ICR® 1st Quarter Newsletter – April 2019

Global stock markets bounced back in the first quarter after a rough ending to 2018. The S&P 500 regained most of what it lost in the fourth quarter with a 13% gain in the first three months of 2019. And the gains were mostly of the slow-and-steady variety as volatility dissipated. Only eleven trading days saw a gain or loss of more than 1% during the quarter.

In foreign markets, the MSCI EAFE developed market index rose 9%, though it was held back by a modestly strengthening dollar. Emerging markets rebounded from their poor performance last year by posting a 9.6% gain in the first quarter. The Shanghai Composite in China rose 24% in spite of ongoing trade tensions with the U.S. that helped cause the index to lose over a quarter of its value in 2018. Great Britain's exit from the European Union was postponed until the end of June and how smooth – or not – that process goes will likely impact not just European markets, but global markets generally.

Investors were encouraged by the Federal Reserve's shift away from a monetary tightening policy. After raising the Federal Funds target rate in December, the Fed elected to keep the rate unchanged in the first quarter. In addition, at their March meeting, the Fed reduced their forecast for 2019 rate hikes to zero. Just six months earlier, the forecast had called for five rate increases this year. In addition, the Fed announced plans to end its quantitative tightening policy before year-end, which will stop the reductions in its balance sheet. These monetary policy developments proved to be a tailwind for risk assets.

In bond markets, the 10-year Treasury yield fell from 2.68% to 2.41% during the quarter. Worryingly, the spread on five-year Treasury yields versus three-month yields inverted on March 7, meaning that an investor could obtain a higher interest rate by loaning to the government for three months than they could for five years. When this inversion has persisted for at least three months, the beginning of a recession has followed within 12-18 months. This has been the case for every recession over the last 60 years and there have been no false signals. As of this writing, that portion of the yield curve is still inverted, which means we are approaching the halfway mark for what has been a reliable signal.

Of course, things change. The yield curve inversion has been a reliable indicator in the past, but what if things are different now? Perhaps Federal Reserve intervention over the last ten years has distorted the bond markets to the point that yield curve inversions no longer mean what they used to. If the current economic expansion reaches July (which seems likely at this point), it would mark the longest period without a recession in our nation's history. While there are some signs that we are in the late part of the economic cycle, expansions have been lasting longer and recessions have been more rare in the last 30 years, so it's possible the music won't stop any time soon. What we do know, though, is that at some point it will stop. Whether that happens in a few months or a few years is hard to say. But, it's important to be prepared when it does. So, what does that mean from a portfolio perspective?

First, it is especially important to be selective and prudent in one's investment decisions. As we approach the end of an economic expansion, the potential for downside volatility increases. It is important to lean one's portfolio towards those securities and asset classes that can survive a recession. We often refer to these types of securities as bend-but-don't-break investments. As we learned in the financial crisis of 2008, when things get ugly, even high quality securities will lose value. This is because investors are selling whatever they can and often it is those high-quality securities that are the easiest to sell when markets are in panic mode. And that is why it requires patience to hold a bend-but-don't-break portfolio. In the event of a recession and market pullback, those securities will lose some value, but the important thing to remember is that they will survive and – over time – recover.

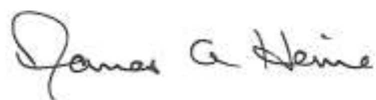
Next, an investor needs to have an investment plan that they can stick with. This sounds like a no-brainer, but it is far easier to stay the course when the economy and markets have been mostly good for the past ten years. While it is important to prepare one's portfolio for a downturn, it is equally important to prepare psychologically for that event. Now is the time to evaluate the potential downside of a portfolio and ask, "Can I stay the course if that downside materializes?" If the answer to that question is 'no,' then the time to make changes is now – not after the downside has occurred.

As mentioned earlier, we do not know when the economy will slow and markets will decline – only that it will happen at some point. We think that excessive debt of multiple varieties – corporate, student loans, and car loans, to name a few – has the potential to provide the catalyst for a downturn. But those issues can take a long time to play out or they can become problematic with very little notice. With that in mind, we are already making portfolio adjustments that we think will help in the event of a downturn.

If you would like to discuss the issues raised here or have any questions about how your portfolio is positioned, please do not hesitate to call us. Meeting your financial goals should be a collaborative process. It is important that we understand your concerns so that we can tailor a financial plan and investment portfolio that allow you to remain confident when challenges arise.

As always, we truly appreciate the opportunity to work with you.

Sincerely,



James A. Heine James L. Cobb

Market Report (as of 3/31/19)

Index	2019 YTD (%)	3-Year Annualized (%)	5-Year Annualized (%)
S&P 500	13.07	11.23	8.65
Dow Jones Industrial Average	11.15	13.60	9.52
U.S. Aggregate Bond Index	2.94	2.03	2.74
MSCI EAFE (Foreign Index)	9.04	4.32	-0.42

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