ROUND TABLE
WEALTH MANAGEMENT

THE BIG PICTURE
FIRST QUARTER 2019

Summary

Economic developments in the first quarter suggest conditions softened across most regions. The U.S. remains one of the stronger developed economies, while Europe and China have seen more meaningful deceleration. The two glaring obstacles in the face of global growth are the U.K.'s Brexit saga and the ongoing trade negotiation between the U.S. and China. Unfortunately, the first three months of the year haven't brought matters closer to resolution on either front. Central banks took notice of slowing conditions, with the most noticeable easing coming from the Federal Reserve. Meanwhile, the ECB may be dusting off old tactics to try to reignite the economy.

Domestic Economy

The U.S. economy continues to shine, but slowing conditions overseas can still have a negative impact.

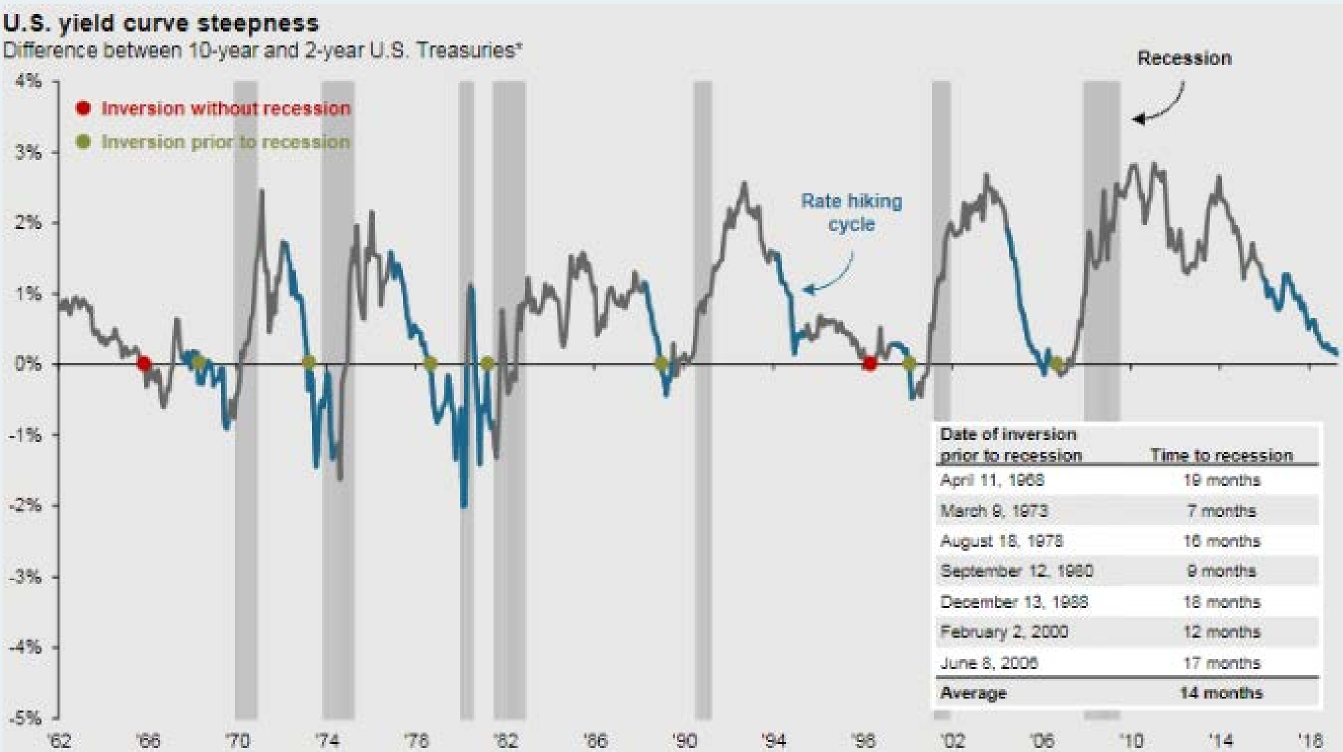
Relative to the rest of the world, the U.S. economy remains a beacon of strength. Unemployment is hovering below 4%, an increasing number of workers are being drawn into the workforce, and wages are growing. Core inflation is also oscillaiting around the 2% target, a level that has eluded other developed regions such as Europe and Japan. However, on an absolute level, data indicate that the pace of growth has slowed some. Fourth quarter GDP growth came in at an annualized quarter-over-quarter rate of 2.2%, a meaningful step down from the 3% and 4% growth rates from the prior two quarters. Indicators of future GDP growth such as the Institute of Supply Management (ISM) business survey indices and the Atlanta Fed's GDP Now tracker suggest that the economy entered a period of slower growth in the first quarter as well.[1]

Part of the issue may be the nature of today's globablized economy. U.S. corporations have sprawling operations across the world, and softer demand from abroad can impact profits at home. While the U.S. is largely an internally-driven economy, weaker export demand can still have an impact on total output.

Monetary Policy

The U.S. Federal Reserve is the most scrutinized central bank in the world, and on that thought, the Fed's decision to raise interest rates in December of 2018 became one of its most controversial decisions. Following a sharp stock market selloff, Chairman Jerome Powell sought to inject some calmness into markets by providing assurance that the Federal Reserve was not deaf to the cries of the market and would proceed cautiously. Sure enough, in its March meeting, the Fed announced that its balance sheet tapering plan would end in September of 2019, and that new projections from Fed members indicated that no additional rate hikes were expected for the remainder of the year. This pivot helped buoy equity markets, but also led to a sharp decline in long-term interest rates. The drop was enough to cause a major portion of the Treasury yield curve to invert. Yield curve inversion is a closely-watched indicator as it has historically been an accurate predictor of an oncoming recession, although timing has varied greatly. With long-term rates depressed, further interest rate hikes would only invert the curve more steeply. The likelihood that interest rates will be cut has certainly increased.

Yield Curve Inversion and Oncoming Recessions



Date of inversion prior to recession	Time to recession
April 11, 1968	19 months
March 9, 1973	7 months
August 18, 1978	16 months
September 12, 1980	9 months
December 13, 1988	18 months
February 2, 2000	12 months
June 8, 2006	17 months
Average	**14 months**

Source: FactSet, Federal Reserve, J.P. Morgan Asset Management Guide to the Markets – U.S. March 31, 2019

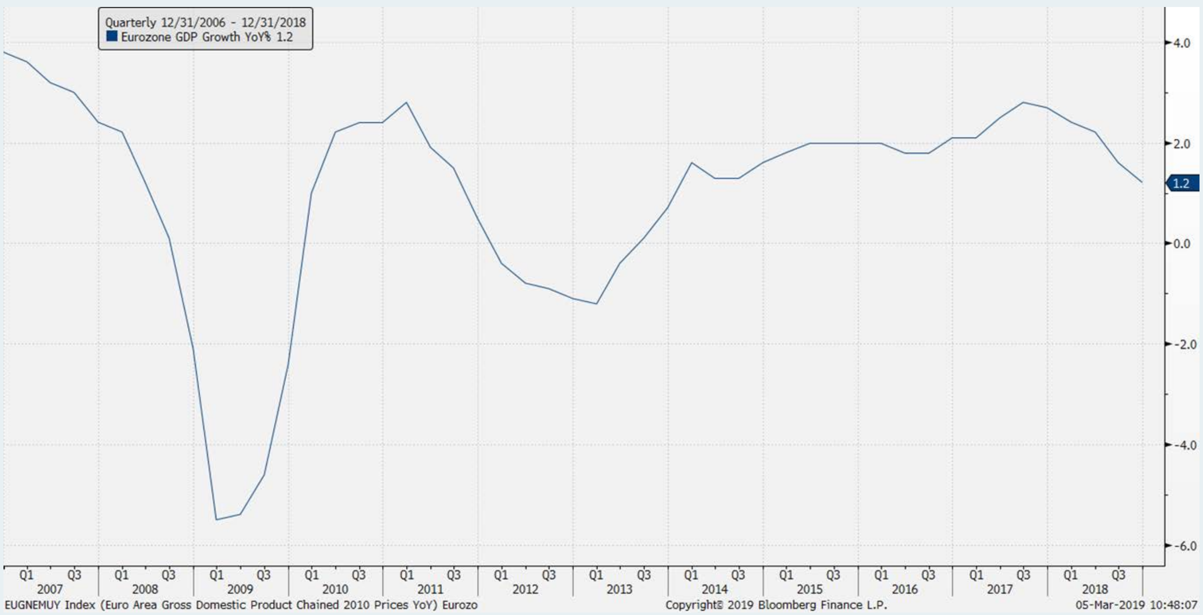
International Economy

Developed Europe

Economic momentum has declined within the Eurozone.

The Eurozone has experienced a marked decline in economic momentum in recent quarters. Fourth quarter GDP growth registered just 1.1% year-over-year, although that figure masks the fact that countries such as Italy actually contracted. Using 10-Year German Bund yields as a proxy for growth expectations does not provide additional comfort as they closed the quarter in negative territory for the first time since 2016. Forward-looking indicators, such as the Markit PMI Manufacturing Index, indicate a rather meaningful contraction, particularly in production powerhouse Germany.[2] In his March press conference, ECB President Mario Draghi outlined “substantially” lower real GDP forecasts for the coming year. Additionally, a new round of the TLTRO (Targeted Longer-Term Refinance Operation) program was announced. TLTRO provides cheap funding to banks under certain conditions that those funds are lent into the economy. All this being said, the ECB forecasts a rebound in growth for 2019, and a portion of the weakness in Germany can be attributable to a temporary slowing within its auto industry. Even with a rebound in growth, given that core inflation is running below 1%, there is ample runway for continued monetary easing and it appears policy normalization may be delayed for an extended time.

Eurozone GDP Growth (Year over Year)



Source: Bloomberg

United Kingdom

Another quarter passes by, and the United Kingdom has not secured its future with the European Union. Parliament has now rejected Theresa May's withdrawal plan three times as internal disagreement has prevented the necessary votes from securing its passage. Following the timeline of events over the recent months is actually quite confusing. On the one hand, Parliament has clearly rejected the current proposals as they stand. On the other hand, Parliament has recognized that a "No-Deal" Brexit would be a diasterous event and voted against the prospect of a No-Deal scenario in March. Prime Minister May has asked the E.U. for an extension to allow Britain to solidify its plans, which the E.U. will likely grant. The two primary parties, Labour and the Conservatives, do share some common goals such as an end to the free movement of citizens throughout the E.U., and Theresa May recently has taken a more conciliatory stance on the government's ability to come to a rational compromise.

From an economic perspective, the U.K. appears to be holding up better than other European nations in some regards. Unemployment has actually fallen below the 4% level, which is well below the Eurozone average of roughly 8%, and wages have been growing steadily. However, measures of future economic activity such as the OECD Leading Indicator Index and the Markit Services PMI Index have fallen into contractionary territory.[3] While current trends are mixed, a deal which either keeps the U.K. in the customs union or becomes something akin to a "No Deal" scenario could rapidly change conditions.

Emerging Markets

China

Negotiations between the Chinese and U.S. delegations have yet to produce a deal, although the Trump administration appeared to indicate that one was becoming likely. As many trade analysts have detailed, the larger issue at hand concerns intellectual property rights, protection, and enforcement. While it is difficult to parse through the ebb-and-flow from the news wires, the two sides at least appear to be holding off on further escalations with regard to tariffs.

The Chinese economy has shown signs of stabilization, although growth levels will continue to moderate.

While the U.S. economy has been growing at a strong rate relative to recent history, the Chinese economy has tapered off some. The economy grew at 6.4% in the fourth quarter, the lowest rate since 1996. In response to slowing domestic and global growth, officials have loosened restrictions on credit growth, and the effects appear to be showing through. Markit PMI Indices rebounded across the board, with manufacturing rebounding back into expansionary territory as of March 31, the first meaningful increase since Q1 of 2018.[4] Retail sales and infrastructure investment data also stabilized as well relative to the prior reading. Officials are expected to continue to provide a supportive environment for business through additional cuts to bank required reserve ratios. These cuts are intended to free up additional capital for banks to lend out into the economy. Of course, growth fueled by credit is not ideal for an already leveraged economy, but Chinese officials are keen on keeping pace with projected growth targets. Additionally, given that the Chinese are entrenched in a negotiation with the U.S., they likely would not want to appear weak for fear of losing leverage in any proposed resolutions.

[1] Source: Bloomberg
[2] Source: Bloomberg
[3] Source: Bloomberg
[4] Source: Bloomberg