Intrinsic Investors

Investors Quarterly

*Timely Insights into Markets and the Economy*

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### ***Equities***

- Sometimes, the stock market is a little like winter in Wisconsin. If you don't like the weather, wait a few months until things warm up again. While we are still waiting for the weather to change, stock prices began warming up again in January, erasing all of December's losses and as of this writing, we find the S&P 500 within striking distance of the all-time highs.

- The most recent quarter delivered the best first quarter performance for stocks since 1998. This resulted, in part, from the resolution of the temporary government shut-down, (remember that?) but more significantly from the signal from the Federal Reserve that the much feared ongoing rate increases have, for now, been put on hold forestalling the dread over the flattening yield curve (*see below*) and an imminent recession.

- Not that there isn't always something to worry about, we still have to contend with slowing global growth, continuing trade and tariff concerns and not to be ignored, Brexit. The current state of the UK's divorce from the EU deals with the desire of some to maintain some level of *customs union* (soft Brexit) versus the government just moving ahead with the 2016 referendum and leave with *no deals* (hard Brexit). It remains to be seen how this plays out in the days and weeks ahead.

- Domestically, while the political circus in Washington appears to be between acts, the ongoing theater on the trade front grinds on. The short take on China and *tariffs* is that despite the short-term impact on the U.S. economy, the Chinese want the tariffs *gone* and will agree to whatever makes that happen.

- A new quarter brings a new earnings season. Despite the nay-saying, earnings grew in the *3-4% range* in Q1. Some question whether this can continue since the tax cuts are cooked into the cake (but the cuts are still there!). After strong earnings growth since mid-2016, we wouldn't be surprised to see a leveling out of *EPS growth*. Still, the economy continues to grow.

## ***Fixed Income***

- As mentioned above, the Fed's decision to play *wait and see* on additional rate hikes has had a tonic effect on equity prices, but it also sends a signal to fixed income investors, who have had to suffer through bond price volatility these past three years. Relief may be at hand.

- It doesn't hurt to repeat that the financial system, including the Fed still finds itself in unknown territory (*terra incognita*). The 2008 financial crisis took us down a strange path. Without getting into the minutia again, fixed income investors might use this pause in monetary tightening to re-visit a strategy we have been unable to use for a long time - *Laddering*.

- Some of you are familiar with this old-school and largely successful strategy. Laddering works best in a rising interest rate environment. Think of the rungs of a ladder representing various maturities. By dividing your assets into equal amounts and placing them on successive rungs, you can maintain partial liquidity, but achieve a higher average yield. Each maturing security is rolled out to the next open rung, locking in a higher yield. I love this strategy!

- Naturally, we cannot conclude our review of the fixed income market without commenting on ongoing *crisis-du-jour* surrounding our old friend, the Yield Curve. In the last installment of this letter, I pointed out that the media was sort of getting it wrong on yield curve *inversion*, pointing out that it's the 3 Month/10 Year spread that matters. The inversion actually *occurred* in late March.

- While it was only a fractional inversion and it only lasted a day, it confirms we are late in the game and need to look at the probability of *recession* hitting, albeit in the *still distant future*. Our Recession Predictor currently records the odds of recession at 73.45%, up from last quarter. The probability component to the formula is up from 35% to 51%. Stay tuned for updates.

## ***Conclusions***

- We had a good quarter and erased all of December's losses. The economy continues to plod along making this one of the *longer* expansions in economic history. The current bull market hit its *10-year anniversary* in March. Unemployment remains low and we are seeing signs of wage growth; good for the consumer economy. Interest rate pressures have subsided, *for now*.

- The Relative Value chart on our website reflects the improvement in valuations, reversing the oversold conditions at the end of 2018 and reflecting the improved picture for the current year. We've come back far and fast, but not too fast. We continue to be cautiously optimistic on the economy and the equity markets for the balance of the year.

- Finally, we constantly remind clients that if you have a good financial plan, then you develop the confidence to ignore short term volatility and stick with your longer term objectives. I leave you with my favorite quote from St. Augustine – "*Patience* is the constant companion of *Wisdom*."

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