Financial Advisory Service, Inc.

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FAS Monthly Economic & Market Update

May 2019

As of April 30, 2019

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Economic Conditions

The US economy grew at an annual rate of 3.2% in the first quarter of 2019 according to the advance estimate from the US Department of Commerce; much higher than expected given the headwinds of weakening consumer demand, lower earnings expectations, and being in the 10th year of the business cycle. Q1 GDP growth was the strongest first quarter growth in four years and came in significantly higher than most estimates, some of which were as low as 0.3% mid-quarter (Atlanta's GDP Now forecast). The New York Fed Nowcast estimates for Q1 ranged from as low as 0.8% to 2.4%. Much of the growth, however, was largely driven by increased exports, decreased imports, and rising inventories which helped offset the slower gains in consumption and business expenditures. Increased imports in the second half of 2018 in anticipation of higher tariffs contributed to the slowdown in imports in Q1. After removing those volatile categories that contributed to the higher than expected number, sales to domestic purchasers rose by half of what they did in Q4, increasing by 1.3% compared to 2.6%. However, unemployment continues to fall and wages continue to rise which point to continued growth as we get closer to the halfway point of 2019. Historically first quarter growth is the weakest quarter for the year, so while another quarter of 4% growth like we saw in Q2 2018 may not be conceivable, there's certainly a case to be made for accelerating growth in 2019.

Market Conditions

April was a fairly quite month with regard to the markets as earnings figures came in mostly positive for the quarter and economic activity continued to show moderate improvement relative to Q4 2018. Earnings reports were not nearly as bad as most feared with over 75% of S&P 500 companies reporting positive earnings surprise. First quarter earnings for the S&P 500 are expected to decline 0.5% on a year-over-year basis according to FactSet, which is significantly better than an expected decline of 4% on March 31. The S&P 500 returned 3.93% in April and is up 17.5% for the year. The Dow Jones and NASDAQ were up 2.56% and 4.74% in April and are up 14% and 22% for the year, respectively. Despite recent volatility in the markets due to trade tensions with China, the S&P 500's fair value may be somewhere in the 2,890s range assuming a 16x price-to-earnings ratio if the US and China can work out a deal and things get back on track. The Barclays US Bond Aggregate was fairly flat as rates ended the month roughly about where they began. Fed Chair Jerome Powell confused the markets with his statements as the Fed upgraded the economic outlook but downgraded the inflation outlook, potentially hinting towards the possibility for a rate cut by year end if inflation remains low which could be a positive for stocks. However, if inflation remains about where it is and growth slows causing the Fed to cut rates, that could end up being a negative for stocks.

Index Returns

	Apr '19	YTD
S&P 500	3.93%	17.51%
DJIA	2.56%	14.00%
NASDAQ	4.74%	22.01%
MSCI EAFE	2.46%	11.72%
Barclays Aggregate	(0.07%)	2.97%

More Trade Noise

What started out as a run of the mill tweet from President Trump last Friday has escalated to something materially more significant than originally expected as the President threatened to raise tariffs on $200B worth of Chinese imports to the US from 10% to 25%. The markets were rightfully spooked by this news last Sunday and the S&P 500 came off of its record highs and ended last week (5/10) down 2.18%. In an effort that seemed to be an attempt to expedite negotiations between the worlds two largest economies evolved into what is looking to be another tit-for-tat tariff trade war – something we've written about in past updates.

The markets experienced a bit of reprieve on Friday as no real negative news came out of negotiations. Stocks, however, continued their descent on Monday morning as they realized that while trade talks didn't collapse on Friday, no progress was made either. The S&P fell another 2.4% on Monday putting the index down 4.5% for the month, albeit still up 12.16% for the year.

On Monday Beijing announced they would increase tariffs on $60B worth of American imports only to have the Trump administration answer with a 142 page document detailing their plans to tax nearly every good imported from China. The $300B worth of goods on that list includes nearly every consumer good imaginable.

If no progress is made over the course of the next several weeks, this could become a more significant headwind for stocks as we head into the second half of 2019. Keep in mind the S&P is up over 14%

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More Trade Noise

for the year and even after Monday's down day, the index is still trading at almost exactly 16x forward earnings which is right about fairly valued. In order to see an upswing from here we will either need to see multiples expand from 16x to 17x – meaning that while forward earnings estimates remain the same, the S&P continues to rise from 2811 to maybe 2975 – or we will need to see forward earnings estimates increase, which is unlikely to happen if tariffs are to remain in place or move higher.

While economic conditions have improved since the end of 2018, the markets have largely priced in the positive news from recovering global growth, earnings surprises, and the potential for a rate cut from the Fed. So while it may take a full on trade war – which ultimately affects corporate earnings – or a significant slowdown in China to completely derail the current rally, there are still enough headwinds on the horizon to keep this market moving somewhat sideways for the time being. The bottom line is that we don't know what the future holds, but we do know fundamentals have not completely deteriorated. We've been reiterating for some time now that volatility was expected to return and it definitely has; and through similar fashion as it did in the past. However, we can't let every little tweet disrupt our investment strategies which is why diversification continues to be of utmost importance – just as it was six months ago in December of 2018.

Disclosures & Index Definitions

Under style performance boxes, indexes referenced in the equities section for large, mid and small reference the Russell 1000, Russell MidCap and Russell 2000 stock indices, respectively. The Barclays US Government, Barclays Credit and Barclays High Yield fixed income indices refer to Gov't, Corp, and HY, respectively. Short, Intermediate and Long refer to the time frame of the investments and their positions on the yield curve.

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All dates are as of April 30, 2019 unless stated otherwise.

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Index Definitions

The **S&P 500 Index** is based on the market capitalizations of 500 large companies whose stocks are listed on the NYSE and NASDAQ. This is widely regarded as the single best gauge of large cap US Equities.

The **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials. It is used as a barometer of how shares if the largest US companies are performing.

The **NASDAQ** is a market capitalization weighted index of the more than 3000 common equities listed on the NASDAQ Stock Exchange. These securities include American Depository Receipts, common stocks, real estate investment trusts, and tracking stocks.

The **MSCI EAFE (Europe, Australasia, Far East) Net Index** is recognized as the pre-eminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America, Europe, Australia, and the Far East.

The **MSCI Emerging Markets Index** captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 822 countries, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **Barclays US Aggregate Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS.

All index information has been gathered from public sources who are assumed to be reliable, although we cannot guarantee the accuracy or completeness of those public sources.