2018. The chart below shows the spread (interest rate differential) between high-yield corporate bonds and 10-year Treasuries. While the rally in corporate credit has been impressive, the amount of corporate leverage, which has surpassed the levels seen before the 2008/2009 financial crisis, is still a concern we have going forward.

High-Yield Corporate Bond Spreads
(5 Years Ending 2/28/19)

Source: Federal Reserve Bank of St. Louis

Looking Ahead

The February 2019 employment report and news pertaining to trade negotiations between the United States and China will likely be the events that affect financial markets this week. A strong jobs report, especially combined with a strong wage growth reading, may force the Fed to take a more aggressive approach with the implementation of monetary policy.

The sharp rise in equity prices has offset most of the decline investors experienced in the fourth quarter of 2018. While stocks could continue to advance higher, given the strong short-term momentum that has been building in the markets, we think it is prudent to examine targeted asset allocations (mix of stocks, bonds, etc.) to ensure exposures align with investor risk tolerance levels.

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