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# First Quarter Commentary


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***Investors entered 2019 fatigued by the market turmoil that closed out 2018 and were face-to-face with what turned out to be a 35-day federal government shutdown. Concerns were plenty, ranging from tightening Fed monetary policy to Chinese trade relations. Providing relief to risky assets was the change in the tone of trade negotiations between the U.S. and China, as well as the sudden dovish pivot in Fed monetary policy. Initially, interest rates appeared to be range-bound, while equities and risk-sectors within fixed income rallied and mostly reversed their fourth quarter performance. Further supportive language from the Fed in March disrupted interest rate stability and drove 10-year interest rates briefly below 2.40%. As a result, the Bloomberg Barclays U.S. Aggregate Bond Index returned 2.94% for the quarter, its highest quarterly return since the first quarter of 2016.***

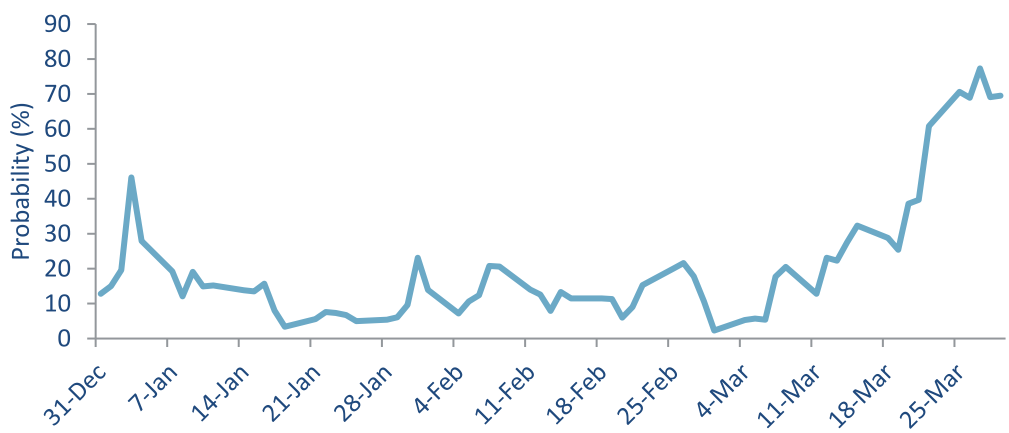
## The great pivot

Throughout 2018, the Fed did not stray from their plan to raise rates four times despite increasing political pressure, slowing global growth, and inflation trending below their target. Providing support to their plan were robust job growth, resilient domestic growth, and strong consumer and business optimism surveys. Acknowledging tightening financial conditions, the Fed did reduce 2019 rate hike expectations to two in December, but their desire to raise rates appeared to be undeterred.

With the release of the official FOMC statement in January, the Fed surprised investors by introducing the word “patient” into their strategy for interest rate policy. Although still confident in the strength of U.S. economic activity and the labor market, the Fed cited slowing global economic conditions, muted inflation pressures, and tighter financial conditions as the reasons for a pause in raising the target rate. Investors quickly translated this as a “risk-on” indicator and capital market returns were driven higher.

Further supporting, and again surprising, markets was the outcome of the March FOMC meeting. The Fed maintained their pause, which was widely expected, but the release of their “Dot-plot” is what garnered attention. This release pointed to zero rate increases in 2019 and only one by the end of 2020. This triggered a roughly 30 basis point decline in interest rates across the curve, pushing intermediate and long-term interest rates below some cash benchmarks. Additionally, the Fed announced their plan to conclude balance sheet reduction by September.

**Exhibit 1**: The probability of a rate cut by the Fed’s December 2019 meeting increased throughout the quarter




Source: Bloomberg

To illustrate the magnitude of the impact these actions had on the market, one can review implied interest rate change probabilities for the Fed’s target rate. At the end of 2018, there was a 77% chance of no change by the end of 2019. As of March 31, there was a 70% chance of a rate cut.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### U.S. growth returning to trend

While central bank policy certainly has been the focus this year, it is worth noting that economic metrics continue to point to expansion, albeit at a slower pace. After expanding 3% in 2018, consensus estimates have U.S. GDP growth moderating to 2.4%, while the Fed is expecting growth of 2.1%. This slowdown in growth has widely been anticipated as the benefits from the tax reform package fade. Positively, unemployment remains below 4%, surveys of manufacturing and non-manufacturing, although slowing, remain solidly in expansion territory, and consumer confidence is still elevated. With inflation stubbornly below the Fed target and interest rates falling globally, it appears there are strong forces at work preventing interest rates from breaking significantly higher. This should continue to support economic expansion.

As this long-running expansion continues, there are hazards that could jeopardize the slow and steady growth rates the U.S. has experienced. European growth has once again slowed, causing trepidation for the European Central Bank. German economic data is clearly slowing, while Italy has experienced two consecutive quarters of economic contraction. Furthermore, the U.K. is struggling to negotiate terms to leave the European Union. Looking further eastward, the impact of tariffs is reducing growth in China, resulting in efforts to support growth through various measures. There are early signs that growth has bottomed-out, and trade negotiations have taken a more positive tone, but investors are keenly focused on the potential impact on global trade if there is no resolution.

***As we look ahead, we believe growth will stay on trend in the U.S. and that a more accommodative Fed will further extend this period of expansion. We expect monetary policy to be a major focal point for the media and investors, with portions of the yield curve inverted and high implied probability of a rate cut by the end of the year. Additionally, we are mindful of investor perceptions and sentiment, which can cause significant swings in valuations as witnessed over the last six months. With yields of credit sectors recovering, we maintain our cautious view when investing and allocating portfolios as we attempt to limit the effects of negative price swings while creating the flexibility to seize on opportunities as they present themselves.***