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FIRST QUARTER, 2019

"ON THE WINGS OF A DOVE"

Think back three months. At that time, we titled our outlook "Against the Wind". We discussed the high hopes investors had going into 2018, and the dread they had going into 2019. We invoked Henry Ford, who said that "when everything seems to be going against you, remember that the airplane takes off against the wind, not with it."

To that end, we concluded that "the downside risk is actually waning and the upside potential is waxing." With more than a little help from a central bank "pivot" toward easier monetary policy both in Europe and in the US, 1Q19 delivered the best first quarter in the S&P 500 since 1998.

At a risk of spoiling the rest of the presentation, the conclusions presented in January still remain – volatility will probably remain, growth is likely to continue to decelerate somewhat (especially in the first half of the year) and there will be more opportunities to buy well-run, robust firms. However, the price levels witnessed here in April are markedly different than those from three months ago.

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I. 1Q19 in Review

"And the dove came back to him in the evening, and behold, in her mouth was a freshly plucked olive leaf."

-Genesis 8:11

Photo credit: Alpha Wealth Strategies

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After one of the worst Q4s in recent memory, Q1 staged stunning reversals

Policy

- European Central Bank and the Federal Reserve ease monetary policy

Markets:

- Stock markets come roaring back
- Worst performing sectors in Q4 2018 outperform in Q1 2019
- Worst performing stocks in Q4 2018 outperform in Q1 2019
- Most-hated asset classes at year-end outperform in Q1 2019

We all understand that there are ups and downs in markets and that the key to successful investing lies in determining when those ups and downs are simply "normal" gyrations and when they are but tips of the proverbial iceberg. This is made all the more difficult with the advent of Modern Monetary Theory (MMT), which takes a more active role in setting prices (i.e. interest rates). In order to approximate future market movements, one must also acknowledge the role of central banks and their influence on markets.

When looking at the first quarter, the strong market rebound was undoubtedly influenced by both monetary policy and the "normal" gyrations. However, it is impossible to determine just how much of the rally was due to either cause.

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Treasury Secretary Steve Mnuchin kicked things off on December 23

December 23, 2019

- "The CEOs confirmed that they have ample liquidity…"
- "We continue to see strong growth in the US economy with robust activity from consumers and business."

U.S. Treasury Department
Office of Public Affairs

Secretary Mnuchin convened individual calls with the CEOs of the nation's six largest banks

The banks all confirmed ample liquidity is available for lending to consumer and business markets.

Washington – Secretary Mnuchin conducted a series of calls today with the CEOs of the nations six largest banks: Brian Moynihan, Bank of America; Michael Corbat, Citi; David Solomon, Goldman Sachs; Jamie Dimon, JP Morgan Chase, James Gorman, Morgan Stanley; Tim Sloan, Wells Fargo. The CEOs confirmed that they have ample liquidity available for lending to consumer, business markets, and all other market operations. He also confirmed that they have not experienced any clearance or margin issues and that the markets continue to function properly.

Tomorrow, the Secretary will convene a call with the President's Working Group on financial markets, which he chairs. This includes the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and the Commodities Futures Trading Commission. He has also invited the office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation to participate as well. These key regulators will discuss coordination efforts to assure normal market operations.

"We continue to see strong economic growth in the U.S. economy with robust activity from consumers and business," stated Secretary Mnuchin and added "With the government shutdown, Treasury will have critical employees to maintain its core operations at Fiscal Services, IRS, and other critical functions within the department."

Steve Mnuchin alerted his Twitter followers to this update on December 23. As of the date of this presentation, it is easier to find the displayed memo on Twitter than it is on a government website: https://twitter.com/stevenmnuchin1

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A month later, the European Central Bank (ECB) reversed its tightening cycle

January 24, 2019

- The ECB discusses TLTRO III, a program in which the central bank provides loans at (very) favorable interest rates to banks
- TLTRO stands for Targeted Long-term Refinancing Operations
- Under TLTRO III, banks will be allowed to borrow at the ECB's refinancing rate for up to two years
- Currently, the refinancing rate at the ECB is 0.00%
- If this sounds like the ECB is giving banks free money to recapitalize their balance sheets, that's because it is

The ECB actually announced reinstitution of the TLTRO program in a March press release (excerpt follows) but the damage was done in January:

"A new series of quarterly targeted longer-term refinancing operations (TLTRO-III) will be launched, starting in September 2019 and ending in March 2021, each with a maturity of two years. These new operations will help to preserve favourable bank lending conditions and the smooth transmission of monetary policy. Under TLTRO-III, counterparties will be entitled to borrow up to 30% of the stock of eligible loans as at 28 February 2019 at a rate indexed to the interest rate on the main refinancing operations over the life of each operation. Like the outstanding TLTRO programme, TLTRO-III will feature built-in incentives for credit conditions to remain favourable. Further details on the precise terms of TLTRO-III will be communicated in due course."

Source:
https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.mp190307~7d8a9d2665.en.html

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The US Central Bank – the Federal Reserve – was next to act

March 20, 2019

- The Fed reduced its expectation for interest rate hikes to zero, from prior expectations of two
- The Fed also decided to slow the pace of its balance sheet reduction, instead choosing to reinvest more principal and interest payments in new Treasury securities
- In layman's terms, the Fed's printing press isn't fully switched on, but it's firing up

Percent

Variable	Median[1]			
	2019	2020	2021	Longer run
Change in real GDP	2.1	1.9	1.8	1.9
December projection	2.3	2.0	1.8	1.9
Unemployment rate	3.7	3.8	3.9	4.3
December projection	3.5	3.6	3.8	4.4
PCE inflation	1.8	2.0	2.0	2.0
December projection	1.9	2.1	2.1	2.0
Core PCE inflation[4]	2.0	2.0	2.0	
December projection	2.0	2.0	2.0	
Memo: Projected appropriate policy path				
Federal funds rate	2.4	2.6	2.6	2.8
December projection	2.9	3.1	3.1	2.8

Not to be outdone, the Federal Reserve took a significant step to ease policy in March when it reduced its expectation for interest rate hikes. One can speculate as to the cause here.

1) The Fed realized that it should be more accommodative in December, but doing so would look as if the Committee had caved to President Trump's demands. Trump had called for the Fed be more dovish on interest rates.
2) The Committee was responding to the ECB's move toward easier policy. If the Fed continued to press forward with interest rate increases, it posed the risk of strengthening the dollar so much that it would make US exports even less competitive with Europe.
3) The downshift in interest rates alarmed members of the Fed. Further hikes risked causing a "curve inversion". An inversion occurs when interest rates on longer-term bonds (10-30 years) are lower than interest rates on shorter-term notes (0-2 years). Historically, this phenomenon has coincided with presaging recession, with roughly a 12-24 month lead time.
4) The Fed is reactionary. As inflation data for prior periods came in weaker, the Fed reacted. This is different than past policy where the Fed paid more attention to market-based expectations of inflation.

Source:
https://www.federalreserve.gov/newsevents/pressreleases/monetary20190320c.htm

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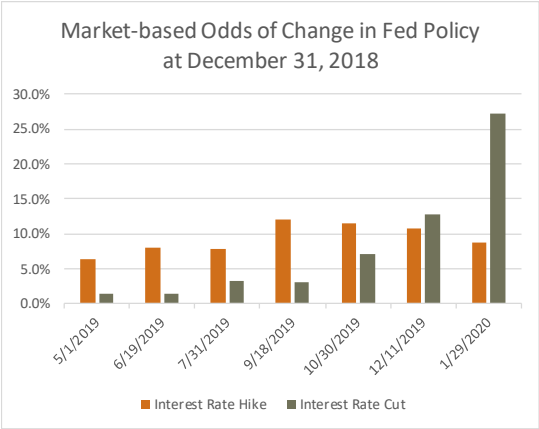
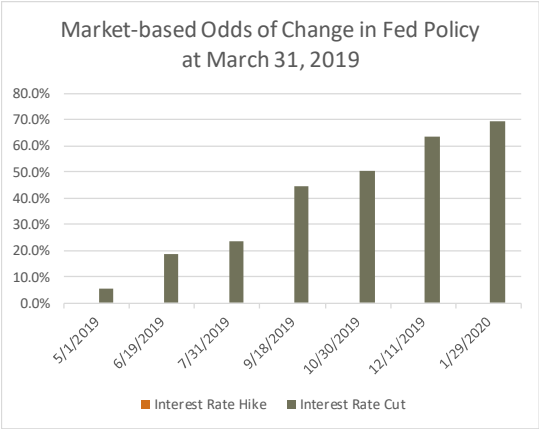
The Markets Responded Aggressively, with an interest rate Cut now more likely than a Hike





As show in the charts on this slide, the Federal Reserve's "pivot" toward fewer interest rates was quickly addressed by the market. In fact, as of March 31, the market's implied probability no longer expects any interest rate hikes for the remainder of the year. And odds of an interest rate *cut* by January 2020 have risen from ~27% to ~70%.

Of course, this could easily change in the other direction. But the path Chairman Jay Powell laid out was clear. There is an added element of caution at the Fed that was not present 3-6 months ago.

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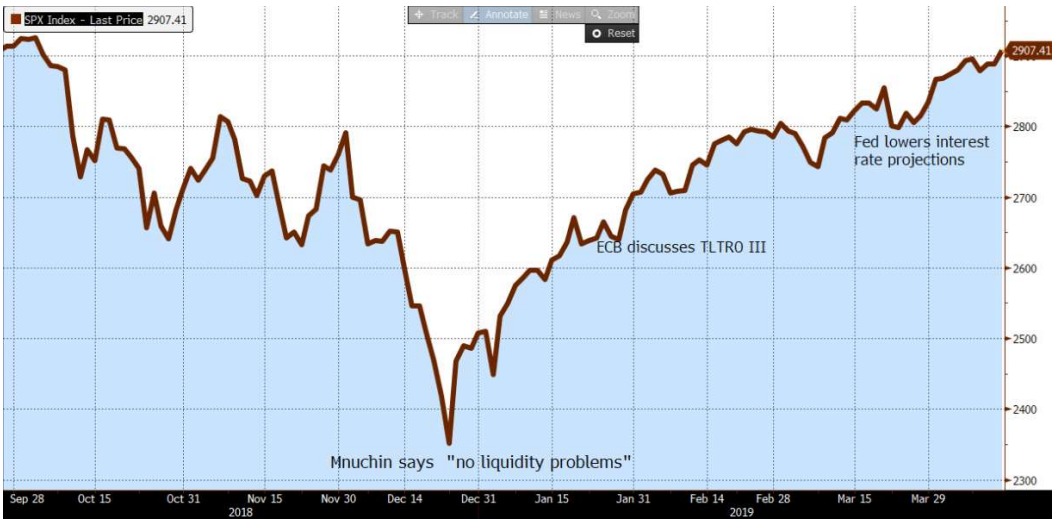
The Change in Policy Acted as an Accelerant to the Rebound from Oversold Levels

US Stocks Rebounded (S&P 500)



Market participants eager to attribute causes to price movements will often use charts like these to “demonstrate” that the stock market is centrally-planned and dependent solely on what economic “mandarins” in Washington decide. We have dutifully provided this red meat.

However, it is crucial to remember that investing is not that simple and to think so would be extremely dangerous. We should not discount the impact policymakers had on markets in Q1 but we also cannot say that their pronouncements were the sole reason for the market’s rebound.

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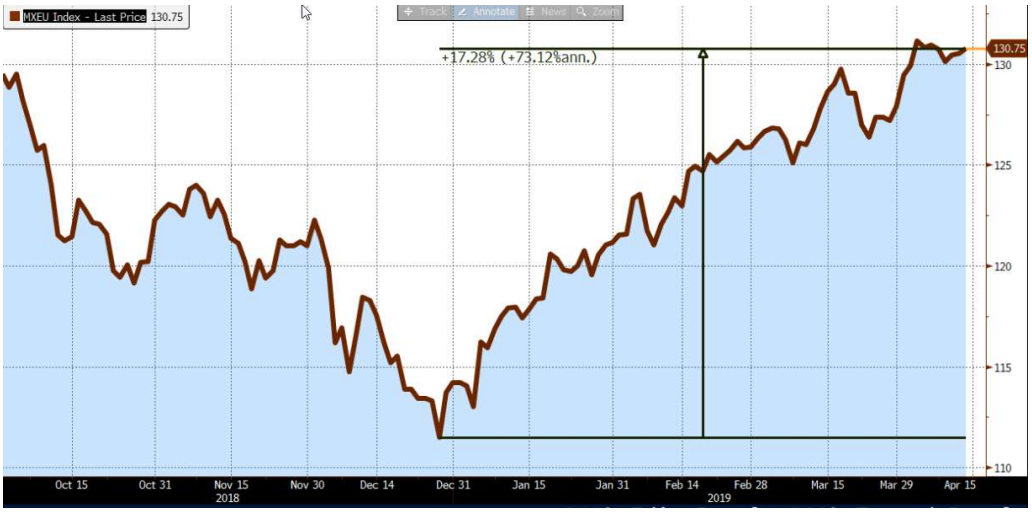
The Change in Policy Acted as an Accelerant to the Rebound from Oversold Levels (cont.)

As Did European Equities (MSCI Europe Index)



In Europe, the direct impact from the TLTRO program is more obvious. The ECB plans to provide very cheap loans to corporations to recapitalize balance sheets and stimulate lending. This should have a real economic impact by improving credit quality and potentially increasing revenue. European markets have outperformed US indices year-to-date.

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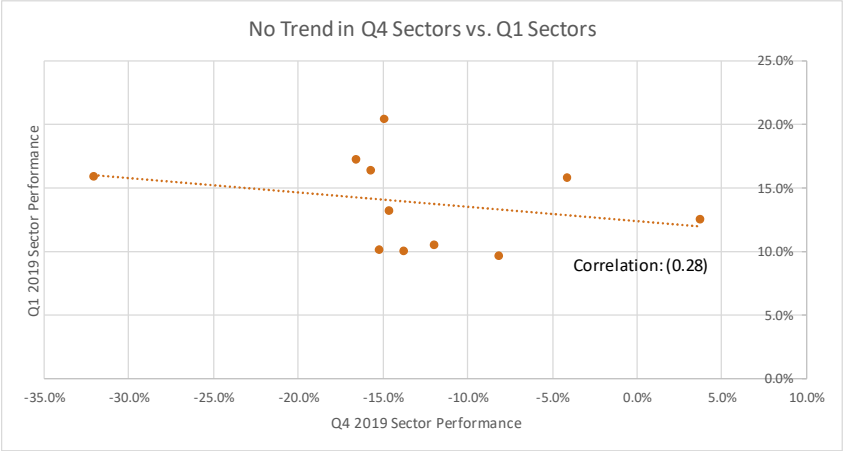
Sector by sector, performance reversed, modestly

Weak Q4 sectors (e.g. Energy) strengthened; strong sectors (e.g. Utilities) relatively weakened



The chart shown here displays the correlation in sector performance from Q4 to Q1. In short, there is none. Utilities have underperformed somewhat year-to-date and energy stocks have benefited from a rebound in oil prices but the trends are far from significant.

In short, the noise in markets continues to be mixed and volatile sector performance partially belies the strong, robust rally in broader indices.

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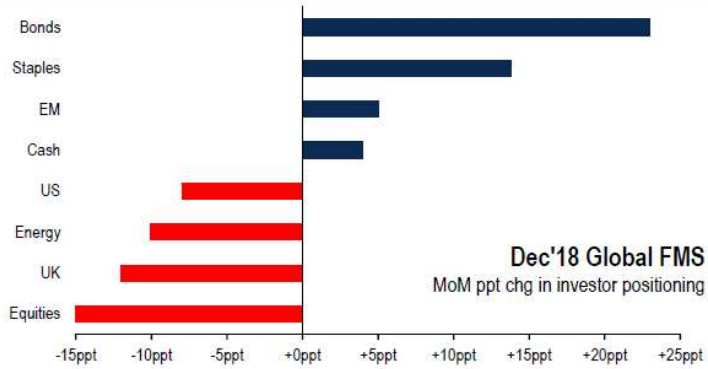
Fund Managers Sold at the Bottom and Bought at the Highs

Managers had reduced holdings of equities, the UK and Energy, just in time for those to outperform

Exhibit 1: Month-on-Month changes to Global FMS positioning



Source: BofA Merrill Lynch Global Fund Manager Survey

Unsurprisingly, investors sold what they wished they didn't own, and bought what they wish they had owned in December. Stable, boring assets like Consumer Staples stocks and bonds were purchased; equities and energy stocks were sold. Fear of loss drove the flight to these safe havens at the end of the year.

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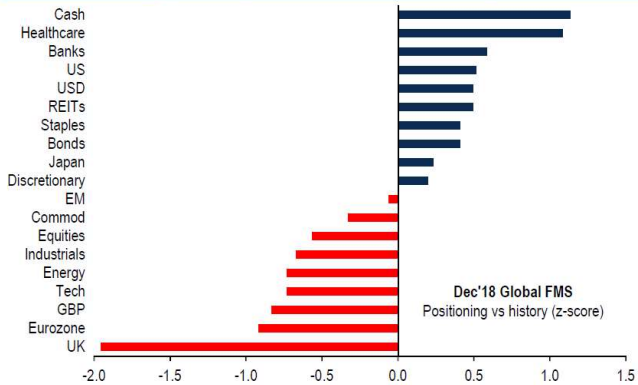
Fund Managers Sold at the Bottom and Bought at the Highs

They also carried larger healthcare and bank positions, while reducing technology

Exhibit 2: The Longs & Shorts, relative to Global FMS history*



Source: BofA Merrill Lynch Global Fund Manager Survey. *data since 2006 for commodities & real estate; since 2001 for all others

Fund managers were dramatically underweight the UK and even equities in general. They carried higher cash balances and gravitated toward healthcare and staples stocks.

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Fund Managers Sold at the Bottom and Bought at the Highs

Managers are still underweight equities, but less than in December; they also added significantly to emerging markets

Exhibit 1: FMS investors positioned for low growth & low rates

Source: BofA Merrill Lynch Global Fund Manager Survey. *data since 2006 for commodities & real estate; since 2001 for all others

Today, investors are still underweight energy, the UK and equities in general. And they are still overweight utilities. However, there is a creeping risk appetite as they've increased the allocation to emerging markets and consumer discretionary stocks.

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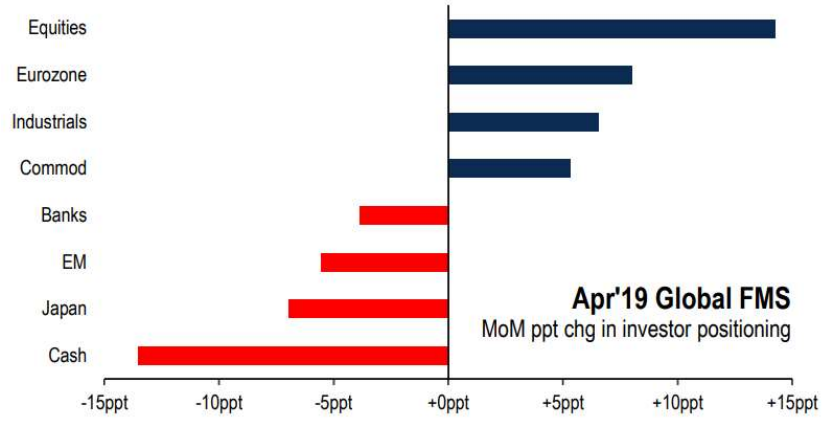
Fund Managers Sold at the Bottom and Bought at the Highs

Even though they remain underweight, a massive +15ppt move in April narrowed the historical gap – the inflow from March 15-April 15 was as big as the outflow in December

Exhibit 2: Month-on-Month changes to Global FMS positioning



Source: BofA Merrill Lynch Global Fund Manager Survey

And there has been a remarkable move out of cash and into equities in the last month alone. For perspective, go back two slides and compare this move to the move in December. If the past is any guide, therefore, it appears that there could be a near-term peak in investors' risk appetites.

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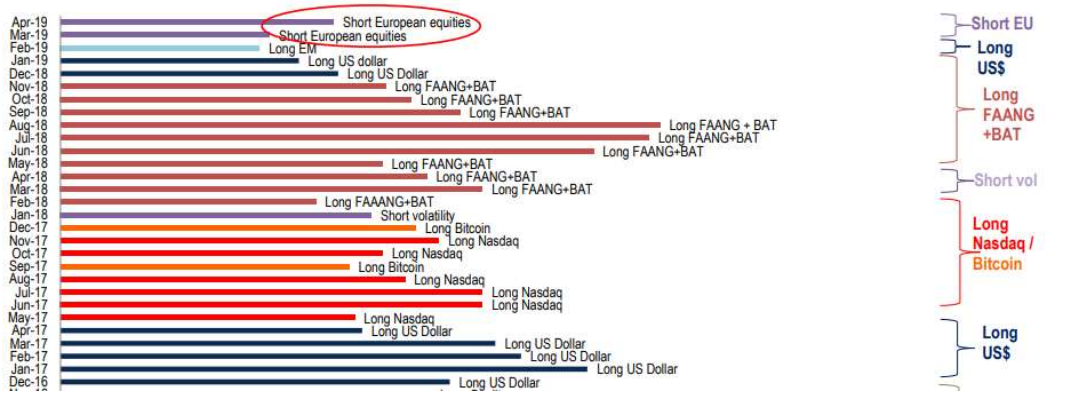
Fund Managers Sold at the Bottom and Bought at the Highs

The most crowded trade is now SHORT European stocks

Exhibit 11: Evolution of Global FMS "most crowded trade"



Europe continues to be a pariah, which is odd given the fact that the ECB has responded so actively to addressing the risks there. In addition, while fund managers have used the strength in the US to follow onto the momentum, in Europe, managers have used the strength to reduce exposure, on net.

Contrarians would be adding to European equities at the current time.

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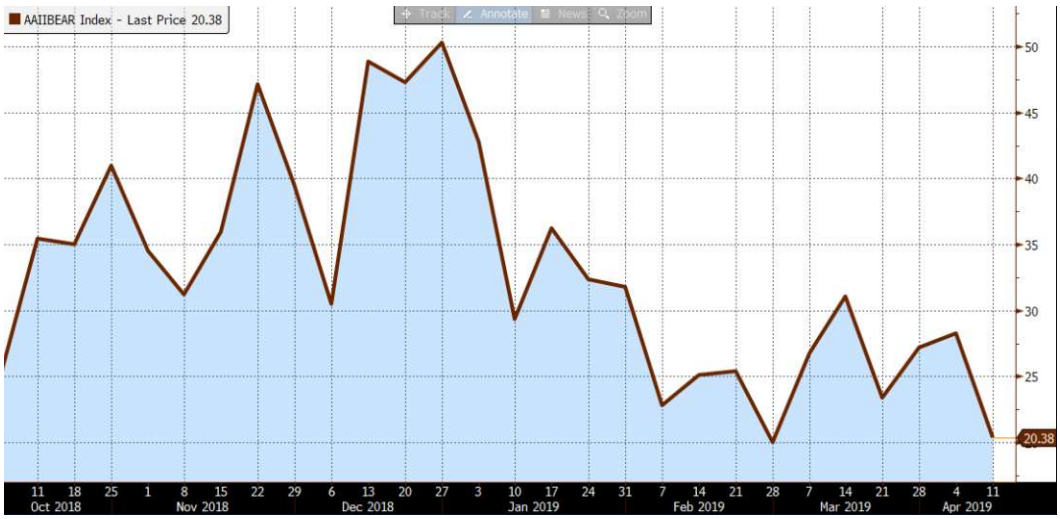
Fund Managers Sold at the Bottom and Bought at the Highs

Bearish Sentiment has dropped…



Accordingly, bearish sentiment as measured by the American Association of Individual Investors (AAII) has dropped substantially, from 50% to ~20%.

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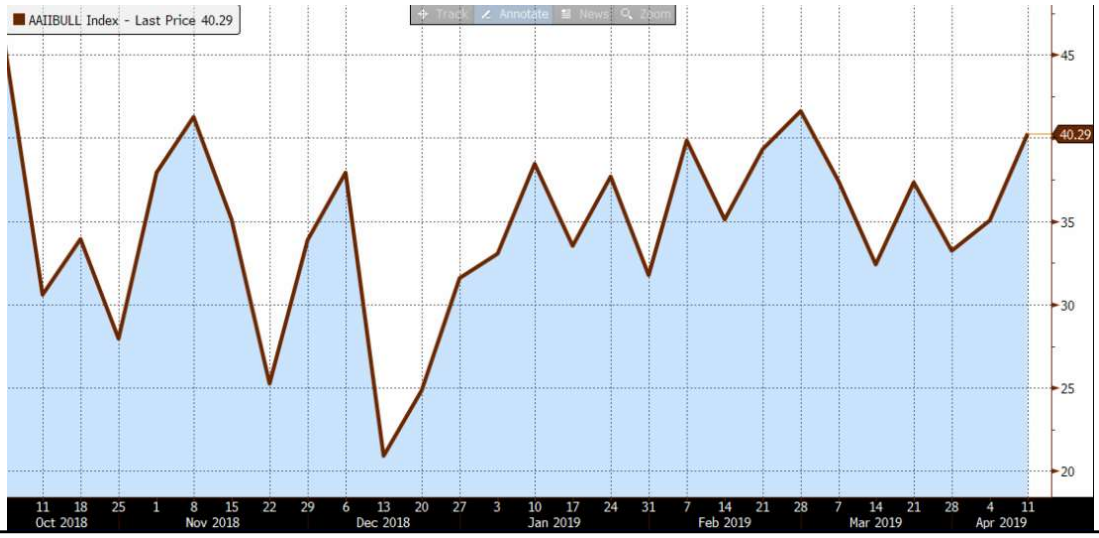
Fund Managers Sold at the Bottom and Bought at the Highs

But Bullish Sentiment isn't exactly off to the races



But bullish sentiment hasn't had such a strong rebound. There continues to be a pervasive nervousness in the market that suggests that while we are approaching a near-term peak in bullishness, we are not quite there yet.

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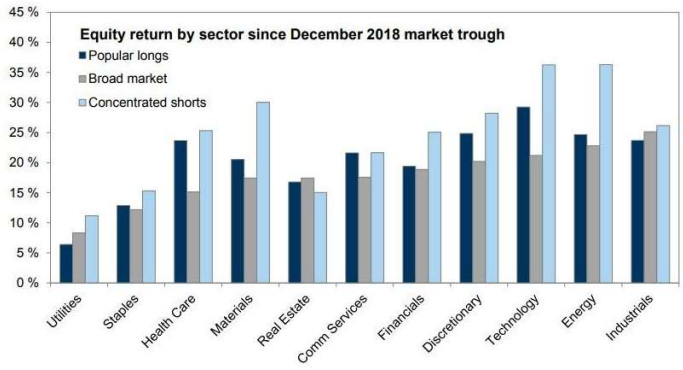
Fund Managers Sold at the Bottom and Bought at the Highs

Sector-by-sector, the "ugly" stocks actually outperformed the more popular stocks

Exhibit 6: Returns of the most popular long positions and the most concentrated short positions during the market rebound
as of February 19, 2019



Source: FactSet, Goldman Sachs Global Investment Research

If the light blue line is higher than the dark blue line, it shows that investors are worse at picking losing stocks than they are good at picking winning stocks. This could be due to the idea that some of the market rally has been driven more by bad businesses recovering rather than strong businesses strengthening.

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After one of the worst Q4s in recent memory, Q1 staged stunning reversals

Policy Reversals

- Central Banks reversed course from "Quantitative Tightening"

Markets Reversals

- Fear evaporated
- But Q4 still haunts investors and it has yet to turn into greed
- Greed is most obvious in emerging markets, and most absent in Europe

Fund Managers Remain Underweight…But Are Quickly Closing the Gap

- Significant equity inflows over the last month has helped drive the market rally
- Not there yet, but closing in on a near-term sentiment peak

II. The Home Front

"The job market of the future will consist of those jobs that robots cannot perform. Our blue-collar work is pattern recognition, making sense of what you see. Gardeners will still have jobs because every garden is different. The same goes for construction workers. The losers are white-collar workers, low-level accountants, brokers, and agents."

-Michio Kaku

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Consumption trends are driving the economy; after a weak December and January, what we expect

Where the jobs are

- And the wages

Where the sales are

- And where they're going

Where personal balance sheets are

- And how they're invested

What the housing market looks like

- And what rates can you get

Photo credit: MarketWatch

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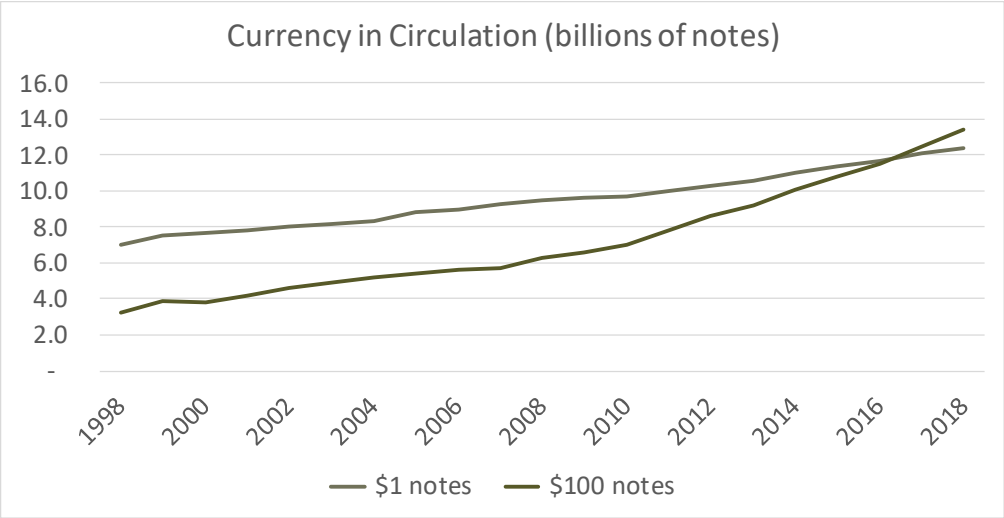
Fun Fact: There are now more $100 notes in circulation than $1 notes



As an April "Easter Egg" we present the fun fact that, as of December 31, 2018, Ben Franklin is a more popular currency face than George Washington. Interestingly, studies show that ~39% of Americans believe Ben Franklin was a US president. Perhaps with the rise of the $100 note, that statistic will finally go higher and catch $10-bill incumbent, Alexander Hamilton. 71% of Americans believe Hamilton was a US president.

Sources: Recognizing the Presidents: Was Alexander Hamilton President? *Psychological Science, Forthcoming*. 10 February 2016; FRED

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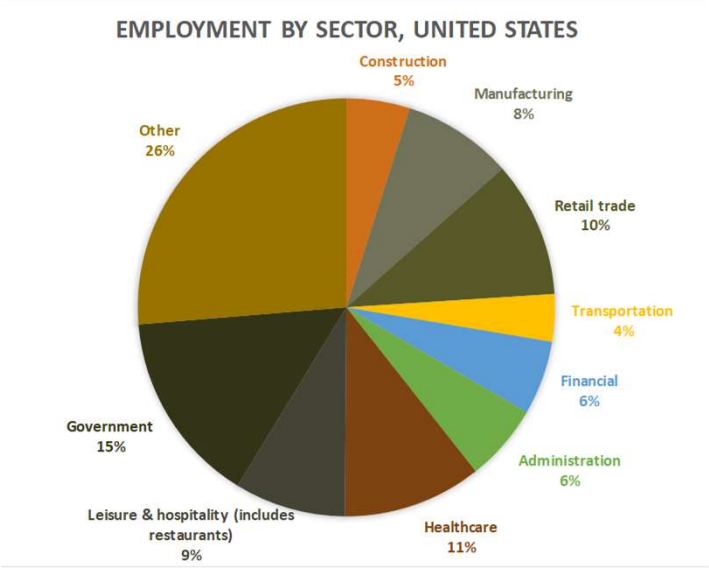
US Labor Force Composition



Before assessing the health of the American worker, it is helpful to understand where America works. This chart does just that.

Source: Bureau of Labor Statistics

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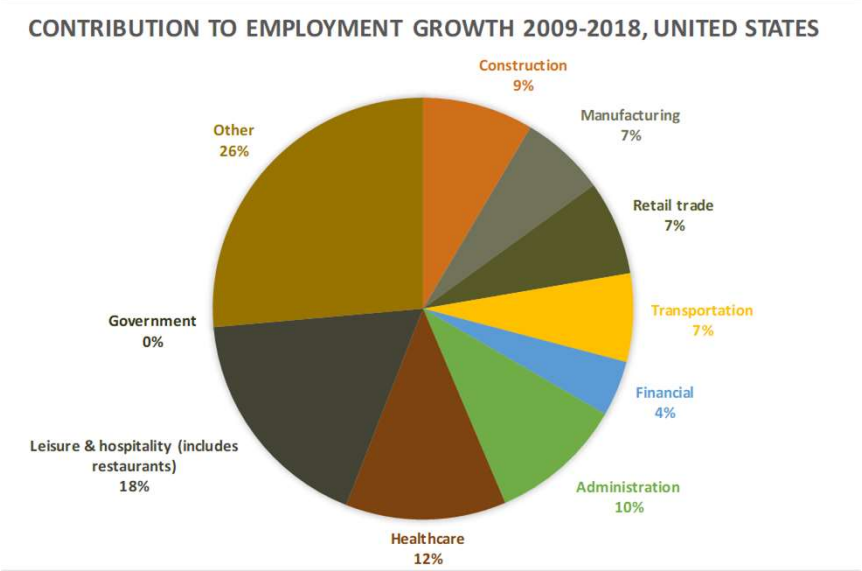
Restaurants have largely driven 1/5 of US employment growth since the Global Financial Crisis (GFC)



Comparing the prior chart to this one, we can see that health, hospitality, construction and administration have driven outsized job gains since the global financial crisis.

Source: Bureau of Labor Statistics

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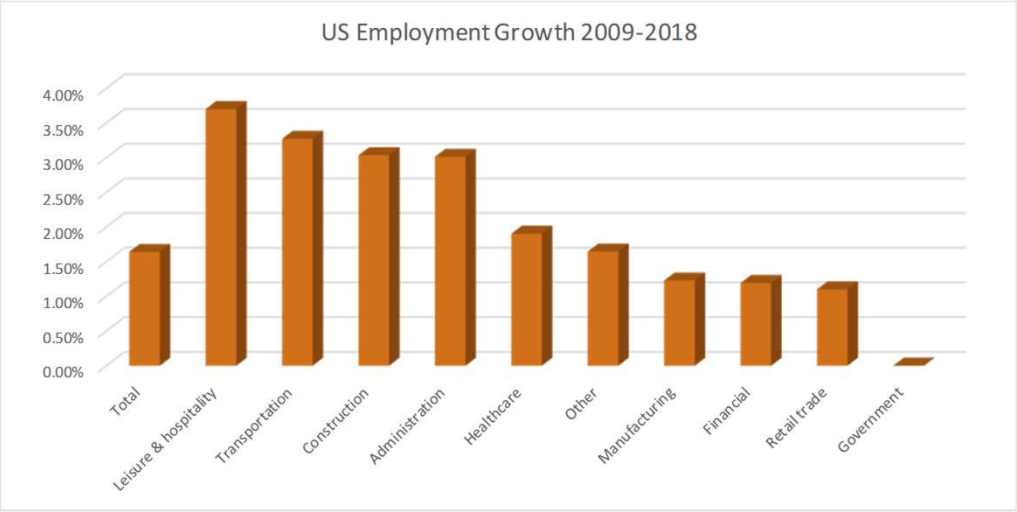
Growth has been highest at restaurants, transportation, construction and administration



Not surprisingly, the areas experiencing the highest rate of job growth is in the hospitality arena, followed by transportation and construction. These are blue collar type jobs; not so much white collar (e.g. administration, government, financial).

Source: Bureau of Labor Statistics

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Fastest Segments of Growth in 2018

Segment	2018 Job Growth
Residential Construction	+6.63%
Heavy and Civil Engineering Construction	+6.60%
Computer System Services	+4.13%
Transportation and Warehousing	+4.08%
Accounting Services	+3.96%
Non-residential Construction	+2.56%
Securities, commodity contracts, investments and funds and trusts	+2.46%

In 2018, the “blue-collar” wave continued, with hiring fastest in construction. Finance people snuck into the top seven…barely.

Source: Bureau of Labor Statistics

Photo credit: Theconstructionindex.co.uk

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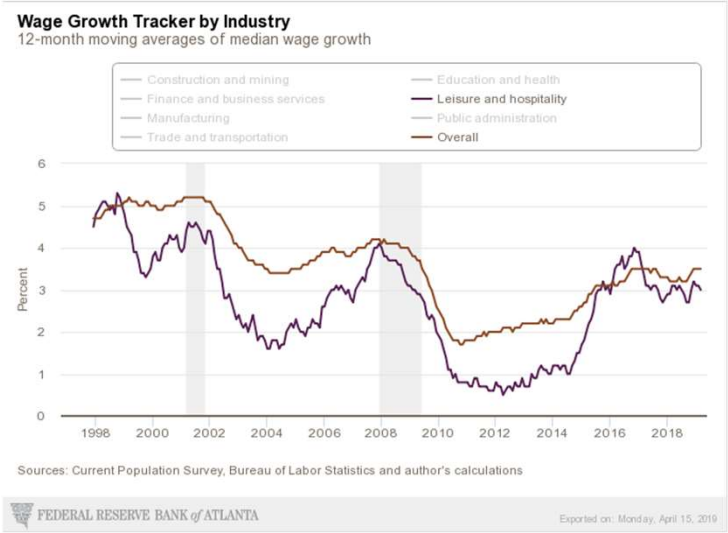
Wages are growing faster, in the 3-4% range, depending on the industry



Interestingly, although job growth has been strong in hospitality, it has underperformed the broader economy. Thus, it would appear that the supply of these workers is higher than the supply of workers in other industries.

Source: Federal Reserve Bank of Atlanta

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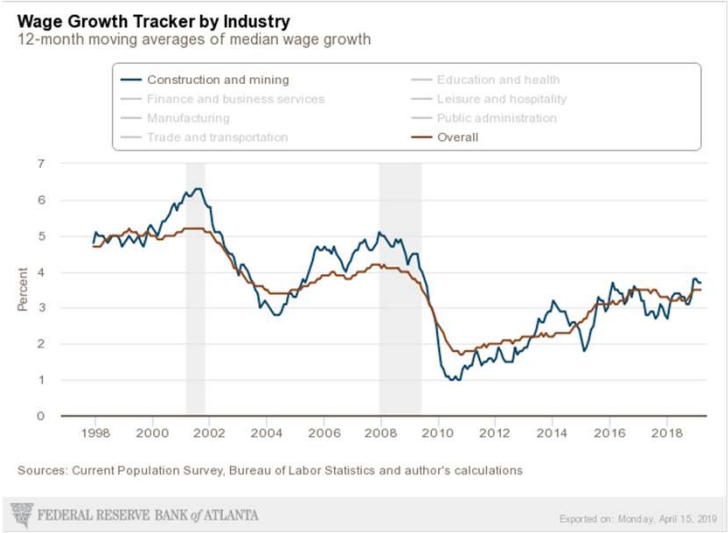
Wages are growing faster, in the 3-4% range, depending on the industry (cont.)



In construction, supply of workers appears to be less available, which is resulting in upward pressure on wages, especially in context of the aggressive hiring that took place in 2018.

Source: Federal Reserve Bank of Atlanta

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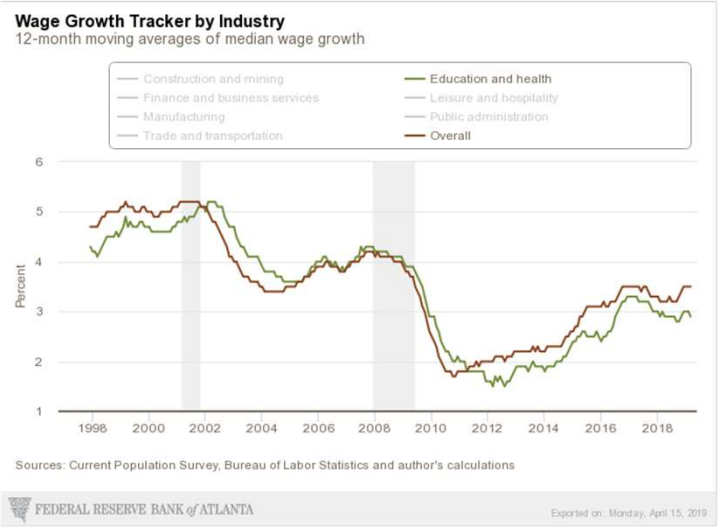
Wages are growing faster, in the 3-4% range, depending on the industry (cont.)



And amid headlines of inferior teacher compensation, wage growth among healthcare and education workers has underperformed the national average. Although this discrepancy appears minimal from year-to-year, it adds up over time. This is especially notable given the growth in property values and implied growth in property taxes.

Source: Federal Reserve Bank of Atlanta

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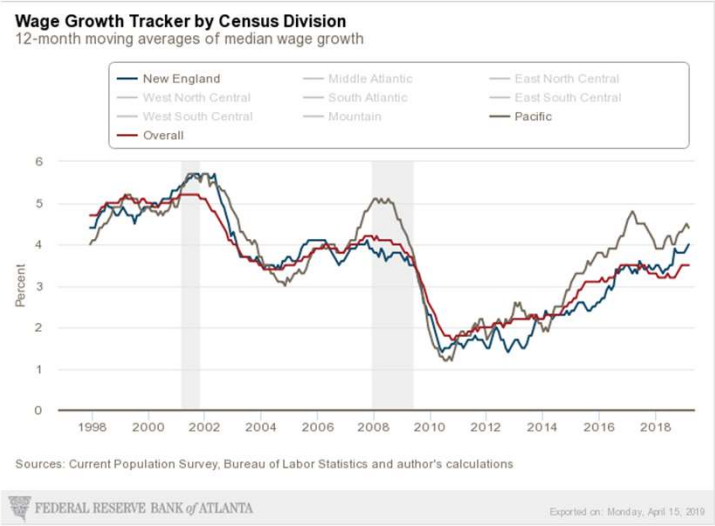
Median Wage Growth is Strongest in the Pacific and New England Regions



Wage growth continues to outperform in the Pacific region. Growth is accelerating the fastest in New England.

Source: Federal Reserve Bank of Atlanta

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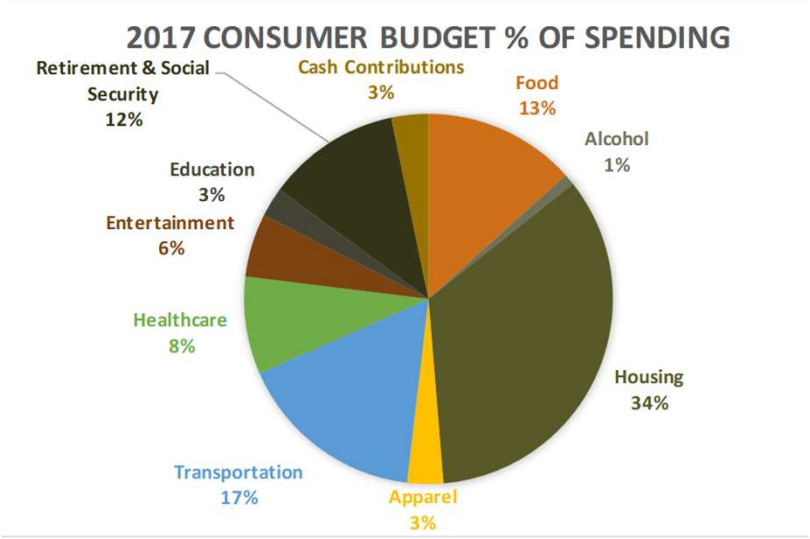
Budget remains relatively consistent on the surface



Source: Consumer Expenditure Survey, U.S. Bureau of Labor Statistics, September, 2018

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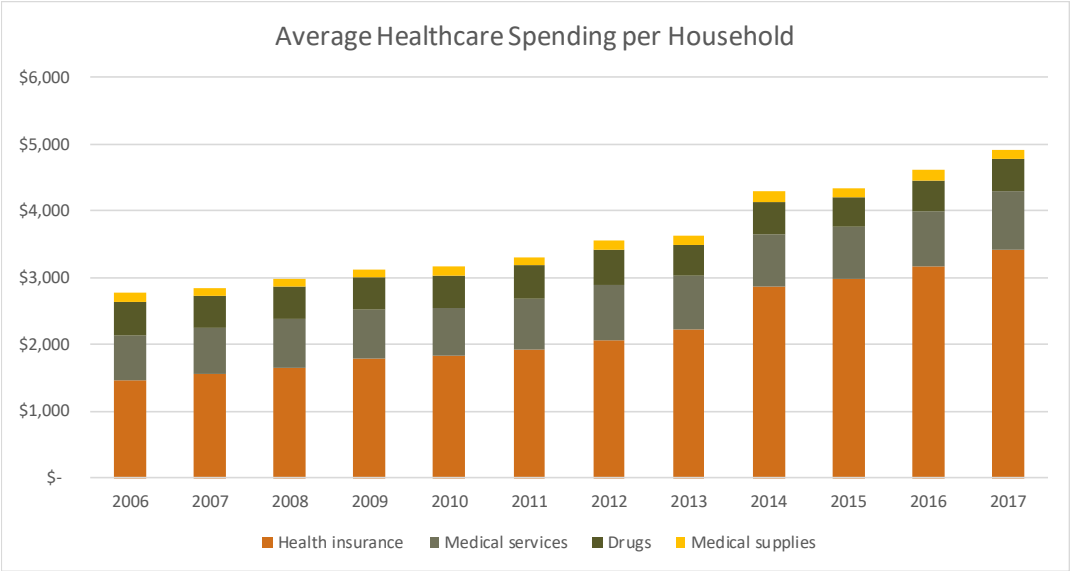
Growth highest in healthcare, especially on insurance



Even though healthcare spending accounts for only 8% of consumer expenditures in 2017, this figure was just 6% in 2006.

Healthcare spending per household continues to rise significantly, driven by growth in the cost of health insurance. Little wonder, therefore, that the insurance companies have recently fallen under the microscope of policymakers gunning for elections in 2020.

Health insurance providers would argue that they have raised premiums due to the inflation in the system; others in the system say the insurance companies are simply padding their own profits. The answer is probably a combination of both.

Source: Bureau of Labor Statistics

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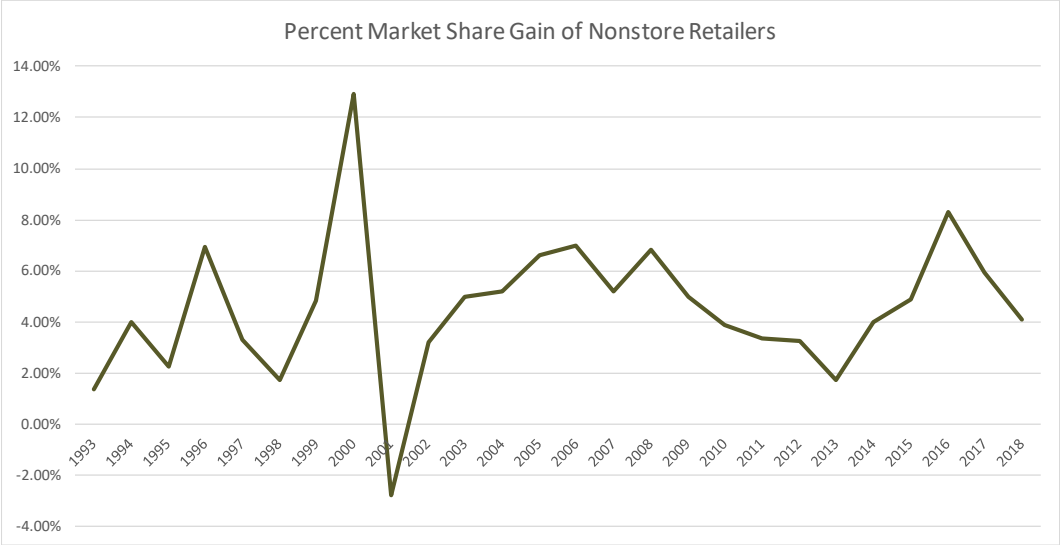
Nonstore retailers are still gaining market share, but at a slower pace than recent years



One of the largest themes of the past two decades is the growth of non-store retailers (like Amazon and Netflix) and the displacement of traditional brick-and-mortar retailers. 4-5% growth in 2018 would have been the envy of an average brick-and-mortar firm, but as online providers go, that growth was relatively anemic. It suggests that online retailers could be succumbing to the law-of-large-numbers that ultimately affects every business.

The trend is probably behind the stall in Amazon and Netflix stock as well as the stabilization and growth for companies like Target and Walmart.

Source: US Census Bureau – Monthly Retail Trade

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Over the trailing three months, retail sales are roughly 0.5 standard deviations below median

Nonstore retailers and Restaurants appear to be rebounding while Health Care stores are trending lower

Retail Sales Trended Growth (1992-2019)	**Adj. Retail Trade & Food Services**	**Motor Vehicle and Parts Dealers**	**Furniture and Home Furnishings Stores**	**Food & Beverage Stores**	**Grocery Stores**	**Health and Personal Care Stores**	**Clothing and Accessories**	**Nonstore Retailers**	**Food Services and Drinking Place**
Stdev	3.4%	7.4%	5.7%	1.3%	1.4%	2.6%	3.2%	4.9%	2.1%
Min	-11.2%	-27.0%	-17.9%	-1.0%	-1.0%	-0.8%	-9.1%	-8.0%	-1.9%
Q1	3.3%	2.0%	2.2%	1.9%	1.8%	3.5%	1.8%	7.3%	3.7%
Median	**4.7%**	**5.2%**	**4.8%**	**2.8%**	**2.6%**	**5.4%**	**3.6%**	**9.3%**	**5.1%**
Mean	4.4%	4.5%	3.4%	2.7%	2.6%	5.4%	3.3%	8.8%	5.0%
Q3	6.4%	8.3%	6.8%	3.7%	3.7%	7.5%	5.5%	11.6%	6.4%
Max	9.4%	19.8%	12.6%	6.2%	6.5%	10.7%	9.8%	21.0%	9.4%
Trend	*2.6%*	*2.0%*	*0.9%*	*3.2%*	*3.1%*	*3.1%*	*2.4%*	*7.8%*	*4.9%*
Current (Feb 2019)	**2.6%**	**2.3%**	**-0.9%**	**2.5%**	**2.5%**	**4.4%**	**3.1%**	**7.6%**	**4.7%**
Z-score	(0.52)	(0.30)	(0.77)	(0.19)	(0.11)	(0.35)	(0.07)	(0.24)	(0.15)

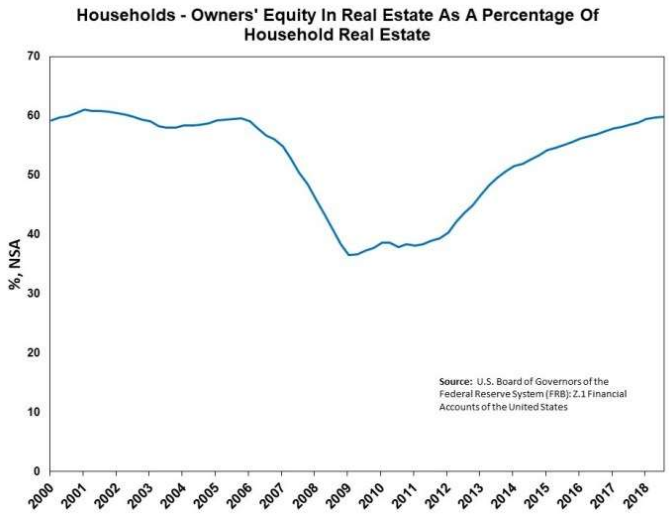
On a relative basis, non-store retailers are still in a good position and have recently re-accelerated. Note the strong above-market performance of food services and drinking places. Clearly, more Americans are not only working at restaurants; they are dining there, too.

It is important to watch furniture stores. Sales there are well below trend and are likely confirming the muted new home sales we've seen over the past six months. However, with talk of a rebound in housing now becoming a little clearer, we could see renewed traffic in and out of furniture stores. This is one reason the housing market is so important – there is a great deal of "knock-on" consumption associated with it.

Source: US Census Bureau – Monthly Retail Trade

NCM Macro

Household Balance Sheets Have Improved



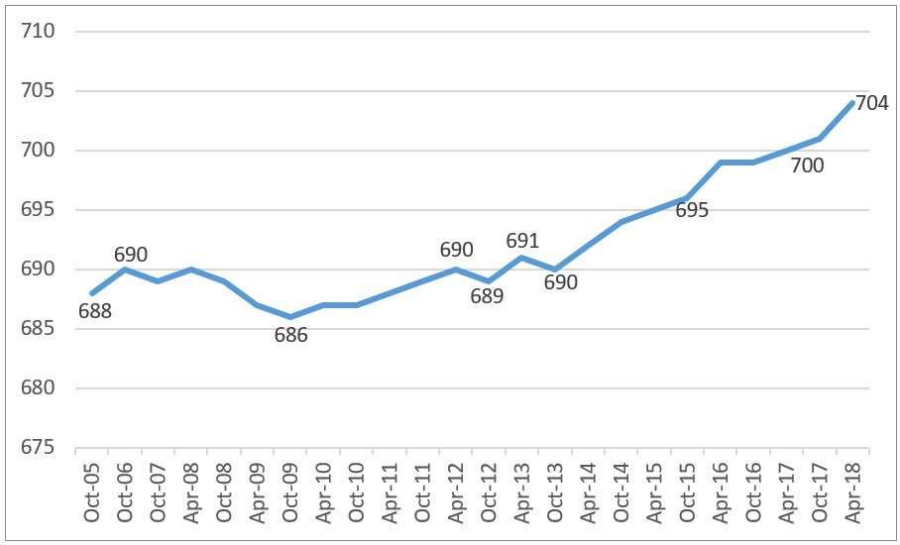
With all the talk about worsening household balance sheets, it is worth dispelling that myth. Home equity as a proportion of home value has increased significantly. Of course, much of that is due to the length of the bull market – if home prices crash then so would home equity.

Nevertheless, in order to return to the low levels of roughly 37% from the current level of 59%, home values would need to crash by 35%.

Source: FRED

NCM Macro

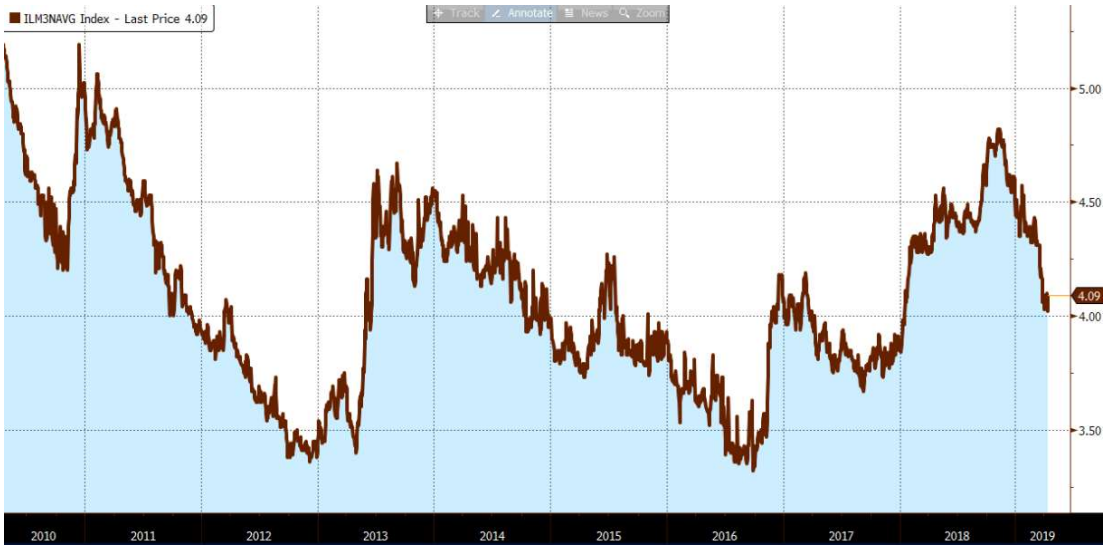
The Average US FICO Score is now over 700



On top of that, it's notable that the average US FICO score continues to improve. The consumer does not appear to be taking on undue credit risk at the present time.

NCM Macro

Mortgage Rates have returned to attractive levels



Given the recent fall in mortgage rates, potential buyers who may have had “sticker shock” in Q4 could be all the more eager to snap up homes now that rates are roughly 0.75% lower.

NCM Macro

Home Prices are still rising at >4%, but this has cooled slightly

NCM Macro

Housing Commentary

The Fed's Beige Book, March 6, 2019:

- Most Districts reported stronger home sales, although some Districts noted low demand for higher-priced homes.
- Residential real estate continued to improve modestly, with hopes for strong demand in April-June. Commercial real estate is improving a bit faster.
- Several real estate contacts noted that inventories had risen slightly but remained historically low, while home prices continued to appreciate but at a slightly slower pace.

Lennar Conference Call, March 27, 2019 (emphasis added):

- Generally speaking, it seems as though the market paused in the back half of '18, corrected in the first quarter and is now on **solid footing**, as we begin the 2019 spring selling season.
- Looking backward, the housing market continued to slow to the fourth quarter of 2018, as higher home prices and rapid interest rate increases combined to create a mismatch between prices and buyer expectations.
- Through the first quarter, interest rates moderated and **home price appreciation stalled and even pulled back**.
- We clearly saw **traffic and sales accelerate through the first quarter** as strong employment, wage growth, higher participation rate, consumer confidence and economic growth drove the consumer to return to a more affordable housing market.

NCM Macro

On the Home Front, it's Business as Usual

Jobs and Wages are not explosive, but still growing steadily

- Construction is a particular bright spot for jobs and wages
- Restaurant-hiring has strongly contributed to the post-GFC job gains

On a percentage basis, the average household budget has not shifted significantly

- Home prices have risen in lockstep along with income
- Higher healthcare spending is causing consumers to modestly shift their budgets
- The market share gains of non-store retailers is slowing

After a pause in Q4 and into Q1, home buying has resumed steady growth

- Spurned by low mortgage rates and lower FICO scores, consumer are buying again
- Some of the improvement in sales has also been driven by lower home prices

III. Good Times?

"A heart well prepared for adversity in bad times hopes, and in good times fears for a change in fortune."

-Horace

Photo credit: Wikipedia

NCM Macro

Figuring out where we are in the cycle

The Economy

- US
- Rest of the World

Expectations

Inflation

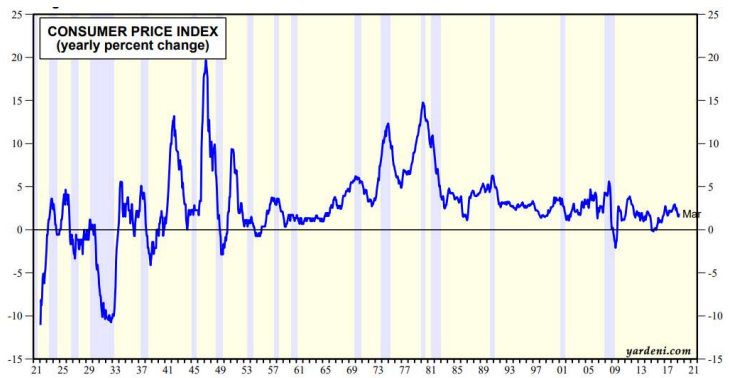


Photo credit: Yardeni

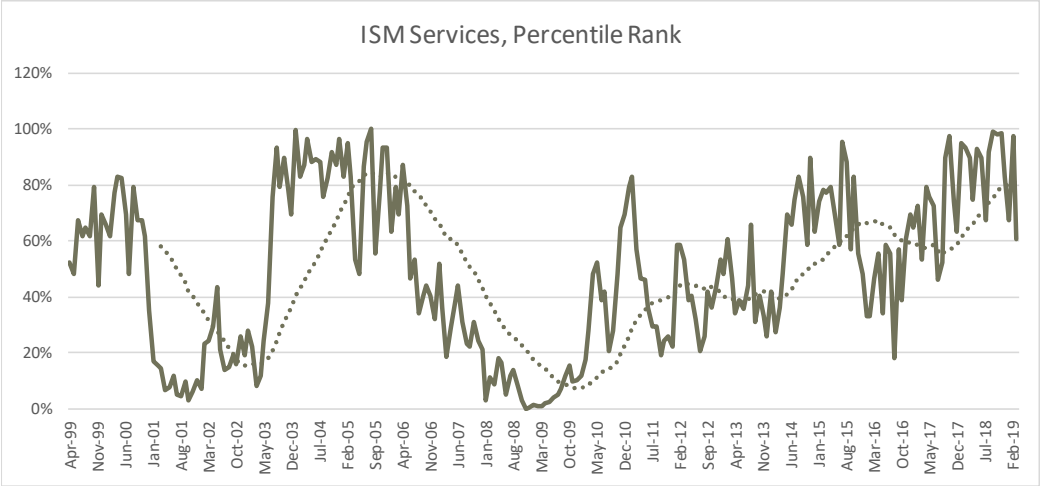
Despite the strong rally in Q1 and the hope that things are good and will stay good forever, it is wise to consider where we are in the economic cycle and what that looks like for stock returns. As much as we would like this not to be the case, the economy does indeed run on (inconsistent) cycles, as demonstrated in the chart of consumer price inflation on this slide.

Source: https://www.yardeni.com/pub/hiscpi.pdf

NCM Macro

The US Economy

The Services Sector of the Economy is near a Historical Peak, but that could last for a while



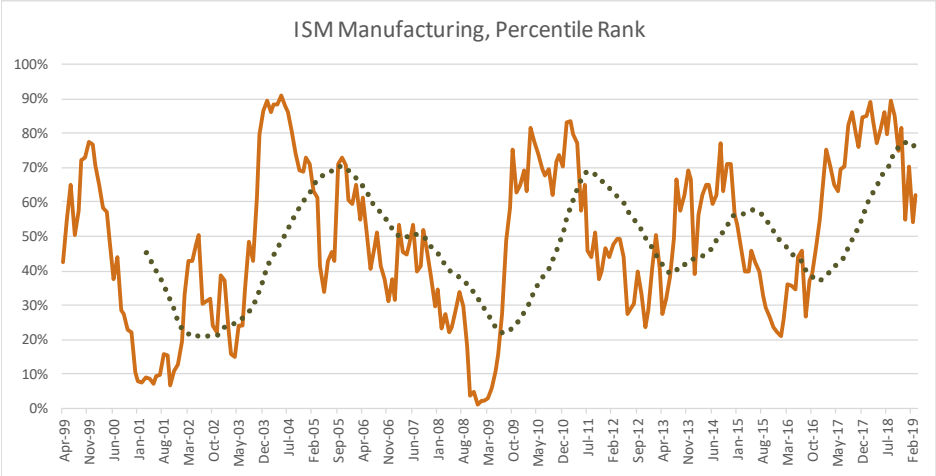
The services side of the economy continues to run at a strong rate. This chart shows the percentile rank of ISM Non-Manufacturing readings. Because we have normalized it to a percentile rank, the average reading should be right at 50%, with half the time spent above that mark and half the time spent below it. This means the chart should inherently be mean-reverting; every reading above the midpoint requires reading below the midpoint.

Nevertheless, the chart shown takes place over many years; therefore, a strong signal doesn't necessarily mean that we are poised for a crash. It simply means that we can't expect performance like this to last *ad infinitem*.

NCM Macro

The US Economy

The manufacturing sector of the economy appears to be taking a step back, but it's early days



The manufacturing side of the economy appears to be rolling over a little bit more. The cycles here are both more frequent and more pronounced. Given the strong hiring trends over the last few years, it wouldn't be surprising to see the manufacturing side of the economy taper off to more reasonable, modest growth rates.

On the flip side, we could be positioned for a rebound here. Oil prices have picked up; this should boost those parts of the US economy that benefit from higher energy activity.

NCM Macro

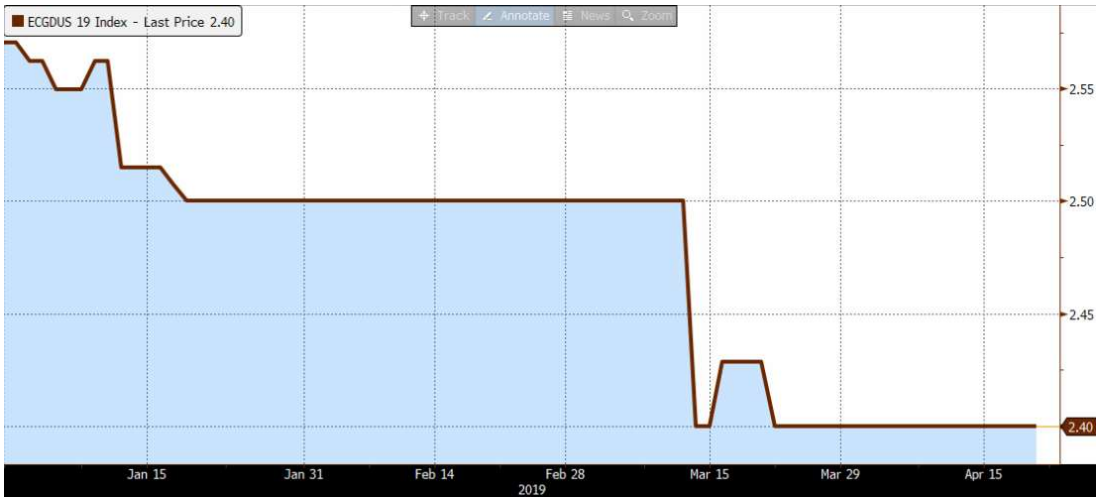
The US Economy

GDP Forecasts have declined for the first quarter…

NCM Macro

The US Economy

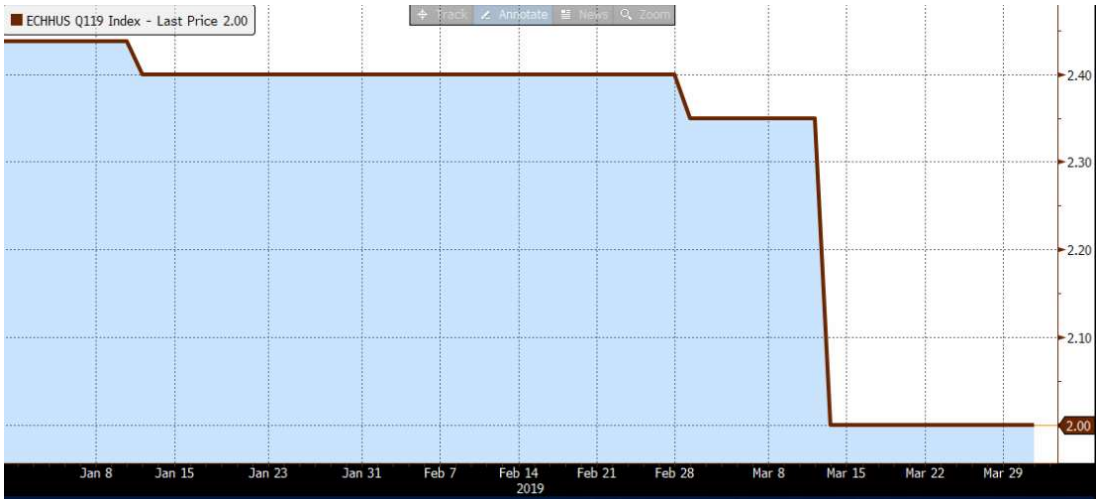
…And for the Year as a whole



NCM Macro

The US Economy

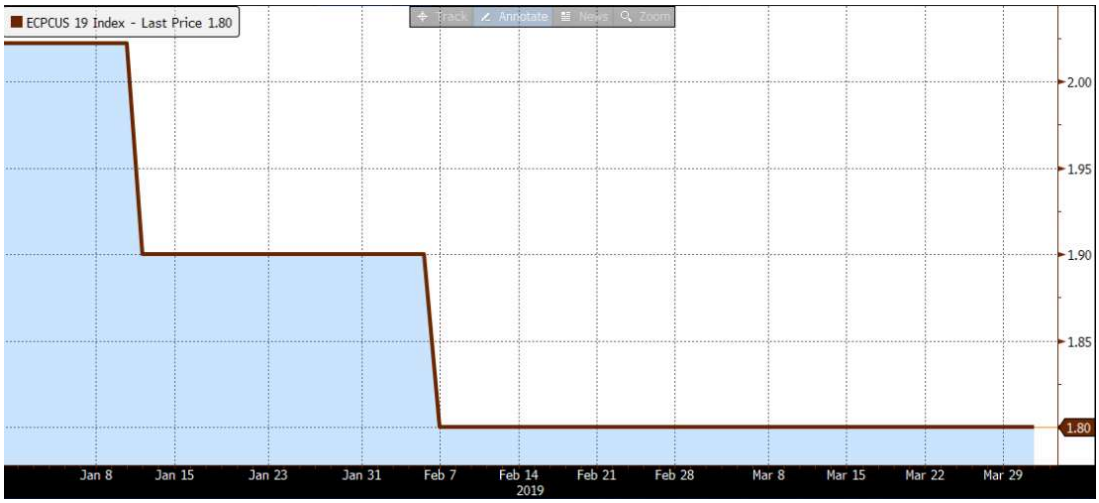
This is driven by slower-than-expected consumption growth for Q1…



NCM Macro

The US Economy

Inflation expectations are somewhat lower

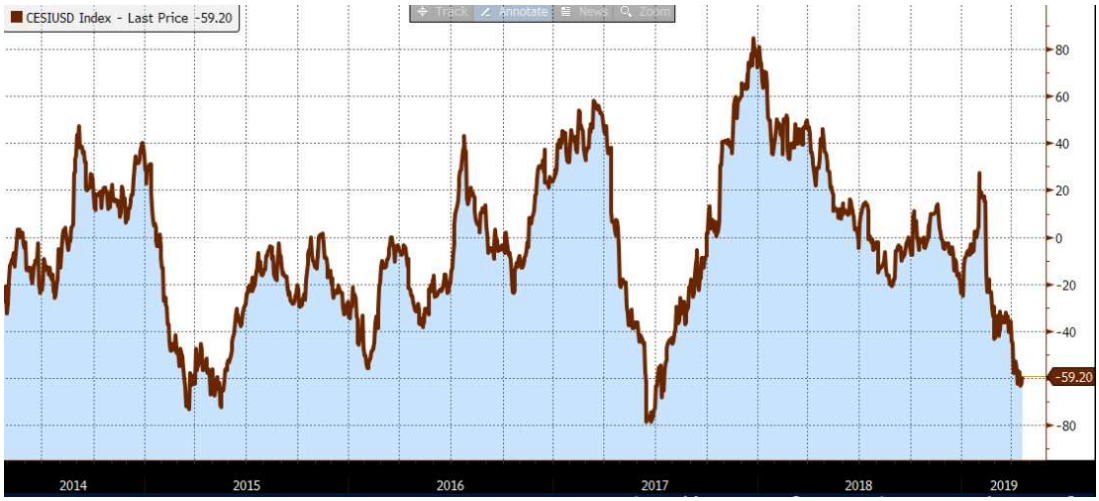


Interestingly, market-based expectations, measured by spreads like forward 5-year break-evens, have ticked up after reaching a low at the turn of the year. They now suggest an inflation rate of close to 2% (1.97%).

NCM Macro

The World Economy

While the US Economy has been disappointing relative to expectations…



The chart shown here shows the performance of high-frequency economic data like jobless claims, GDP and ISM survey results *relative* to economist forecasts. If data comes in better-than-expected, the number will be above zero. If data comes in worse-than-expected, the number will be below zero. Clearly, even with the reduced expectations in 2019, consensus forecasts were still too high.

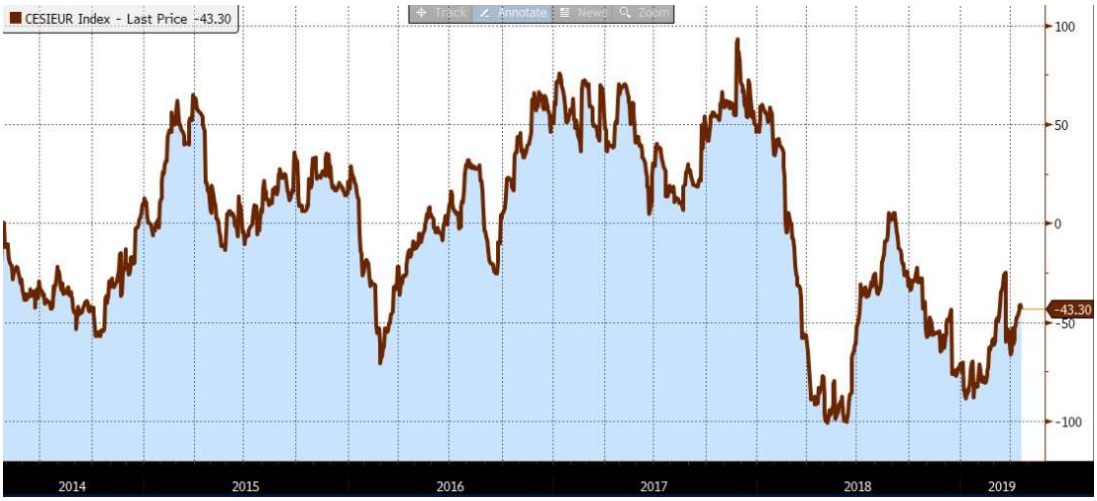
Unaffected by central banks, it appears that underlying economic growth and inflation is indeed decelerating and doing so significantly. In our view, this could continue through the middle of the year, at which point easier comparison periods from last year could boost results.

The nature of the chart shown is that it is self-correcting. As data disappoints, analysts will revise forecasts downward. Eventually, they will be so aggressive in cutting forecasts that it is almost impossible for data to come in worse-than-expected. Given the historical range of this chart, it appears we are close to that point now.

NCM Macro

The World Economy

The European economy is showing signs of improvement

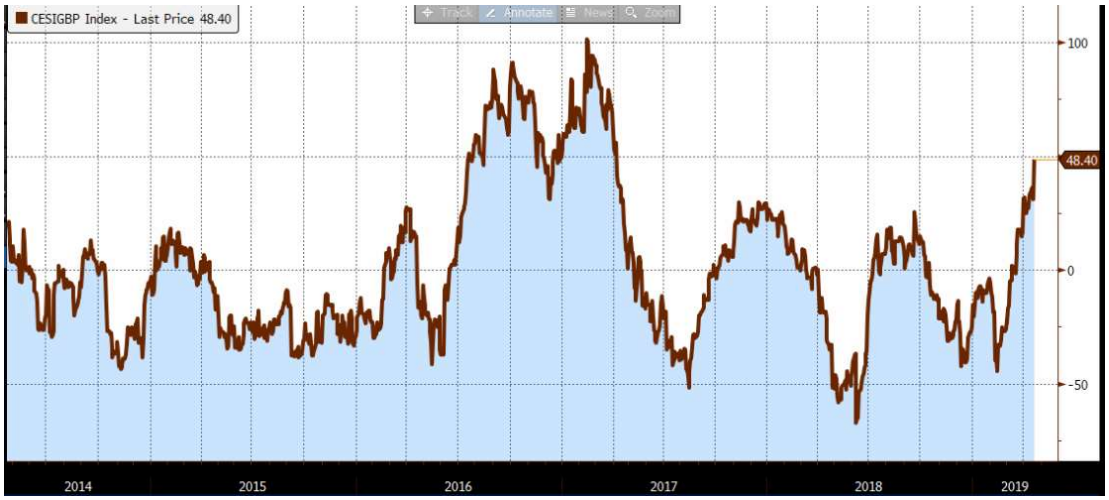


The previous slide looked at data from the US economy, but it is interesting to note the improvement in the European economy. Data is still disappointing but things are beginning to look a little bit more stable. This supports the case to look at Europe for short-term investment ideas.

NCM Macro

The World Economy

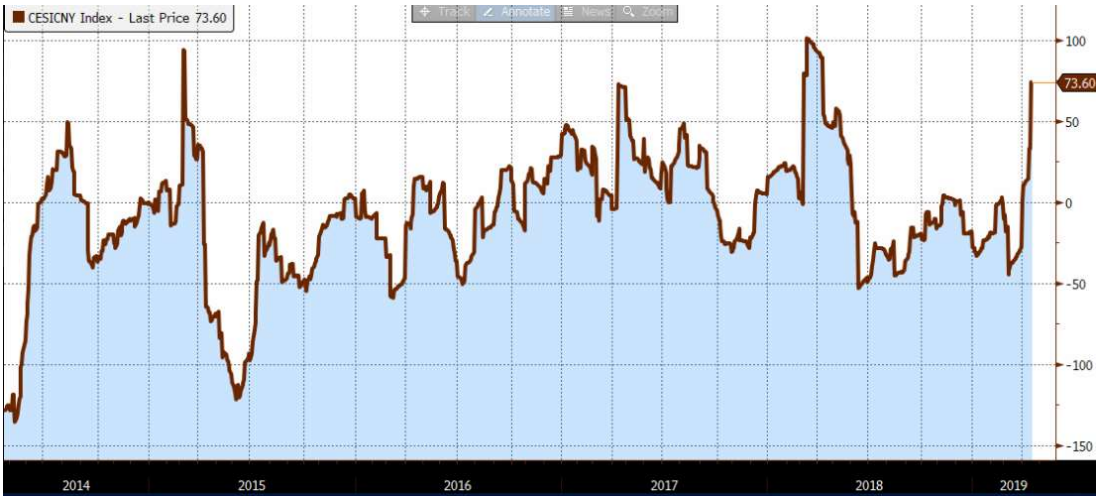
Especially in the UK



NCM Macro

The World Economy

China, too

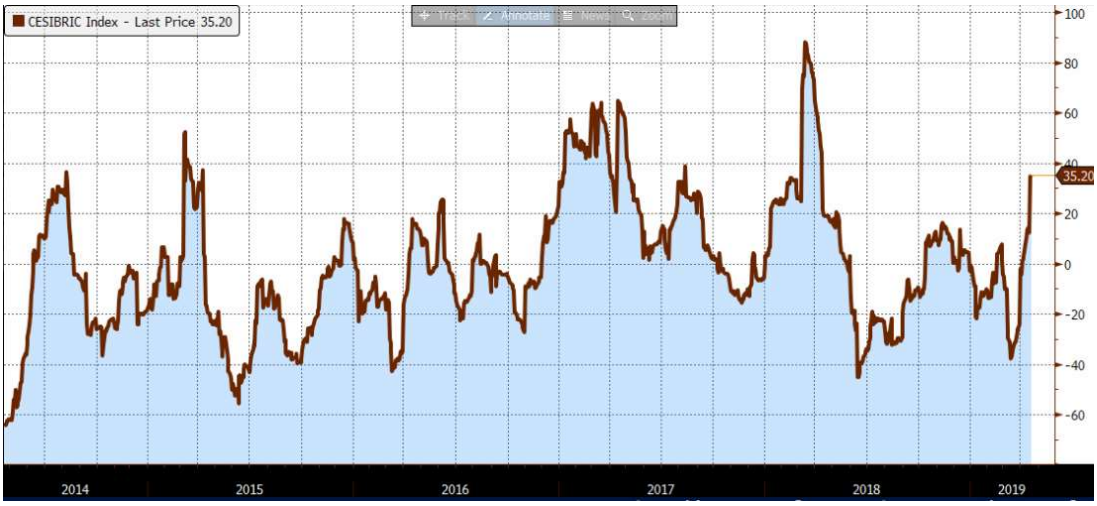


It should be noted here that China data is conspicuously volatile. A few positive readings does not a trend make. It would still be wise to tread carefully when considering equities in China.

NCM Macro

The World Economy

And that goes for all BRIC countries (Brazil, Russia, India, China)



Note, again, the influence of China in these numbers. One should also watch out for higher oil prices, as that is a significant input cost for these economies.

NCM Macro

Different Economies are Running at Different Paces

There are opportunities internationally

- Areas where recent growth may be sustained (e.g. China)
- Areas of heavy under-allocation (e.g. UK)

The domestic economy is relatively stable

- Small revisions to GDP are not anywhere near the recessionary fears which sprang to life at the end of 2018
- The manufacturing sector is more at-risk of rolling over than the services sector, although that could be attributed to short supply of experienced labor

Inflation remains well-contained

- Yet, in spite of the Fed's pivot to an "easier" monetary policy, inflation does not appear to be dropping as precipitously as some may fear

IV. Conclusion

- *Growth appears to have stabilized at a moderate level*
- *There are pockets of opportunity globally where low expectations coincide with improved economic fortunes*
- *Volatility is likely to return; increasingly aggressive buying from fund managers hastens that eventuality*

-Narwhal Capital Management

NCM Macro Outlook

QUESTIONS?

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