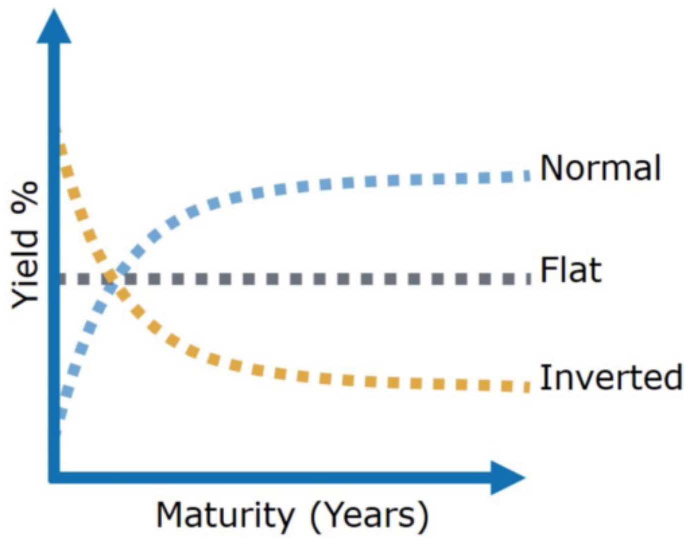
Portfolio Partners Newsletter

April 2019

COMMENTARY

The noise machine that is the financial media sounded the alarms like Paul Revere on his midnight ride, “The Yield Curve Inverted! The Yield Curve Inverted!” If you’ve read previous newsletters you know our take on financial media – fear, fear and more fear to get clicks, clicks and more clicks. We get it, they’re running a business and they have smart people running the companies who understand cognitive psychology and decision theory. Studies suggest that losses are twice as powerful as gains at a subconscious level, so its no wonder we see more stories that tap into the fear of losing. Rant over. Let’s take a look at the yield curve and see what it is and why is it important.



What is the yield curve? A yield curve is a graph that plots the interest rates of bonds at different lengths of maturity. Most of the time the yield curve is in the “Normal” position. The “Normal” position shows investors demand a higher interest rate for a longer maturity OR demand a higher rate of return for more risk. The longer you invest funds, the more you should be rewarded for that investment/risk. A “Normal” position in the yield curve is usually the case when investors are positive on the economy and do not see major concerns. An “Inverted” yield curve is the opposite of a “Normal” yield curve with short-term rates higher than long-term rates. If investors think rates are going to be lower in the future, they will start buying longer maturing bonds to lock in those higher yields. With bond prices and yields inversely related, the buying of the bonds drives down the yield. You may also see the short-end

ECONOMIC HIGHLIGHTS

S&P 500	2,834.40
DJIA	25,928.68
NASDAQ	7,726.32
OIL	$61.14/barrel
GOLD	$1,298.50/ounce
10-YEAR TREASURY YIELD	2.41%
UNEMPLOYMENT	3.8%
GDP	2.2% (Q4 Final)
CONSUMER PRICE INDEX (CPI)	-0.2% / 12 month change: +1.5%
CORE CPI	+0.1% / 12 month change: +2.1%

GDP – the fourth quarter was solid (2.2%) with strength from consumer spending in both services and goods. Business investment also show strength. We expect weaker numbers for the first quarter of 2019, but weakness in the first quarter is typical.

FOMC Meeting Announcement – rates remained unchanged (targeting 2.25% to 2.50%) as the Fed shift to the dovish side continued. The stock market is enjoying the dovish of the Fed, but the downgraded assessment of the economy is something that needs close monitoring.

Inflation – the Personal Consumption Expenditure (PCE) price index showed weakening inflation year-over-year (+1.4%). PCE is the main inflation gauge for the FOMC and ideally would like to see a year-over-year number around 2.0%.

of the curve move up as invests sell shorter-term bonds to buy longer-term bonds. A “Flat” or “Humped” (Humped curve not pictured) needs to happen before the yield curve goes from “Normal” to “Inverted”.

Why is the yield curve important? The yield curve has inverted before recessions in the past; it hasn’t inverted every time we’ve had a recession, but anytime we’ve had an inverted curve a recession has followed at some point (anywhere from 10-22mo), so it’s something that is closely followed.

Where is the yield curve today? The current yield curve is a mixed bag with the short-end of the curve inverted (3mo to 5yr), but the overall curve is still in a normal position. Looking at the two graphs we can compare the current state of the yield curve vs the last time the yield curve inverted in February 2007. We think this shows that the panic from financial media is a little much right now. This is something to watch for sure, but the panic isn’t called for.

Current:

Feb. 2007:

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Our long-term view (multiple years) for equity markets is still bullish. We believe we are in the middle part of a secular bull market. With the previous two secular bull markets lasting 17 years, so we could be in for a nice ride if this secular bull market is of similar duration. The Fed has done an about-face turn in regard to the target rate on the Federal Funds and have been more dovish in 2019. Our S&P 500 target for 2019 is 2800 for the year-end. In Fixed Income, we are maintaining our over-weights in International and Floating Rate bonds and underweight in U.S. Government Bonds and Mortgage-Backed Securities. Our research team is constantly evaluating our products and tactical positions inside both our fixed income portfolio and equity portfolio, looking at both larger trends and short-term opportunities. With daily monitoring to accounts on an individual basis, we continue to rebalance accounts when they fall too far from their equity-to-fixed income ratio.

MARKET TRACKER

Index	3 Mo	1 Yr	3 Yr	5 Yr
S & P 500	13.65	9.50	13.51	10.94
MSCI EAFE	9.98	-3.71	7.27	2.33
BARCAP AGG BOND	2.94	4.48	2.03	2.74

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The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the Nasdaq. The Nasdaq is a global electronic marketplace for buying and selling securities, as well as the benchmark index for U.S. technology stocks and is also used to refer to the Nasdaq Composite, an index of more than 3,000 stocks listed on the Nasdaq exchange. The MSCI EAFE index is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted. The Barclays Capital U.S. Aggregate Bond Index, which used to be called the 'Lehman Aggregate Bond Index', is a broad base index, maintained by Barclays Capital, and it often used to represent investment grade bonds being traded in the U.S. Barclays Capital (BarCap) U.S. Aggregate Bond Index is made up of the Barclays Capital U.S. Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Based Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million.