Quarterly Outlook

APRIL 2019

First Quarter 2019

After a sizable selloff in the fourth quarter of 2018, the S&P 500 surged 13.65% in the first quarter of 2019 (total return), with all eleven economic sectors posting positive results. The Information Technology, Real Estate and Industrials sectors gained the most with returns of 19.86%, 17.53% and 17.20%, respectively. On the opposite end, the Materials, Financials and Health Care sectors underperformed the index despite posting healthy gains of 10.30%. 8.56% and 6.59%, respectively. Although fourth-quarter GDP did pull back from an anticipated 2.6% to a final 2.2%, overall 2018 gross domestic product rose by a robust 3.0% driven by strong consumer spending boosted by tax cuts.

The Fed played a central role in driving the quarter's positive market dynamics. In January, the committee signaled that it would adjust planned interest rate hikes to mitigate an expected economic slowdown. At the March meeting, Chairman Powell confirmed that the Federal Reserve had decided to hold interest rates steady and refrain from further increases this year. The announcement came alongside lowered expectations for GDP growth, inflation and unemployment. In response to the Fed's new outlook, interest rates pulled back 0.6% to 0.9% across all maturities, and the yield curve measured by 3-month and 10-year treasuries inverted for the first time since July 2007.

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Market recovery in the US was mirrored in international markets. The MSCI ACWI ex USA (all Caps) Index, which covers approximately 99% of the global stock market outside the US, returned 10.39% in the quarter after a 14.43% loss in 2018. While European equities have been moving higher, the Eurozone economy grew only 0.2% in the fourth quarter of 2018. Germany, an historically reliable indicator of overall European economic health, saw zero growth, while Italy slipped into recession. The UK's economy grew only 1.4% in 2018, hindered by ongoing Brexit uncertainty. Bearing in mind that the European Central Bank's monetary policy remains accommodative, the Eurozone's economic growth is concerning.

Going Forward: Tandem's Outlook

While yield curve inversions are known as reliable indicators of a pre-recessionary period, the recent inversion was short-lived, and equity markets are not signaling a recession right now. However, US GDP growth and corporate earnings may move lower this year.

Tandem implemented modest changes to clients' portfolios in the quarter, slightly broadening exposure to defensive sectors while increasing fixed income holdings' duration. We have kept credit quality high in accordance with our philosophy of valuing quality over yield. We are concerned about the real credit quality of BBB-rated (investment grade) bonds that currently have features of high-yield (junk) instruments.

Tandem continues to focus on downside protection and risk-adjusted returns through proper diversification and asset allocation, positioning portfolios for both up and down markets.

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