The *Philadelphia* Story

A Quarterly Commentary on the Economy & the Financial Markets April 2019

From: *Philadelphia* Investment Management Group

OVERVIEW

- *U.S. Growth Should Slow to a Below-Consensus Range, With Lower Growth for the Eurozone*
- *U.S. Stocks Have Continued Their Sporadic Move Higher After the Short-Lived Dip in the Last Quarter of 2018*
- *Given the Slowdown Expected, the Fed is Now Forecasting No Rate Hikes in 2019*
- *While Slower Economic Growth is Expected in 2019, We Remain Conservative on the Outlook for Both Stocks and Bonds*

THE ECONOMY

As we entered the second quarter, markets have sustained their recovery from last December's sell off. Underlying fundamentals remain supportive of stronger growth in consumer spending in coming quarters. The labor market is strong, consumer confidence remains high and household balance sheets are generally healthy. The recent drop in mortgage rates has breathed new life into the housing market. Investment spending continues to grind higher and growth in government spending should be robust in the coming quarters.

There are some key points that should drive the economy forward. While the path for risk assets has climbed in the past quarter, we continue to see opportunities to take profits. The 10-year Treasury yield has fallen to a 15-month low, painting a mixed picture of global growth trends. The global economy must remain strong to quiet recession fears, and we believe this is happening. In the U.S., we look for growth to slow to a below-consensus 2.0-2.5% range, while for the Eurozone, we expect growth in the 1.0-1.5% range.

We would be remiss if we didn't mention China, the world's second largest economy, with its influence throughout the world and growing. Talks are underway and we are confident that some agreements will be reached with compromise on issues at hand.

The Federal Reserve is no longer in any rush to raise rates. The Federal Open Market Committee (FOMC) voted to maintain its target rate at 2.25-2.50%. All things considered, we did not see any real surprises in the latest release. The Fed's recent indications point to slower growth for household spending and business fixed investment. It looks like the FOMC is now expecting no hikes in 2019 and, potentially, only one in 2020. The Federal Reserve members are expecting slightly lower GDP growth in the short term, as well as slightly higher unemployment levels.

FINANCIAL MARKETS

EQUITIES

The U.S. mid-cap and growth segments stood out as top performers for the quarter. The 16.49% gain for the NASDAQ and 14.58% gain for the Russell 2000 supported this superior return versus the S&P 500 index of large capitalization companies, as shown in the following chart. Further, overall, U.S. stocks outperformed international stocks.

	Equity Returns*			
Index	**Jan**	**Feb**	**Mar**	**1st Qtr**
S&P 500	8.01%	3.21%	1.94%	13.65%
Dow	7.29%	4.03%	0.17%	11.81%
NASDAQ	9.74%	3.44%	2.61%	16.49%
Russell 2000	11.25%	5.20%	-2.09%	14.58%

*Total: price change + reinvested dividends

Equities posted mixed results in the first quarter, as reflected in the following table. Information Technology posted the best result of all the S&P 500 sectors, rising 19.86%, followed by a 17.53% gain for the Real Estate sector and a 17.20% return for the Industrials area. With the rebound in oil and gas prices in the past quarter, the Energy sector rose 16.43%. A further breakdown of the sectors into individual industries shows the semiconductor equipment industry leading the way for the Information Technology sector, with communications equipment a close second. In the Real Estate sector, real estate services led the way, followed by the industrial REIT area.

Sector	S&P 500 Weight*	Returns* 1st Qtr
• Energy	5.4%	16.43%
• Materials	2.6%	10.30%
• Industrials	9.5%	17.20%
• Cons. Discretionary	10.1%	15.73%
• Consumer Staples	7.3%	12.01%
• Health Care	14.6%	6.59%
• Financials	12.7%	8.56%
• Info Technology	21.2%	19.86%
• Communication Svcs	10.1%	13.98%
• Utilities	3.3%	10.84%
• Real Estate	3.1%	17.53%

While we see the overall market having a positive trend going forward due to both the Federal Reserve's hold on rate increases and better-than-expected news on the overall negotiations taking place in both Europe and Asia, it becomes increasingly important to invest carefully in areas that will benefit from the moderate increase in overall activity. Having said, investment in areas with as clear a forecast as possible is of utmost importance in portfolio construction.

FIXED INCOME

Bonds will continue to trade in a very narrow range. The Treasury curve has been flattening for several years, and we do not see this changing. The 30-year fixed rate has fluctuated little more than two basis points, while the 15-year fixed rate has declined by only one basis point. The very low rate of inflation, coupled with a somewhat sluggish economy, bodes well to hold interest rates at their low levels.

Base Interest Rates

	U.S. Treasury Yields				
	------ Maturity ------				
Date	3 mo.	2 yr.	5 yr.	10 yr.	30 yr.
Dec 31, 2018	2.35%	2.49%	2.51%	2.68%	3.01%
Mar 31, 2019	2.39%	2.26%	2.23%	2.41%	2.82%
Change:					
12/31-3/31/19	0.04%	-0.23%	-0.28%	-0.27%	-0.19%

Yields outside the U.S. have also been a factor in keeping our rates low. In addition, recent government and private data show weakness in housing, retail sales and consumer sentiment. This weakness will foster in higher growth in government spending to provide an offset to these subpar conditions.

The longer Treasury, corporate and municipal bonds outperformed the intermediate area in all cases. In fact, the lower BBB-rated corporates were the top performers for the quarter versus A-rated and higher. The enthusiasm following the Fed policy of, for now, holding the line on rate increases was felt throughout both the bond and stock markets. Investors comfortable that rates wouldn't be raised opted for lower quality debt instruments. We would hope this won't backfire in the future and our policy, nevertheless, is to stay with investment grade quality and shorter duration.

Fixed Income Returns

Index	1st Qtr
Corp/Govt	3.26%
Int. Corp/Govt	2.35%
Long Corp/Govt	6.17%
U.S. Government	2.18%
- Intermediate	1.57%
- Long	4.59%
Corporate	5.01%
- Intermediate	3.80%
- Long	7.85%
- Quality	
- AAA	4.98%
- AA	3.73%
- A	4.59%
- BBB	5.58%
Municipal	2.95%
- Intermediate	2.09%
- Long	3.49%

Source: BofA Merrill Lynch

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In summary, we believe the Fed's pause in tightening monetary policy remains the most important relief to financial markets. Tighter credit spreads, tame inflation, a recovery in equity markets and lower interest rates have collectively helped ease conditions. Earnings growth estimates for the first quarter will be handicapped by tough comparisons due to the tax cuts and JOBS Act, with a few companies, such as Apple and Micron Technology, struggling with company-specific issues. However, domestic stocks have recovered almost 20% since their lows on December 24.

From a technical standpoint, the momentum behind this rally has been historically strong. Furthermore, solid performance earlier in the year has historically led to strong full-year performance. Attractive opportunities still exist, but stock and bond selection have become increasingly important.

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