Turbulent Start to 2019

FNBC BANK&TRUST
WEALTH MANAGEMENT

This year has started off with a bang as market volatility from late 2018 continues.

Plunging treasury yields, particularly in the front of the curve, sent the spread between 10-year and 2-year U.S. Treasuries to 0.16%. The U.S. Treasury curve has not been this flat since the summer of 2007, six months before the Great Recession.

Flat yield curve consistent with a downshift, not a recession

In our view, the relatively flat yield curve does not portend a recession, but is consistent with a downshift in the global economic outlook against the backdrop of tightening financial conditions.

The bond market is sending Federal Reserve policymakers a clear message: No more rate hikes! When Fed policymakers meet at the end of this month we expect no change in the federal funds rate and will focus on potential changes to the Fed's balance sheet reduction program.

In contrast to gains in high-quality fixed income, investors found little solace in global equities thus far in 2019 as a weaker global growth outlook will likely spur downward revisions to corporate earnings estimates.

By comparison, as of December 31, Bloomberg consensus estimated 8.3% growth in earnings per share in 2018 with three-fourths of the year in the books. For 2019, the consensus still expects earnings growth of 8.3% despite peak U.S. GDP growth in second quarter of 2018, declining ISM data and slowing Industrial production reports from U.S., Euro Area, China and Japan.

Is Apple an indicator for other firms with international revenue sources?
Apple soured hopes of New Year optimism this week when the company lowered revenue forecasts for the first time in 16 years citing an unexpected decline in iPhone sales in China. Share prices promptly fell nearly 10% the first two trading days and raised the specter of additional negative surprises from other firms with international revenue sources.

Overall, the S&P 500 price index remains 16.5% off its all-time high reached in September 2018.

The full impact of tighter U.S. monetary policy following the December Federal Open Market Committee meeting has yet to flow through economic channels.

On Friday, January 4, at the American Economic Association in Atlanta, Fed Chair Jerome Powell said policymakers are not on a fixed path toward monetary policy normalization and will be patient to see how the economy evolves.

Expect elevated volatility in 2019

His statement gave stocks a much needed reprieve but we caution investors to expect elevated volatility in 2019. We continue to observe credit spreads and long-duration interest rates as barometers for investor risk sentiment.

We continue to believe that investors should be patient and adhere to a well-constructed, diversified investment portfolio anchored to your goals and time horizon. Despite elevated uncertainty, we do not find compelling reasons at this time that would justify overriding our asset allocation methodology.

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