Dear Clients and Friends ~

Following a tumultuous close to 2018, stocks enjoyed a robust January. Positive feedback from ongoing negotiations between the United States and China, coupled with strong job growth, low inflation, and stable interest rates, helped fuel investor confidence that pushed the major benchmark indexes to levels not seen in 30 years — despite a partial government work stoppage. Each of the indexes listed here posted notable gains, led by the Small-cap Russell 2000, followed by the Nasdaq, S&P 500, Global Dow, and the Dow.

Stocks continued to climb in February, albeit not at the breakneck pace of the previous month. Corporate earnings reports were generally positive, and trade talks between the United States and China continued with no deal being reached, but signs of a favorable resolution in sight. With a collective sigh of relief from many, the partial government shutdown ended at the end of January.

So, anxious investors, take heart: The U.S. Federal Reserve hears you. It appears that policy uncertainty and market volatility prompted the Fed's re-think for short-term interest rates in 2019. The new baseline forecast is for a single additional rate increase (the tenth since December 2015) and perhaps the final hike of the current monetary-policy cycle. In fact, Fed policymakers themselves have signaled a willingness to reconsider their path forward. Not long ago, that path included as many as three expected rate hikes this year. The latest forecast from the Fed's policy-setting Open Market Committee perhaps one rate increase for 2019 and none for 2020. There will be enough going on in that election year to fully occupy the headlines without additional chatter from the Feds!

Some might say, “What bond bear market?”
There aren’t any signs of one yet. The consensus for both interest rates and inflation is that both stay “lower for longer,” a view that’s been right on target for years. That belief became ingrained in investors from thirty years of disinflation as falling tariff barriers allowed global companies to produce their products at lower costs by employing hundreds of millions of low-wage workers from China and other emerging countries. That disinflation was followed by a near-decade of slow growth and intense fears of deflation from the global financial crisis and its aftermath. So, modest inflation and the low interest rates that accompanied it still seem permanent.

But, the manufacturing cost advantage of many emerging markets has been narrowed by years of fast wage growth, especially in China. One consistent theme that echoes the shift is tight labor markets and accelerating wage growth across major developed countries. Robust productivity growth in the United States, though, is keeping business’ unit labor costs tame, so there is less current need for raising prices to protect profits. However, if wage gains persist and spare capacity gets utilized, eventually, inflation will work its way higher. At that point, long-term interest rates will need to contain an inflation premium and yields will rise. That may not come until sometime in 2020.

Investors continued to push stocks higher. The Russell 2000 again led the way for February, increasing its value by over 16% over the first two months of 2019. Of the indexes listed here, only the Global Dow failed to gain at least 3.0% (or very close to it) by the end of February.

March saw stock values fluctuate on a fairly regular basis throughout the month. The large caps of the Dow posted minimal end-of-month gains, while the Russell 2000, which had been riding a solid wave of gains during the first two months of the year, took a bit of a dive in March, falling over 2.20% from its February closing value. The Global Dow moved ever so slightly down by the end of March. Only the Nasdaq and S&P 500 posted notable gains for the month.

At the end of the day, well, quarter, the first quarter of 2019 proved to be a positive one for stocks, period. Each of the benchmark indexes listed here closed the quarter with gains of more than 10% (except for the Global Dow), kicking the year off on very solid footing. Despite signs of a weakening global economy and low inflation, news that the Fed is backing off its plan to increase interest rates helped quell investors' concerns. Both the technology and energy sectors enjoyed a strong first quarter. By the close of trading on February 28, the price of crude oil (WTI) was $57.26 per barrel, up from the January 31 price of $53.95 per barrel. The price of gold dipped by the end of February, falling to $1,314.40 by close of business on the 28th, down from $1,325.70 at the end of January.

Market/Index	2018 Close	As of March 29, 2019	Monthly Change	Quarterly Change	YTD Change
DJIA	23327.46	25928.68	0.05%	11.15%	11.15%
NASDAQ	6635.28	7729.32	2.61%	16.49%	16.49%
S&P 500	2506.85	2834.40	1.79%	13.07%	13.07%
Russell 2000	1348.56	1539.74	-2.27%	14.18%	14.18%
Global Dow	2736.74	3000.81	-0.01%	9.65%	9.65%
Fed. Funds	2.25%-2.50%	2.25%-2.50%	0 bps	0 bps	0 bps
10-year Treasuries	2.68%	2.40%	-31 bps	-28 bps	-28 bps

Chart reflects price changes, not total return. Because it does not include dividends or splits, it should not be used to benchmark performance of specific investments.

Latest Economic Reports ~

- **Employment:** Total employment rose by only 20,000 in February after adding 311,000 new jobs (revised) in January. The unemployment rate declined by 0.2 percentage point to 3.8% in February, and the number of unemployed persons decreased 300,000 to 6.2 million. Among the unemployed, the number of job losers and persons who completed temporary jobs declined by 225,000. This decline reflects, in part, the return of federal workers who were furloughed in January due to the partial government shutdown.

- **GDP/budget:** The third and final estimate of the fourth-quarter gross domestic product showed the economy grew at an annualized rate of 2.2%. Of note, consumer spending (personal consumption expenditures) rose by 2.5% in the fourth quarter, and 2.6% for the year. Also of note, business investment rose 5.4% for nonresidential fixed investment.

- **Inflation/consumer spending:** The report on consumer income and spending, one that is favored by the Federal Reserve as an inflation indicator, showed personal income decreased 0.1% in January but increased 0.2% in February. Disposable (after-tax) income fell 0.2% in January, but then increased 0.2% in February.

- **Housing:** Following a mundane 2018, it's taken the housing sector some time to pick up steam in 2019. February appears to be the month where sales picked up the pace. Sales of existing homes *vaulted* 11.8% in February after dropping 1.2% in January. Year-over-year, existing home sales remain down 1.8%.

Understanding that these are national numbers and not indicative of home prices in most of California, we think these numbers may still be of interest to you. The February median price for existing homes was $249,500, up from $247,500 in January. Existing home prices were up 3.6% from February 2018. Sales of new homes also improved in February. Sales of new single-family houses in February were 4.9% higher than January's rate. The median sales price of new houses sold in February was $315,300, $303,900 in January.

- **International markets:** In Great Britain, Prime Minister Theresa May was unable to gain parliamentary approval of the exit deal she negotiated with the European Union. Parliament could do no better as it failed to find consensus on any kind of Brexit plan. The European Union agreed to extend the deadline for a deal to April 12, with the proviso that a further extension would be possible only if the United Kingdom agreed to hold European election on May 23, which Prime Minister May does not wish to do. The eurozone's fourth-quarter GDP advanced at an annual rate of 0.2%, dragged down by sluggish consumer spending. The negotiations between the United States and China continue to drag on. Apparently, the two sides are trying to come up with a plan that provides increased U.S. exports to China, greater access to American companies, and added protection of intellectual property. And the beat goes on . . . . .

- **Consumer confidence:** Of note, the Conference Board Consumer Confidence Index® dropped from 131.4 in February to 124.1 in March. Consumers expressed growing doubt over the labor market following the latest jobs report. The Present Situation Index, which gauges how consumers feel about current business and labor market conditions, declined in March from 172.8 to 160.6. Consumers' outlook for income, business, and labor market conditions over the short term also fell.

Eye on the Month Ahead ~
At the close of February, there was guarded optimism that a trade accord between the United States and China would come to fruition. As we leave March, negotiations are still ongoing with no real signs of progress being made. In any case, April may bring with it a heartier employment report while there's hope that the residential sector will continue to advance. A big unknown heading into April is the aftermath of the Brexit saga and its impact on the global economy.

Where Do We Go from Here?

With valuations high, yields so low and spreads so tight, could bonds still be a buy?

For new purchases perhaps short-term only might be worth a try.
But, stocks and bonds tell different tales about what lies ahead. Stocks say optimism reigns, but bonds cry growth will shred. If bonds are right and growth is poor, then stocks will start to fall. If bonds are wrong, then yields will rise, and stock returns stay small.
Inflation's not a problem now, with the consensus being "low for long." But, wages are surging and could turn that view all wrong. If inflation starts to rear, we may need more than FMOC Powell's bat to finish out the year.

Never a dull moment . . . . .

Best Regards,

Barbara, Gloria, and Kate

Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). News items are based on reports from multiple commonly available international news sources (i.e. wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations. All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Past performance is no guarantee of future results. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful.

The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. The U.S. Dollar Index is a geometrically weighted index of the value of the U.S. dollar relative to six foreign currencies. Market indices listed are unmanaged and are not available for direct investment.

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