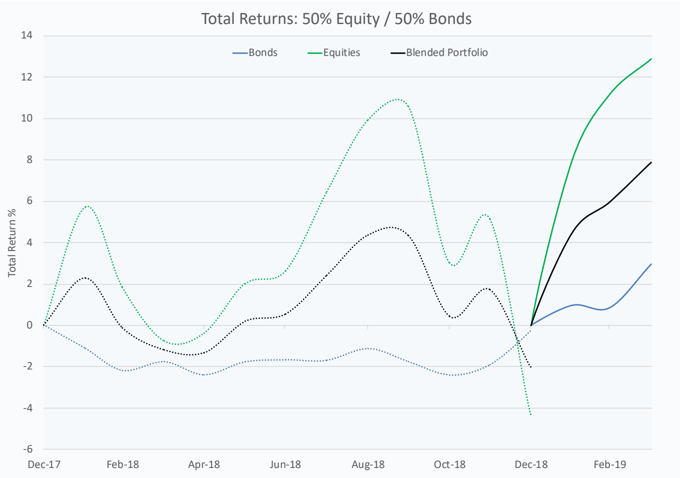
APRIL 1ST, 2019
RYE, NY
914.282.0941
WWW.BLUMBERGADVISORS.COM

WHERE WE STAND – Q1 2019

The S&P 500 Total Return Index was up 13.6% (including dividends) in Q1. See the solid green line to the right in the chart below. The Aggregate Investment Grade Bond Index (including interest) was up 3.0% for the quarter (blue line). If your portfolio comprised 50% S&P 500 and 50% Bonds, your YTD return would be 7.9% (black line). Data for 2018 is shown, broken lines, to the left.



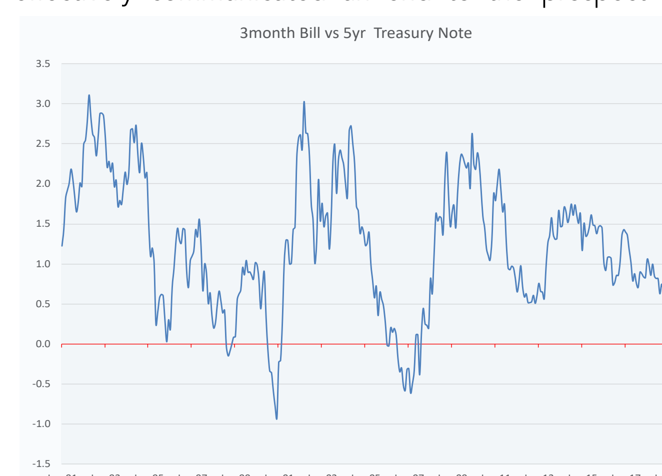
Overview

US equities, in response to easier global monetary conditions, rallied sharply in the first quarter, partially recovering the declines that were seen in Q4 2018. The index regained the 2800 level and the 200-day moving average, as shown below. For now, this leaves open the

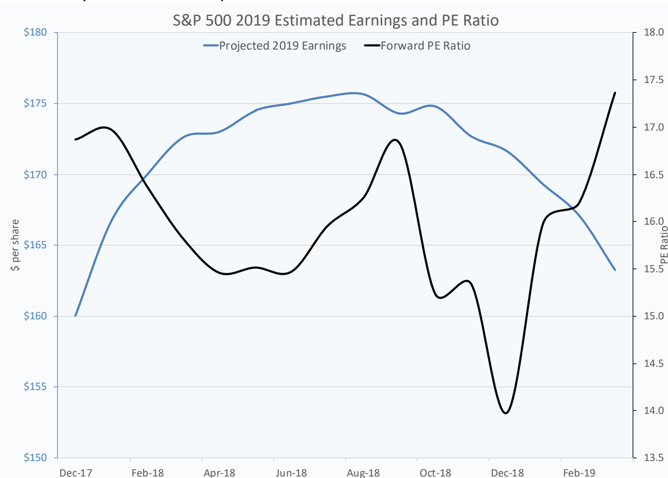
question as to whether the equity market's 20% correction in late 2018 was the beginning of a 'topping', end-of-cycle phenomenon, or merely a correction in what will be an ongoing bull market.

Long term interest rates fell during the quarter, with the benchmark US 10-year note falling back below 2.5% from 3.25% in late 2018, as shown in the chart below. In the

process, the US yield curve continued to flatten and by some measures invert (see next chart), intensifying the debate over whether the current US economic slowdown will worsen or not. The Federal Reserve has taken this bond market signal very seriously, aware that similar inversions have presaged most recessions. The Fed has effectively communicated an end to the prospect of



raising its benchmark interest rate, at least for the foreseeable future.
During the quarter, earnings forecasts for the S&P 500 benchmark stock index continued to decline, as indicated by the blue line in the chart below. The black line in the chart (the forward PE ratio), is a reflection of investor confidence in future earnings, and specifically, how much they are prepared to pay for those earnings. To be sure, earnings projections have been on a steady decline since late 2018, and investor confidence has been on a roller coaster: plunging into late 2018 and returning strongly in 2019. Investors have made a recent leap of faith and the current sentiment is: global central banks have come to the rescue and easy money has returned and will reverse the current global economic slowdown. Note, how in the process, the forward PE ratio has risen from an attractive ~14x earnings in late 2018 to ~17.5x earnings today, the most optimistic/expensive in over a year.



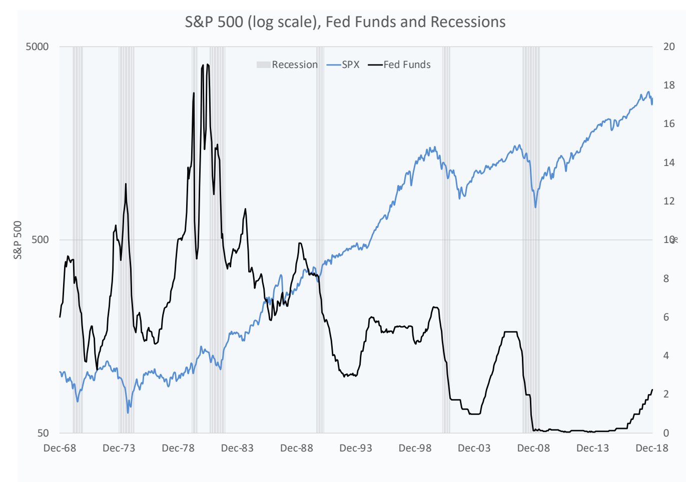
Where We Stand

The last 6 months has seen volatility return to markets with a vengeance. After plunging 20% in Q3 2018, equities have rallied back substantially in Q1 2019. This volatility is understandable, as investors struggle to interpret the increasing informational cacophony that surrounds them: tax cuts; rising deficits; negative interest rates; Fed raising rates; Fed cutting rates; trade wars; China economy slowing; German production slowing; FED, ECB and PBOC pumping liquidity into their monetary systems and Brexit, to name a few.

The increasing democratization of information and the rise of artificial intelligence as utilized in algorithmic trading/investing has played a part in creating this frenzied investment environment. And, in addition, the last few years have seen a developing environment that is different from previous cycles. The global economy has become increasingly complex with shifting economic prominence towards so-called emerging markets. There has become an increasing reliance on debt at the corporate level, central bank liquidity pumping and deficit financing by governments to achieve desired economic growth. It seems to us, that these imbalances are growing day by day, and ultimately, fiscal and monetary authorities will lose control, the market will enforce the required discipline, and over time these imbalances will correct.

Our recent approach has been to reduce the volatility in our portfolios (recognizing that we are late in the economic cycle); to fundamentally have a strategy of capital preservation with, as always, an emphasis on maximizing risk-adjusted returns; and to take advantage of short-term market volatility to seek short-term return opportunities. Ultimately, we want to be well prepared for the next cycle and at that point to find long term investment propositions.

The sudden turn in Federal Reserve policy, however has forced us to ask the question: are we currently in a period like the mid-1990's when the Federal Reserve paused, but the equity market continued rising into bubble territory? Or is this like 1999 and 2007 when the Fed pause presaged a recession and equity bear markets. See the following chart.



Only history will provide us with the answer to these questions, and it's probable that the outcome will be different because the geo-political and socio-economic backdrop is so different this time round. Our work points to the likelihood of an equity market bubble being less likely, and even so, we have no interest in relying on

bubble like conditions to generate investment returns. There will always be opportunities to make value-based investment decisions over the years to come.

We've concluded that for now we don't feel forced to make long term adjustments to our portfolios, especially when we believe there is very little fiscal or monetary safety net below.

All our portfolios are on their high-water mark and we are well positioned for the next cycle as it unfolds.

We will continue to take advantage of short-term opportunities as we did in Q1, and just as the Federal Reserve has said they want to be patient (because of the uncertain economic outlook), so do we.