# Capital Market Review

## First Quarter 2019

*By Jack Peluso, Allegheny Research Team*

After an unexpectedly severe fourth-quarter correction, the markets were rewarded with a solid snapback to start 2019. We credit a large portion of the previous quarter's volatility to negative sentiment and believe the quick reversion can likely be attributed to a combination of factors (most of which directly addressed areas of uncertainty).

First, the 35-day federal government shutdown (the longest in U.S. history) was partially resolved in late January, and following the passage of new funding bill in February, the prospects of yet another shutdown have officially been delayed (keep in mind, this bill only keeps the government funded through September). Secondly, heading into 2019, the Fed (or FOMC, "Federal Open Market Committee") seems to have adopted a much more dovish stance. It also became apparent that Fed Chairman Jerome Powell takes his cues from the markets. After being consistently criticized for several months, it ultimately took an adverse reaction from the marketplace to lead the Chairman to pause. Additionally, the Fed just announced a plan to end its balance-sheet unwinding process by September of this year, which will be three months earlier than expected.

Another (somewhat unsurprising) factor that played into the first quarter snapback was the continuation of strong underlying fundamentals here in the U.S.; Despite falling off from last year's record-setting figures, stock earnings still look strong. According to FactSet, 78% of companies who have reported Q1 earnings have come in with EPS above estimates (which is above the five-year average). The trailing GDP growth for the fourth quarter also fell off slightly as compared to 2018, but remained positive, coming in at 2.2% (versus a 2.7% forecast). Consensus forecasts remained around 2% going into 2019; however, actual GDP growth for the first quarter came back more than a full percentage point higher than expected (increasing by 3.2%). We believe it's important to keep in mind, even 2% GDP growth (relative to the rest of the world) is certainly nothing to sneeze at.

Along with positives here in the states, inflation remains low around the globe, and there has been improving economic news coming out of China (a major positive for global growth) — aside from the general expectation of a trade agreement with the U.S., China has recently announced improved PMI data, as well as an additional stimulus for the upcoming year.

First-quarter optimism aside, there is certainly no shortage of uncertainly looming in the market. It's likely you've heard about a few of the potentially worrisome issues that remain or have recetly come about. In our opinion, these are several of the more noteworthy topics currently catching headlines:

- A brief yield-curve inversion occurred during the fourth quarter
- The unresolved trade/tariff war between the U.S. and China
- The ongoing pattern of political friction in the United States and other countries around the globe
- The impending worry of the next recession
- The strength/weakness of the U.S. dollar
- U.S. government debt levels
- The U.S. 2020 presidential election
- The unresolved Brexit vote
- Oil prices/price direction
- Climate change, etc.

We view some of these topics as much more relevant (and potentially impactful) than others, especially as they relate to our industry. Remember, underlying fundamentals such as earnings and valuations, as well as things like interest rates and inflation, will ultimately drive the markets long-term. Geopolitical issues, while they may cause some temporary angst, generally won't have lasting effects on the markets. The same thing can be said for sentiment, and while this long-term view is important to remember, that doesn't mean these things can just be overlooked entirely. After all, keep in mind just how much sentiment-related issues can move the markets; as we suggested previously, much of the fourth quarter's volatility can be attributed to uncertainty surrounding only a handful of factors. We know all too well that the markets hate uncertainty. Uncertainty leads to fear; fear leads to negative sentiment, which in turn may cause a pullback in stock prices (given that underlying fundamentals remain the same). We will touch on some of the topics mentioned above briefly, sticking to those that seem the most relevant, as we review first-quarter performance across both equity and fixed-income markets.

## STOCK MARKET

It seems that our fourth-quarter review proved prescient as we posited, "The sharp pullback is a concerning factor, but ultimately, we don't believe it was the start of the next recession. Considering the continuation of strong underlying fundamentals, ***a snapback is generally expected.***"

Looking across all (seven) of the major market averages, we can see that a general reversion has either taken place already or is taking place as we speak. Using the S&P 500 as a proxy, U.S. large-cap stocks saw essentially mirrored results as compared to last quarter, with the index finishing the three-month period up 13.7% (versus a -13.5% drop last quarter). The bulk of the first-quarter rally came during January with the S&P up over 8%, while returns for February and March came in much more tempered, with the index gaining 3.2% and 1.9% respectively.

Returns for the other major market indices followed a very similar trend for the three-months ending 3/31/2019, with each index producing positive quarterly returns as compared to the (entirely negative) results we witnessed last quarter. The D.J. Industrial Average was up 11.8% (versus a -11.3% drop last quarter), while the Russell 2000, an index representing the stocks of small companies, was up 14.6% (versus a -20.2% decrease previous quarter). The MSCI EAFE and MSCI EM indices, which represent international stocks from developed and emerging countries, finished the quarter neck-and neck with gains of 10.0% and 9.9% respectively (versus last quarter's losses of -12.5% and -7.5% respectively). The D.J. U.S. Select REIT, an index representing U.S. real estate companies, led the way this quarter with a 15.7% gain (versus a -6.6% loss last quarter), while the Bloomberg Commodity index returned 6.3% over the three-month period (versus -9.4% during the previous three months).

### Index Returns as of 3/31/2019

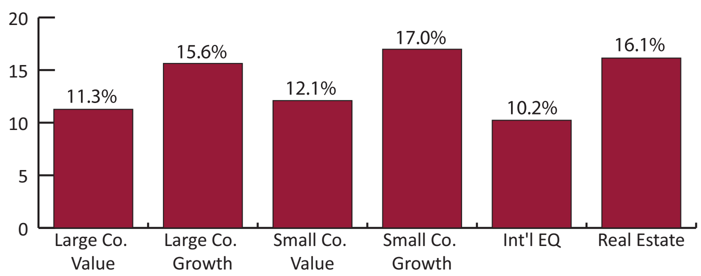
| | 3 months | 6 months | 9 months | 12 months |
|---|---|---|---|---|
| S&P 500 | 13.65% | -1.72% | 5.86% | 9.50% |
| Dow Jones Industrial Avg | 11.81% | -0.84% | 8.71% | 10.09% |
| Russell 2000 | 14.58% | -8.56% | -5.29% | 2.05% |
| MSCI EAFE | 9.98% | -3.81% | -2.51% | -3.71% |
| MSCI Emerging Markets | 9.91% | 1.71% | 0.60% | -7.41% |
| DJ US Select REIT | 15.72% | 8.08% | 8.86% | 19.73% |
| Bloomberg Commodity | 6.32% | -3.68% | -5.63% | -5.25% |

Looking at the index returns as of March 31st, we can see evidence of both the fourth-quarter sell-off as well as the first-quarter rally. Factoring in Q4 of last year, the six-month time period saw the worst results overall (as we would expect), with only two (out of seven) of the major market averages being able to make up enough ground during the first three months of the year in order to drag their six-month returns out of the red. The D.J. U.S. Select REIT (up 8.1%), and the MSCI EM (up 1.7%) finished March with six-month gains, despite losing over 6% each during the final quarter of 2018. On the flipside, despite posting substantial first-quarter gains (four out of five had double-digit increases), the remaining averages could not wipe out their fourth-quarter losses – the S&P 500, DJIA, Russell 2000, MSCI EAFE, and Bloomberg Commodity all finished the quarter with six-month losses. Though most averages still came in negative during the six-month time period, returns were notably improved across the board (as compared to the previous quarter).

Things continue to look better as we incorporate the second and third quarters of 2018, with four (out of seven) market averages producing positive results for both the nine- and twelve-month periods ending 3/31/2019, and just as we saw with the other time periods, all indices showing improved results (as compared to the previous quarter).

### Comparison of Equity Styles

*3 months ended 3/31/2019*




All equity styles increased during the first three months of the year, reversing course entirely from the rocky fourth quarter. Remember, last quarter we observed negative returns for each style across all periods (due primarily to the sharp drop we experienced during Q4). Despite posting strong gains through the first three months of 2019, five (out of six) styles were unable to erase their fourth-quarter losses. Real Estate was the only area that managed a six-month gain, thanks to a relatively modest decline in Q4 followed by a significant gain to start the year.

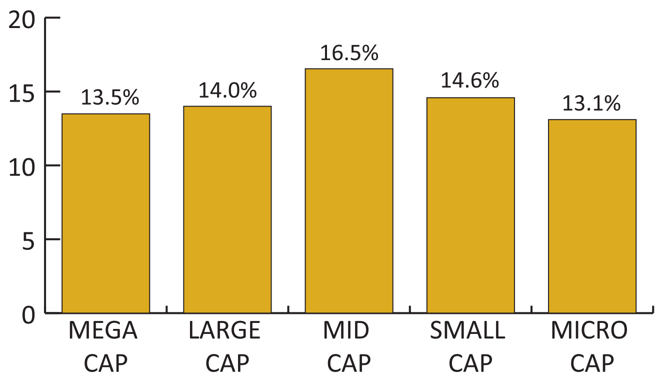
As we saw in the major market averages, overall results improve as we extend our scope further; three (out of six) equity styles produced nine-month gains (Large Value, Large Growth, and Real Estate), while four (out of six) produced annual gains (with Small

Growth joining the aforementioned three). Primarily, the following trends can be observed: growth stocks outpaced value, small stocks outperformed large, and domestic stocks led international.

With regards to the value/growth trend we've witnessed over the past few years, we questioned last quarter, "was the fourth-quarter reversion the start of something bigger, a long-term correction perhaps? Or, simply a short-term shift brought on by an unusually volatile period?" Well, it would appear (for now) to be the latter, as growth companies reclaimed their dominance during the first-quarter, outperforming their value equivalents across all four periods (the three, six, nine, and twelve months ending 3/31/2019). As we discussed during previous reviews, some of our managers have been attributing the extended value/growth trend to what they call the "momentum effect." Mainly, these managers maintain the view that the ongoing upswing in stock prices has evolved into a momentum rally that is significantly disconnected from underlying equity fundamentals. We would generally tend to agree with this assessment, and as such, ultimately believe this trend will reverse course. However, as we cautioned last quarter, predicting inflection points is nearly impossible. As firm believers in reversion to the mean, we encourage all our advisors to continue thinking long-term, and empirical evidence supports value outperforming growth over the long-term.

## Return by Market Cap

*3 months ended 3/31/2019*




Looking at returns broken down by market cap grouping, much like we observed with the various equity manager styles, the impact of the first-quarter rally applied universally. As compared to Q4, returns across the entire market cap spectrum showed improved results during all four periods (the three, six, nine, and twelve months ending 3/31/2019). Unlike the equity styles, not even one market cap segment managed to produce a first-quarter gain significant enough to white-out their fourth-quarter loss, as all five segments finished the six-month period in the red.

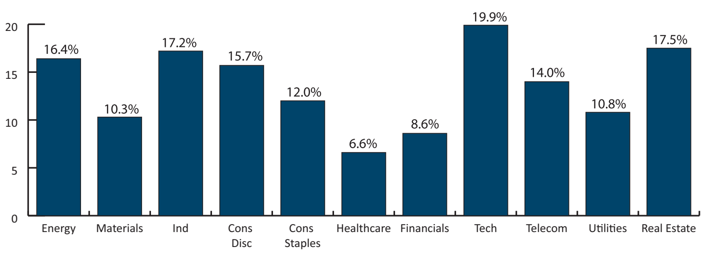
Once again, despite being exclusively negative, six-months results came back dramatically improved across the board (as compared to the year-end figures). Just as we noticed within both the major market averages and equity manager styles data, overall results improve as we extend our time horizon beyond the fourth quarter of 2018. Three (out of five) market cap segments produced nine-month gains (Mega-caps, Large-caps, and Mid-caps), and four (out of five) segments produced annual gains (the Small-cap segment landed in the black, while Micro-caps remained in the red).

One of the trends we observed in the previous section (smaller stocks generally outperformed larger when looking across all four time periods) is evidenced here as well. We can see a pattern of cascading returns (going from higher to lower) as we look across the market cap spectrum (going from larger to smaller). There are a few deviations that can be found in the three-month figures. For example, Mid-caps led the pack, while Small-caps outperformed both Large and Mega caps. However, this pattern is expressed precisely in the six-, nine-, and twelve-month periods ending 3/31/2019.

***Index Representation:*** *Mega-caps (Russell Top 50 Index), Large-caps (Russell 1000 Index), Mid-caps (Russell Mid Cap Index), Small-caps (Russell 2000 Index), and Micro-caps (Russell Microcap Index).*

## Stocks by Sector

*3 months ended 3/31/2019*



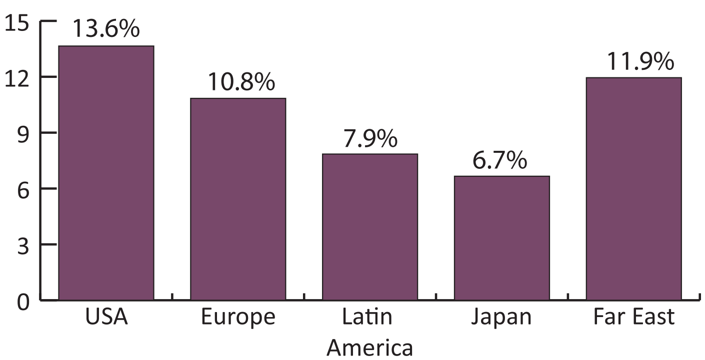

With Real Estate being separated from the Financials sector during 2017, the S&P 500 Index now has eleven sectors. These sectors, along with their quarter-end weighting in the index [as of 3/31/2019] are as follows: Energy 5.4%, Materials 2.6%, Industrials 9.5%, Consumer Discretionary 10.1%, Consumer Staples 7.3%, Healthcare 14.6%, Financial Services 12.7%, Technology 21.2%, Communication Services 10.1%, Utilities 3.3%, and Real Estate 3.1%.

Continuing on trend, all eleven of the individual S&P sectors effectively took part in the first-quarter rally. This can be seen by the (primarily double-digit) gains produced by each sector during the three months ending 3/31/2019.Healthcare and Financial Services played the laggards for the quarter, finishing March with three-month gains of 6.6% and 8.6%, while the other (nine) sectors gained 10-20% each. Similar to what we've observed in the other sections, despite strong results to start the year, only two sectors produced large enough gains in the first quarter to wipe-out their losses from the fourth. Only Real Estate and Utilities managed increases over the six months ending 3/31/2019 (keep in mind, Utilities proved impervious to the fourth quarter volatility, so the bar to clear was much lower here). Unsurprisingly, just like we've seen in each section so far, as we push our start date further and further back, overall results look better and better. Eight (out of eleven) sectors produced nine-month gains (while the Energy, Materials, and Financial Services sectors produced nine-month losses), and nine (of eleven) sectors produced annual gains (while the Materials and Financial Services sectors remained in the red).

As a reminder, the GICs sector methodology was recently updated, and the old "Telecom" sector officially replaced the new "Communication Services" sector. Also, stocks from both the Technology and Consumer Discretionary sectors have been repositioned, resulting in nearly $3 trillion in market capitalization movement. Research distributed an exhibit explaining this change in detail, but to summarize (according to CIGs) the changes to the sector name and broadening of the sector are a result of changes in how communication occurs. While Telecom has traditionally been a defensive higher yielding sector, these changes will lead to higher beta names [such as Alphabet and Facebook] becoming the largest weights in the sector.

## Stocks by Region

*3 months ended 3/31/2019*




Looking at average stock market returns across five main regions [USA, Europe, Japan, Latin America, and the Far East] we can see the first-quarter rally was not merely limited to the United States. All five regions finished March with three-month gains. Taking it a step further, only one region (out of the 16 total that we currently track on the Market Review at a Glance, or MRAGG) finished the quarter in the red, with Argentina dropping -2% over the three months. Given the shifting attitude/direction of the FOMC, this change should not be all that surprising. Consider for a moment how the U.S. dollar has impacted returns in these regions over the past several quarters —a strong dollar is a clear headwind for international equities.

Additionally, areas that are heavily influenced by their relationships with China (like Japan and the Far East for example) are breathing a sigh of relief to start the year as well, with markets already pricing in a resolution to the ongoing trade/tariff war between the U.S. and China. However, if a resolution does not come (and quickly), we believe that this alone has the potential to cause major problems around the globe. Another (somewhat similar) expectation that is also being priced-in to the markets, a soft-Brexit,* which likely contributed to the first-quarter bump as well.

The United States (as represented by the S&P 500) rose by double-digits during the trailing three-month time period (13.7%), dropped slightly over the six months (-1.7%), increased over the nine-month period (5.9%) and rose again during the trailing twelve (9.5%). Europe (as represented by the MSCI Europe) also reversed course in Q1, riding the wave of a soft-Brexit-expectation that seeimingly reemerged following a particularly rough fourth quarter. Europe produced a strong three-month gain (10.8%), while six-, nine-, and twelve-month results came back consistently negative (-3.3%, -2.5%, and -3.7% respectively) as one might expect given a more uncertain economic backdrop. Results from Latin America (as represented by the MSCI EM Latin America) provide an excellent example of this region's overall volatility; results were near the bottom of the group during the trailing three and trailing twelve months (up 7.9% and down -6.7%) but led the way during the six- and nine-month time periods (up 8.2% and up 13.4%).

Both Japan (as represented by the MSCI Japan) and the Far East (as represented by the MSCI AC Far East Ex-Japan) are two regions significantly tied to the Chinese economy. Given the escalation of tensions between the U.S. and China over the past several quarters, and (more recently) a full-on trade/tariff war, it shouldn't be surprising to see negative returns coming out of these regions. Considering the general expectation of a resolution, it should also come as no surprise to see these regions rebounding to start the year. The Japanese region finished the quarter with a three-month gain (6.7%) and six-, nine-, and twelve-month losses (-8.5%, -5.2%, and -7.8% respectively), whereas the Far East finished the quarter with three- and six-month gains (12.0% and 0.9%), and nine- and twelve-month losses (-0.6% and -6.4%).

***Soft-Brexit defined:*** *a Brexit (or British exit from the European Union) in which the United Kingdom's relationship with the European Union (EU) would remain as close as possible to what it was previously. In this scenario, Britain would officially be out of the EU, but would still retain strong economic ties, continue to make budgetary contributions, and allow free movement of people.*

Please note, all data is quoted in **U.S. Dollar terms**, any change in currencies may therefore influence actual returns.

## BOND MARKET

The bond market in general (as represented by the Bloomberg Barclays Aggregate Bond Index) managed to produce improved results as compared to the previous quarter. The Aggregate index increased at a respectable rate during all four periods (the trailing three, six, nine, and twelve), finishing the first quarter with increases of 2.9%, 4.6%, 4.7%, and 4.5% respectively.

As we remarked last quarter, “We would expect the Fed to revert to their former, overly cautious & heavily data-dependent, approach during the near future.” This would prove to be the case, as the Fed has seemingly adopted a much more dovish stance following the fourth-quarter pullback, making Q1 the first quarter without a rate hike since the third quarter of 2017. In addition to announcing a clear intention to pause on additional rate hikes, the FOMC also stated their intention to end their balance-sheet-unwinding process by September (which is three months earlier than expected). These announcements not only acted as a tailwind for the equity markets but aided the performance of fixed-income securities as well.

Despite these positives, the Fed’s new stance is just not cutting it in the eyes of the current administration, as the White House continues to berate the new Fed Chairman (and in turn, continues to ignore the failures that have been caused by this type of interaction in the past). One is still left to wonder whether Powell’s controversial comments in September were more about proving the Fed’s independence than an accurate forecast of their actions, especially considering how quickly he stepped those comments back after the markets reacted poorly.

More recently, the administration has ramped up their critical comments, calling for an immediate 100 basis point cut to the Fed funds rate (along with additional stimulus measures). A decrease at this time, especially of that size, is a measure that we believe would be extremely irresponsible, and given Powell’s comments at the most recent meeting, it also seems extremely unlikely. The CME group is currently predicting the probability of a rate-hike at 0% through January of 2020. As we’ve asserted before, President Trump views the performance of the U.S. economy and U.S. stock market as an arbiter of his success. He wants 4% GDP along with a thriving stock market. Increased spending, talking down the dollar, and even firing Powell seem to be options the President is considering. In our opinion (which was mirrored by recent comments from the Fed, as well as other industry pundits), the U.S. economy doesn’t require further stimulus. Taking additional measures at this point may even result in an economy that ends up overheating. Look at the following fundamentals:

- Interest rates are hovering near all-time lows
- Unemployment is near 50-year lows
- GDP growth is near 3%, and
- Inflation concerns are being viewed as “transitory” (or temporary).

## Inflation as of 3/31/2019

| | 1 MO | 3 MO | 6 MO | 9 MO | 12 MO |
|---|---|---|---|---|---|
| The Consumer Price Index (CPI) | 0.6% | 1.2% | 0.7% | 0.9% | 1.9% |

These fundamentals equate to an economy that has little chance of falling into a recession over the near-term. This also adds up to a small chance of a rate cut in the near future, or any other monetary stimulus for that matter.

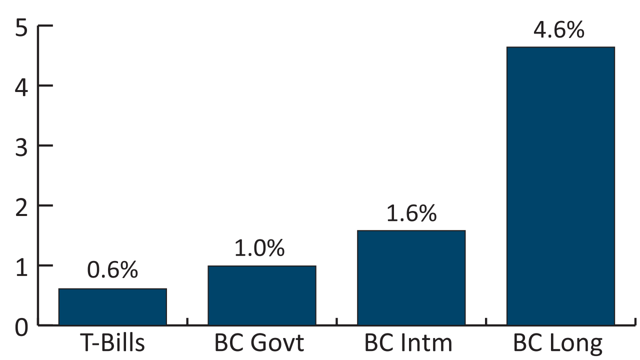
If we assume firing Powell is improbable, there are two other avenues the administration might be more likely to take to further boost the economy; firstly, a trade deal with China. At this point, an agreement between the U.S. and China has essentially been priced-in to the market, with the general expectation that this will occur before the end of the year. However, with no official/tangible progress to be seen, we are viewing the downside risk associated with a deal not happening as far greater than the potential benefits associated with a deal going through. All things being considered, we believe this deal needs to happen soon.

The second avenue, which hasn’t already been priced-in, is the possibility of additional fiscal stimulus. Any such measures would be a clear positive for the markets (near-term) but, considering we have a $1 trillion deficit in a fully-employed economy, there are certainly negatives associated with increased spending. Regardless, deficits do not seem to matter in Washington, thanks primarily to the insatiable global demand for U.S. (treasury) paper, which has also worked to keep interest rates low.

Looking forward, until inflation increases more significantly, rates will remain unusually low, and politicians will continue to increase spending. One risk, of course, is the possibility of inflation spiking due to the exceptionally tight labor market. As we alluded to previously, another potential issue related to additional spending (and one that seems to go completely unnoticed for the most part), is the future servicing cost of this debt. This problem could quickly come to a head early next decade. However, in today’s ultra-low interest rate environment, politicians aren’t focusing on debt-servicing since most of them will be out of office before the issue turns into a full-blown crisis.

## Bonds by Maturity

*3 months ended 3/31/2019*



U.S. Treasury yields remain low in 2019, clearly acting as tailwinds for bond markets during the first quarter. One potentially concerning factor, as the media was quick to point out, is that the yield curve inverted at the end of the quarter. The 90-day yield moved briefly above the 10-year inverting this curve slightly, but that is no longer the case. As of 3/31/2019, the 90-day yield was 2.40% while the 10-year yield was 2.41% (this spread has only widened since, with the 10-year yield now cresting 2.55%). Also, the 2-year yield has remained consistently below the 10-year, so this spread is also not inverted. The FOMC seems to prefer looking at the 90-day / 10-year spread, but experts are generally split as to which yield curve is the most reliable indicator. The 3- and 5-year curve inverted in December, it merely received less publicity. Pundits seemed to shrug off the more recent inversion just as quickly as it came (and went), and we agree with that assessment. Typically, if history is an accurate guide, a curve inversion needs to be much longer (approximately ten weeks) and much more meaningful (approximately 15 basis points) for it to provide a sound bearish signal. Even if/when they gave a warning, inversions have preceded recessions by about two years on average.

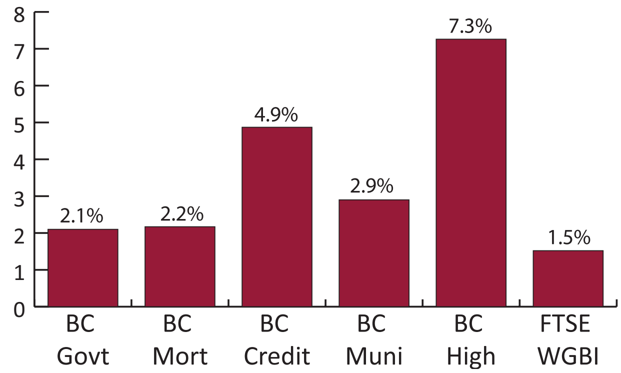
| Treasury | 3/31 2019 | 12/31 2018 | 9/30 2018 | 6/30 2018 | 3/31 2018 |
|---|---|---|---|---|---|
| 90 Day | 2.40% | 2.45% | 2.19% | 1.93% | 1.73% |
| 2 Year | 2.27% | 2.48% | 2.81% | 2.52% | 2.27% |
| 5 Year | 2.23% | 2.51% | 2.94% | 2.73% | 2.56% |
| 10 Year | 2.41% | 2.69% | 3.05% | 2.85% | 2.74% |
| 30 Year | 2.81% | 3.02% | 3.19% | 2.98% | 2.97% |

Government bonds are commonly the most sensitive to interest rates changes (all else held equal, rate-decreases will typically produce a positive impact, while rate-hikes cause the opposite effect). It should come as no surprise then, with interest rates falling across the board, to see the various maturity sectors of the government bond market finish up the first quarter with entirely positive results during all four periods (the trailing three, six, nine, and twelve months ending 3/31/2019). Additionally, as is the case with any bond, when maturity extends, the sensitivity to rate changes increases. So as we would also expect, longer-maturity sectors outperformed shorter-maturity sectors exclusively during the quarter.

Long government (as represented by the Bloomberg Barclays Long Government Index) led the group across all four periods, producing three-, six-, nine-, and twelve-month gains of 4.6%, 9.0%, 5.9%, and 6.2% respectively. The pattern of positive returns remained the same, but the magnitude of returns drops as we slide down the maturity spectrum. Intermediate government (as represented by the Bloomberg Barclays Intermediate Government Index) was up 1.6%, 3.8%, 3.7%, and 3.8% over the trailing three, six, nine, and twelve months. Meanwhile, short government (as represented by the Bloomberg Barclays 1-3YR Government Index) followed closely behind, with gains of 1.0%, 2.3%, 2.5%, and 2.7% during those same periods. U.S. Treasury Bills (last year's top performer) fell back to reality, coming in with modest gains across the board. T-Bills rose 0.6% during the three months, 1.2% during the six months, 1.6% during the nine months, and 2.1% during the trailing twelve.

## Bonds by Sector

*3 months ended 3/31/2019*




Looking at the bond market by sector, we can see more evidence that bond markets participants reacted positively during the first quarter. All (six) major areas of the bond market saw positive results during the more recent quarter, and five (out of six) areas produced improved results across the board as compared to their year-end positions. Only U.S. government debt, though positive during the quarter, did not show marked improvement from the previous period.

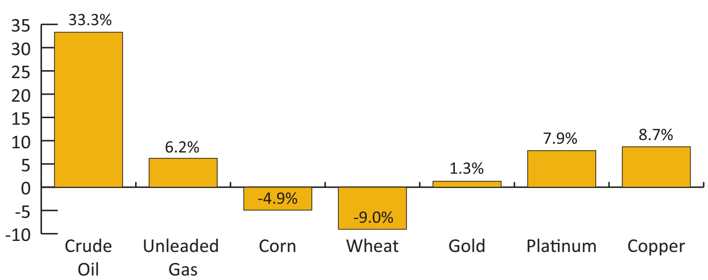
Following a credit sell-off in late 2018, U.S. corporate credit (specifically U.S. high-yield) was buoyed in early 2019 as credit spreads tightened, supported by the Fed's more dovish stance. High-yield credit not only saw the most significant improvement but subsequently led all other sectors of the bond market gaining 7.3% during the first quarter (as compared to a drop of -4.5% during Q4). The first-quarter rally was more than enough to make up for the fourth-quarter sell-off, as highyield sector finished March with a six-month gain of 2.4%, a nine-month gain of 4.9%, and twelve-month gains of 5.9%. U.S. credit also bounced back nicely, gaining 4.9% over the first quarter (versus a flat return over the fourth quarter). Thanks to three-month bump, U..S credit also posted six-, nine-, and twelve-month gains (4.9%, 5.8%, and 4.9% respectively) as of 3/31/2019.

The U.S. government and U.S. mortgage sectors finished the quarter neck-and-neck, gaining 2.1% and 2.2% respectively. These two sectors produced similar results across the other time periods as well (the six, nine, and twelve months ending 3/31/2019) with U.S. government bonds gaining 4.7%, 4.1%, and 4.2% respectively, while U.S. mortgage bonds increased by 4.3%, 4.2%, and 4.4% over the same time periods. Municipal bonds led both government and mortgage-related bonds across three (out of four) periods but could not outpace government over the trailing six months. Returns for the municipal sector came in as follows: three-month gain of 2.9%, a six-month gain of 4.6%, a nine-month gain of 4.5%, and twelve-month gain of 5.4%. Despite outpacing U.S. HY during the six-month period, up 2.9% (versus 2.4% for HY), world-government bonds played the laggard during the other three time periods, up 1.5% during the trailing three months, up 0.6% during the trailing nine months, and down -4.5% over the trailing twelve months.

**Index Representation:** U.S. Credit (Bloomberg Barclays U.S. Credit), U.S. High Yield Credit (Bloomberg Barclays U.S. Corporate High Yield Index), U.S. Government (Bloomberg Barclays U.S. Government Index), U.S. Mortgage (Bloomberg Barclays US MBS Index), Municipal (Bloomberg Barclays Municipal Index), and World-Government (FTSE WGBI Non-USD). ***Please note,*** *all Citi indices have been purchased by FTSE, and as such, Citi WGBI Non-USD has been officially renamed the FTSE WGBI Non-USD.*

## COMMODITIES MARKET

*3 months ended 3/31/2019*



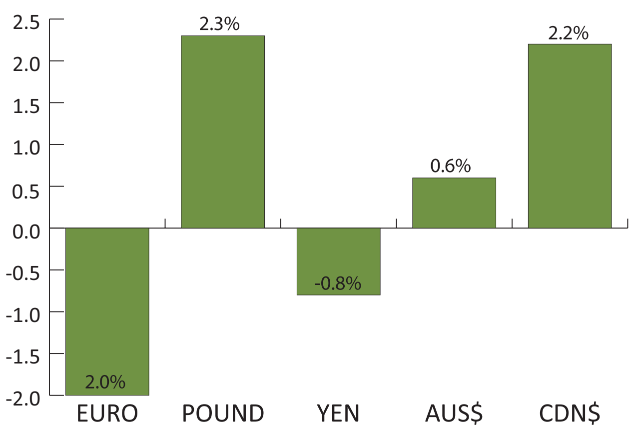

Crude oil prices surged during the first quarter (gaining over 33%), the impact of which can be observed by a corresponding bump in gasoline prices (though the price of gas hasn't risen nearly as much as you might expect, increasing by a modest 6.2%). Crude prices jumped from $45.14/barrel (as of 12/31/2018) the whole way up to $60.19/barrel (as of 3/31/2019). There are multiple reasons for this increase, but two key factors seem to have played the primary role: world growth (which has helped Venezuela and Nigeria in particular), and more significantly, production cuts from Russia and members of OPEC. It's important to note here, despite the first-quarter rally, six-, nine-, and twelve-month returns for both oil and gasoline remain in the red after last year. Crude oil decreased by -17.7%, -18.8%, and -7.2% over the trailing six-, nine-, and twelve-month periods end 3/31/2019, while unleaded gasoline turned in losses of -10.8%, -12.0%, and -0.3% over the same time periods.

Food prices (Corn and Wheat) fell during the first quarter, with Chinese tariffs still weighing on U.S. farmers. Corn prices faired slightly better than wheat prices, which have been extremely volatile over the past several quarters. Both commodities, however, decreased in three (out of four) of the time periods ending 3/31/2019. The two fell in unison over the three-month timeframe (Corn down -4.9%, and Wheat dropping -9.0%), and again over the nine-month timeframe (Corn down -0.3%, and Wheat dropping 8.5%). While results came back split during the six months (Corn up 0.1%, and Wheat down -10.1%), and again during the trailing twelve months (Corn down -8.1%, and Wheat up 1.5%).

Gold, which tends to shine brighter during times of market turmoil, followed up a solid fourth-quarter gain with a much more modest first-quarter increase (1.3%). Thanks to the fourth-quarter boost (over 7%), Gold also managed to produce six- and nine-month gains as of 3/31/2019, finishing March up 9.1% and 3.6% respectively. However, as we extend our scope further, Gold eventually lands in the red (coming in with an annual loss of 2.2%). While the fourth-quarter correction was a positive for gold prices, the other metals (Platinum and Copper) didn't feel the same effects, as both commodities fell simultaneously. As market sentiment shifted early this year, we saw Platinum and Copper prices rise. Platinum returned 7.9% during the first three months of the year, while Copper increased by 8.7%. These gains proved sufficient to wipe-out their fourth-quarter losses, as the six-month returns also came back positive (Platinum increased by 4.3%, Copper was up 3.6%). However, this would not be enough to pull the nine- and twelve-month figures from negative territory (Platinum lost -0.1% and -9.2%, while Copper decreased -2.2% and -3.2%).

## CURRENCY MARKET

*3 months ended 3/31/2019*




As we've discussed previously, during 2016 and the majority of 2017, most foreign currencies had [generally] been appreciating versus the U.S. Dollar. This trend began slowing during 2017, with the rate of appreciation for most currencies dropping off dramatically to start 2018. Starting around mid-year, it began to seem apparent that not only did this trend slow to a halt, but it had actually reversed course. This reversal can likely be attributed to a handful of factors; recent U.S. Foreign Policy [tariff war, the threat of a trade war, etc.], the U.S. Federal Reserve [continued rate hikes], and generally strong fundamentals in the U.S. [as compared to the rest of the world]. The Dollar continued to strengthen against most/all of the currencies we track through the end of 2018, but we've observed yet another reversal to start the year. Is this the beginning of a long-term trend, or merely a short-term deviation? By looking at the factors outlined above and making a few assumptions regarding what's changed in recent months, perhaps we can gain some insight.

Firstly, a resolution to the U.S.-China trade dispute is thought to be imminent and expected to occur before the end of the year. As we pointed out earlier, if a deal doesn't go through soon, the downside potential is quite high. Secondly, the FOMC has dramatically shifted its stance (adopting a much more dovish tone). One final issue that has likely played a role (as it related to the British Pound specifically), is the fact that a soft-Brexit is now being priced-in to the market. This general assumption has led the Pound to rally slightly against the Dollar over the first three months of the year.

Given the continuation of weaker growth throughout eurozone economies (versus the U.S.) and considering political/economic uncertainty across European countries (such as Germany, Italy, etc.), it should come as no real surprise that the Euro continued its decline versus the U.S. Dollar. This is especially unsurprising considering that the European Central Bank (ECB) officially shut down its €2.6 billion Quantitative Easing (Q.E.) Program in January. Typically, the movements of the Euro and British Pound have been highly correlated. Following the unexpected Brexit vote, however, the relationship between these two currencies has slowly begun to break down. Last quarter, thanks primarily to a Brexit-resolution being shot down last minute, the Pound dropped almost twice as much as the Euro. During this quarter not only has the gap widened, but the two currencies moved in opposite directions; the Pound appreciated versus the Dollar (up 2.3%) while the Euro depreciated (down -2.0%) over the first three months of the year.

The Canadian Dollar finished the quarter with the best results (up 2.2% over the three-month period). This bump was not nearly enough, however, to make up for a rough 2018 – this is evidenced by six-, nine-, and twelve-month losses as of 3/31/2019 for the Canadian currency. Meanwhile, with the markets now fully expecting a trade-deal between the U.S. and China, the Australian Dollar (which is strongly influenced by commodity prices along with the Chinese economy) saw a small uptick during as well, rising 0.6% over the three-month period. However (just like the Canadian Dollar), looking beyond the three-month period, the Australian currency turned in consistently negative results, posting six-, nine-, and twelve-month losses as of 3/31/2019.

The Japanese Yen (which was last quarter's lone bright spot), reverted to depreciation-territory, falling -0.8% during the first quarter of 2019. Despite the three-month loss, the Japanese currency was able to turn in a six-month increase of 2.6%. Extending our scope for the nine- and twelve-month periods, we can see the Japanese currency was not impervious to the strengthening Dollar, as the Yen decreased -0.2%, and -4.1% respectively.



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