FIRST QUARTER 2019 REVIEW AND OUTLOOK
EXECUTIVE SUMMARY

Portfolio Themes

- **Quality Tilt:** We prefer equities with stronger balance sheets and consistent margins.
- **Overweight to Information Technology:** The Information Technology sector is heavily skewed toward large, high-quality firms. The sector should benefit from robust global IT spending driven by the growing demand for products and services related to mobile, cloud computing and the "Internet of Things."
- **Overweight to Health Care:** Health Care should benefit from increasing investor preferences for larger, higher quality companies with long term growth prospects. Within the sector, M&A and rapid EM growth as well as strong research and development pipelines are leading to record drug approvals along with healthy sales growth.

Market Outlook

- **Expect the Bull Market to Resume:** Following equities' steep Q1 ascent, we expect equities to keep climbing, though the pace likely slows in the year's second half.
- **Strong Economic Drivers:** In both developed and emerging markets, economic drivers remain strong. We believe these fundamentals will come to the forefront as sentiment improves.
- **Global Political Gridlock:** In much of the developed world political gridlock persists decreasing the likelihood that sweeping legislation, potentially hurting equities, passes.

Global equities are up 16.9% since the December 25 low and 12.2% in Q1.[i] The MSCI All Country World Index has enjoyed the V-shaped recovery we expected following the sharp sell-off in December.[ii] Overall, this should be only the beginning of a great year for global markets.

We expect equities to keep climbing, though the pace likely will be more gradual in the year's second half. The third year of a US president's term is far stronger and more consistently positive than years one and two. It is also usually front-end loaded. We think the early expansion comes as markets celebrate reduced legislative risk post-midterms. This becomes more widely known later in the year, while political uncertainty starts drifting higher as election year campaigning heats up. Equities should still do well, but with more volatility than we have seen thus far.

While it is premature to assess 2020 market drivers, US election years are usually good for equities, too. Although, unlike third years, fourth years tend to be back-end loaded. Election uncertainty weighs early. However as primaries narrow the field of political candidates, conventions pass and nominees are selected, equity returns typically improve with falling uncertainty.

Global economic fundamentals are far better than appreciated. While the media was highly focused on weak manufacturing surveys and the US yield curve's slight inversion in late March, we believe the extensive coverage is a bullish sign. Media attention weakens the negative surprise power as speculation of a potential inversion occurred months before. Markets are efficient and quickly price in broad based fears. Rather than being dangerous, the inverted yield curve sets expectations low, extending the wall of worry. The real time to worry about an inverted yield curve is when no one else does, raising the risk of negative surprise.

We believe what really matters is the global yield curve. Today a big multinational bank can easily borrow very cheaply in most of Europe and Japan, hedge for currency risk and lend profitably in the US. Globalization and interest rate arbitrage render any one country's yield curve largely meaningless—even a country as big as the United States. The difference between a slightly inverted US curve and the preceding months' slightly positive curve is a distinction without meaning. Despite the recently flat curve, US loan growth still rose — demonstrating that interest rate arbitrage is still in action. Further, as the yield curve's return to positive territory on March 29 shows, shallow inversions can reverse fast.[iii]

i Source: FactSet, as of 04/01/2019. MSCI All Country World Index returns with net dividends, 12/25/2018 – 03/31/2019 and 12/31/2018 – 03/31/2019.

ii Source: FactSet, as of 04/01/2019. MSCI All Country World Index returns with net dividends, 12/25/2018 – 03/31/2019.

iii Source: FactSet, as of 04/01/2019. US 10-year Treasury yield minus 3-month Treasury yield on 03/29/2019.

Widespread manufacturing worries are similarly bullish. The concerns center on surveys called purchasing managers' indexes (PMIs), which loosely measure the percentage of businesses growing in a given country. They showed eurozone manufacturing contraction in March, with Germany especially weak. Yet manufacturing is just 25% of eurozone GDP and 23.1% of Germany.[iv] Services are much larger (73.0% in the eurozone and 68.2% in Germany) and they are nicely positive.[v] Meanwhile, most evidence suggests manufacturing's worries should soon fade. For one, EU auto emissions rules' impact looks to be diminishing. Additionally, Chinese stimulus taking effect should boost private sector demand for European exports. Other indicators also point positively, including US and eurozone Leading Economic Indexes—high and rising, inconsistent with a looming recession.

Emerging Markets (EM) equities were also up sharply in Q1 2019 and currently are 13.3% higher than the recent low on October 29.[vi] Following Q4's global volatility, many remain skeptical of the rally's staying power. However in our view, similar to developed equities, this year's sharp early jump is likely the V-shaped beginning to a longer, if more gradual, ascent.

Chinese government stimulus is starting to take its effect in lending and manufacturing PMI data.[vii] Meanwhile, following elections in Thailand and Brazil, both countries' purchasing managers' indexes are showing expansion, suggesting both economies are weathering the political drama well enough. South Africa has faced challenges with political uncertainty and the insolvency of Eskom, South Africa's state-owned power giant leading to widespread blackouts. We continue to monitor tensions between India and Pakistan following a terrorist attack in the Indian-controlled portion of Kashmir by Pakistani militants on February 14. With India's upcoming elections, it is likely that campaign rhetoric will be high, but we don't believe that the dispute will escalate. In our view, headwinds in some EMs don't negate more powerful positives—like steady global growth and a potential nascent recovery in Chinese demand. As economic fundamentals remain sound overall and political turmoil limited to a select few countries, we believe EM equities should continue to move higher in 2019.

Overall, we expect the 10-year-old bull to resume its climb. Bull markets do not die of old age, instead they die when they finish climbing the wall of worry and euphoric investors ignore weakness—or when some huge unexpected wallop knocks trillions off global GDP. Euphoria is absent today. Instead, a surprising amount of skepticism persists despite global equities being just 5.3% below all-time highs as December's volatility weighs on sentiment.[viii] Investors overemphasize small negatives and ignore good news. They seek wallops in China, Brexit and tariffs, not fathoming that all are too small, misunderstood or unlikely to unfold disastrously. In our view, many of the current market concerns are widely reported, limiting their surprise power. Rather than looming disasters, we believe many of these concerns represent opportunities as uncertainty diminishes.

iv Source: Eurostat and DeStatis, as of 03/26/2019.

v Ibid.

vi Source: FactSet, as of 04/02/2019. MSCI Emerging Markets Index return with net dividends in USD, 10/29/2018 – 03/31/2019.

vii Source: FactSet, as of 04/01/2019.

viii Source: FactSet, as of 04/01/2019. MSCI All Country World Index return with net dividends, 01/26/2018 – 03/31/2019.

Should you have any questions about any of the information in the First Quarter 2019 Review and Outlook, please contact us at (800) 851-8845 or FisherInstitutional@fi.com.

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