FORZA

Strengthening Our Clients' Financial Lives

Forza Investment Advisory, LLC

From the Desk of Bob Centrella, CFA ***April 8, 2019***

Q1-19 Summary and 2019 Outlook

Spring is in the air as are baseballs and golf balls for the sports enthusiasts. Although we didn't get a lot of snow this winter, it was still cold and windy. It seems the "wiser" I get the more I prefer warmth and sunshine. Spring is Baseball, The Masters, NCAA Finals, Cherry Blossoms, bike rides, dog walks, oh and allergies… 😌

Speaking of sunshine, stocks around the world offered a ray of light and notched big gains in the first quarter as investors acted with relief that central banks were willing to back off their rate-increase campaigns after growth cooled from China to the eurozone. Investors decided that the market was oversold in December and a rally began shortly after Christmas and has yet to stall. Also, the market has looked positively on perceived progress being made on a trade deal with China. The S&P 500 registered its biggest gain in any quarter since 2009 returning 13.53%, also its largest first-quarter gain since 1998. Major indexes have now recouped almost all the losses suffered in the 4th quarter of 2018. Oddly in a quirk, the S&P return in Q1 was the same as its loss in Q4-18 when it lost 13.53%! Elsewhere in the US the NASDAQ rose 16.5% and the Dow Jones Industrials climbed 11.15%. Small and Mid-Cap stocks also rebounded as the Russell 2000 index jumped 14.2% and the S&P Midcap 400 rose 14%. Outside the US, The Shanghai Composite jumped 24%, the Italian market was up 16.2%, and the All World ex-US index returned 10.3%. Below is a list of price returns for the quarter for various financial assets:

Asset Class Performance Last 12 Mths, Q1 '19, and March - Total Return (%)

US Related

ETF	Description	March	Q1 '19	Last 12 Mths
SPY	S&P 500	1.81	13.52	9.44
DIA	Dow 30	0.15	11.73	9.68
QQQ	Nasdaq 100	3.92	16.68	13.17
IJH	S&P Midcap 400	-0.55	14.48	2.50
IJR	S&P Smallcap 600	-3.26	11.67	1.61
IWB	Russell 1000	1.77	13.88	9.15
IWM	Russell 2000	-2.09	14.64	2.09
IWV	Russell 3000	1.42	13.88	8.53
IVW	S&P 500 Growth	2.67	14.79	12.53
IJK	Midcap 400 Growth	0.64	14.89	1.42
IJT	Smallcap 600 Growth	-2.78	10.83	3.51
IVE	S&P 500 Value	1.02	12.10	5.74
IJJ	Midcap 400 Value	-1.79	13.92	3.36
IJS	Smallcap 600 Value	-3.91	12.33	-0.67
DVY	DJ Dividend	0.93	10.92	6.78
RSP	S&P 500 Equalweight	0.83	14.79	7.01
FXB	British Pound	-1.83	2.14	-7.33
FXE	Euro	-1.42	-2.25	-9.56
FXY	Yen	0.65	-1.15	-4.44
XLY	Cons Disc	3.65	15.38	13.87
XLP	Cons Stap	3.82	11.10	9.78
XLE	Energy	2.13	16.20	1.17
XLF	Financials	-2.56	8.48	-4.85
XLV	Health Care	0.48	6.45	14.52
XLI	Industrials	-1.15	17.16	3.12
XLB	Materials	1.25	10.33	-0.53
XLK	Technology	4.77	19.78	14.78
XLC	Comm Services	2.03	13.50	--
XLU	Utilities	2.79	10.73	19.06

Global

ETF	Description	March	Q1 '19	Last 12 Mths
EWA	Australia	1.13	11.79	3.49
EWZ	Brazil	-4.67	7.30	-5.77
EWC	Canada	-0.75	15.36	2.78
ASHR	China	4.62	31.01	-7.00
EWQ	France	0.41	11.12	-3.75
EWG	Germany	-1.39	6.19	-13.95
EWH	Hong Kong	1.35	16.13	6.45
PIN	India	7.02	4.94	1.93
EWI	Italy	2.36	14.79	-10.00
EWJ	Japan	0.66	7.95	-8.41
EWW	Mexico	0.07	5.85	-13.50
EWP	Spain	-1.62	6.67	-8.94
RSX	Russia	0.88	9.87	-4.80
EWU	UK	1.35	12.47	-0.62
EFA	EAFE	0.92	10.34	-4.03
EEM	Emerging Mkts	1.13	9.88	-9.18
IOO	Global 100	2.43	12.15	6.73
EEB	BRIC	1.77	14.58	-1.78
DBC	Commodities	-0.38	9.73	-5.13
USO	Oil	4.60	29.40	-4.51
UNG	Nat. Gas	-5.05	-4.98	4.12
GLD	Gold	-1.60	0.63	-3.01
SLV	Silver	-3.08	-2.34	-7.98
SHY	1-3 Yr Treasuries	0.63	0.97	2.59
IEF	7-10 Yr Treasuries	2.66	2.78	5.86
TLT	20+ Yr Treasuries	5.57	4.52	6.58
AGG	Aggregate Bond	2.12	2.94	4.57
BND	Total Bond Market	1.94	2.98	4.52
TIP	T.I.P.S.	1.98	3.25	2.69

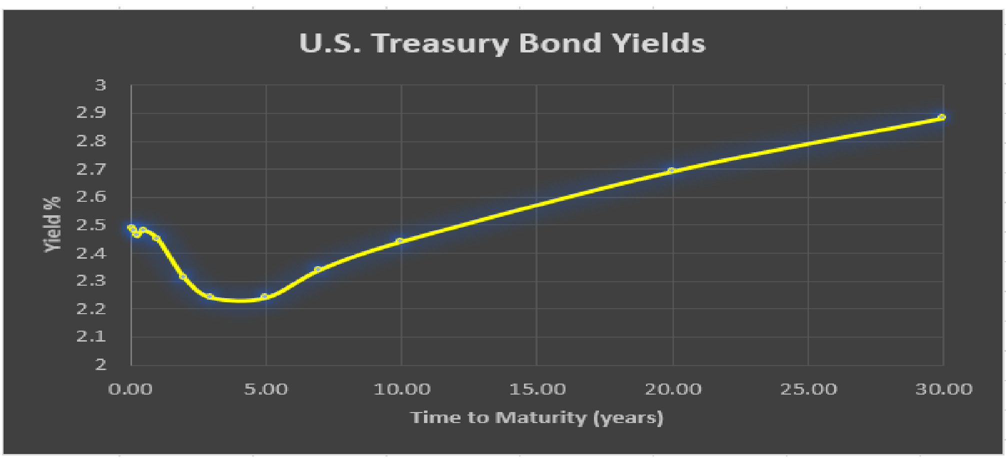
ECONOMY

GDP growth for Q4 was lowered to 2.2% which brought 2018 GDP growth to 2.9% for the year, the most since 2015. The government shutdown will cost Q1-19 growth as economists are projecting it at 1.7%. On the positive side, we could see a rebound in coming months from the depressed levels due to the shutdown. Specific economic news is mixed but still positive. Nonfarm payrolls rebounded in March and the unemployment rate remained at 3.8%. The manufacturing and services indexes are still in the mid 50's showing growth although at a slower pace than last year (readings above 50 signal expansion). The interest rate decline has moved the 30-yr mortgage rate to below 4% for the first time in over a year and this may stimulate the housing and refi market coming into the Spring and Summer selling seasons. Home sales rose in February and that was before rates dropped. Overall, expectations are for GDP growth to pick up from the 1st quarter and average around 2.1% in 2019 according to the FOMC, so now we are in a wait and see mode.

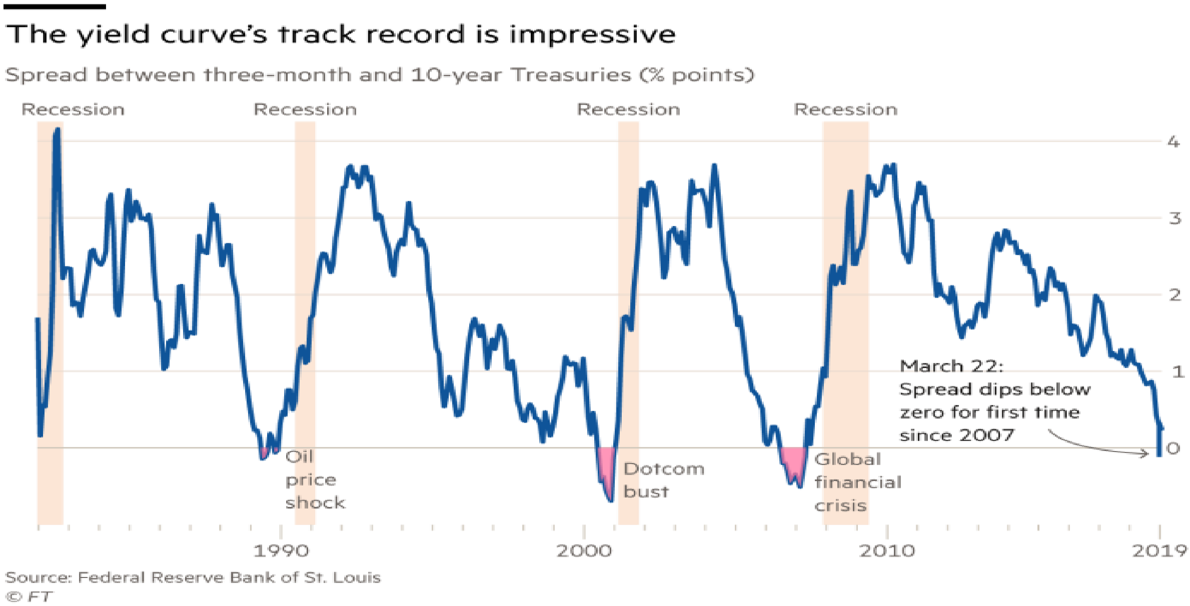
Around the globe, central banks are staying patient on their tightening plans though growth is slowing. The World Trade Organization cut its global trade growth projection from 3.7% to 2.6%, the lowest level in three years. Adding to the uncertainty, U.K. Prime Minister Theresa May asked the European Union to delay Brexit until the end of June. So, the US is still one of the better houses on the street, but weak growth around the globe would be a negative if it continues.

BONDS

Rallying government bonds posted another quarter of gains as inflation data remained pretty tame. The yield on the 10-Yr UST Bond declined to 2.416% at quarter-end down from 2.684% at the end of 2018. Since bond prices move inversely from yields, the Barclays Aggregate index returned 2.94% for the quarter. Oddly again, this is about the exact opposite of what happened in 2018 when bond yields started the year at 2.41% and ended at 2.684%. When the Federal Reserve Chairman Powell indicated that the Fed would pause its rate raising campaign, bond yields fell dramatically causing the Yield Curve to invert between the 30-day Treasury Bill and the 10-Yr UST Bond.

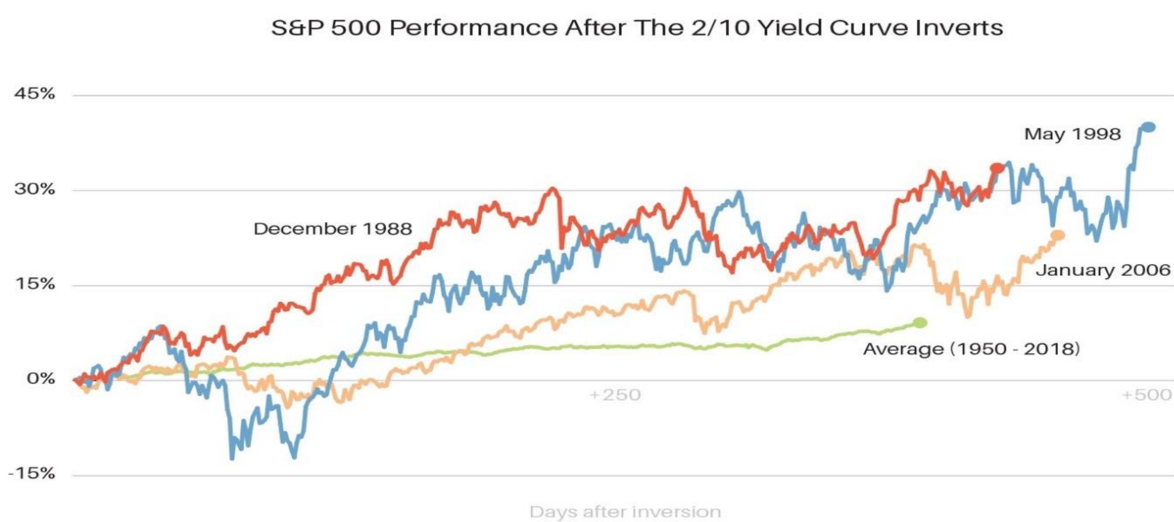


An inversion occurs when yields on short term Treasuries are higher than the 10-Year. Normally, the shorter the maturity the lower the yield as investors are "rewarded" for holding longer maturities. In mid-March, the 30-day bill yielded slightly more than the 10-yr UST. This also caused some brief stock market ripples as an inverted yield curve historically has signaled slowing economic growth and often precedes a recession. However, the curve only inverted for a few days and history has shown inversions to last for months prior to a recession as shown in the chart following. A yield inversion signals that short-term rates need to decline. With the Fed on hold, odds for a rate DECREASE may now be higher than an increase according to the futures market. Some in the Trump Administration including the President and his economic advisor Larry Kudlow are calling for an immediate rate cut to help support the economy. *Personally, I'm in the camp that the Fed did not need to raise rates in December and probably went a little too far. However, I would be shocked to see a rate cut any time soon unless the economy really skidded to a halt.*



STOCKS

So, what does an inverted yield curve mean for stocks? Well, the news isn't so bad. A recent Barron's article showed that economic growth and potential stock market gains can continue for years after the initial inversion. However, recessions themselves are not good for stocks as we know. The chart below shows the last 3 inversions and the average gain from 1950 to 2018. After the initial reaction, stocks tend to move higher and meaningfully so.



The first quarter was a solid one for stocks no matter how you slice it. Small, Mid and Large stocks delivered double digit gains. Large-Cap Growth stocks (+14.9%) slightly outperformed Value (12.2%) but again both delivered double digit gains. The strongest sectors for the quarter were Technology (+19.8%), Industrials (+17.1%) and Energy (+16.2%) while the weaker sectors were Health Care (+6.5%), Financials (+8.5%) and Materials (+10.3%). All sectors had a positive return. With the market up now 15% as I write this, many market strategists have seen their year-end price targets reached already. *Putting things in perspective, if you look at stocks from the beginning of 2018, the gain is not as* *impressive or worrisome. Since the beginning of 2018, the S&P 500 was at 2,673.6 and closed 3/31/19 at 2,834.4 for only a 6% gain in 15 months. So, yes, we recouped much of the loss from Q4-18 but the market is not overvalued IMHO. As a reminder, earnings grew over 20% in 2018, so stocks are still cheaper than they were at the beginning of 2018. The 12-month forward PE is 16.3 compared to 18.4x at the beginning of 2018. It is now about equal to the 5-year average of 16.4x, but below the 10-yr average of 14.7x. Fairly valued perhaps, but not overvalued.*

International stocks finally participated and produced good gains in the quarter. The MSCI ex-US index returned about 10.3%, not bad even while the European economies struggle. Emerging markets returned just under 10%. I recommended underweighting international at the beginning of the year and I'll stick with that for now. But some international exposure is a good possible hedge if things get better overseas. I still prefer developed markets but if rates stabilize then emerging markets may be a less volatile than usual.

So where to from here? Ah, the $64 million-dollar question! First, let's frame this by saying that a positive outcome in a trade deal with China is pretty much built into the market. If somehow the deal falls apart, I have no doubt that the market would take a nasty fall. I am going under the assumption that a deal will be worked out as the Administration knows that a failure would be fatal to the economy as well as the 2020 election. A deal should add some positive momentum to the economy and would also still give the market a boost. The issue for the rest of 2019 is earnings. S&P earnings are expected to drop 3.9% in Q1 which would be the first decline since Q2-16. Q2 earnings are projected flat, Q3 up about 2% and not until Q4 when earnings are estimated at +8% is there a meaningful jump. So, unless things improve and earnings come in better than expected, the market would have to move without much more help from earnings this year. Clearly the market will be tested in coming months with the earnings slowdown. Although we have already had some high-profile earnings cuts (Apple, Fed Ex, Walgreen) I think analysts may have been too bearish and earnings could at least break even in Q1. Still, I see the market going sideways for the near term until we get some clarity on earnings and company outlooks as investors decide whether this is just a temporary blip or a late-cycle slowdown. I wouldn't be surprised to see a consolidation of the recent gains in Q2 with the market pulling back a bit or going sideways. But I remain optimistic on further gains this year, though not in a straight line.

CONCLUSION

In summary, Forza's recommendation is similar to the beginning of the year in that we still prefer equities but now are less cautious on bonds than previously as a rate rise seems unlikely. We would maintain both in the overall allocation of assets for balanced portfolios. We are looking for stocks to consolidate recent gains and move in a range of +5% to -5% over the next 3-6 months. We are still optimistic on US stocks being higher from current levels by year end. But expect some volatility and bumpier ride. It will not be a straight line up. We still recommend overweighting US stocks and underweighting International. Bonds likely return their coupon from here. At best I see bonds return 2% to 3% in a flat rate scenario, maybe 0 to -3% if rates rise and 3% to 5% if rates drop a bit. I prefer individual bonds in a ladder up to 2-yr maturity, but with rates expected flat, some ETF bond funds could add yield. We are entering the April corporate earnings season and as usual it is "Must-View TV". With earnings expected to drop in Q1, what companies say and how they report will give indication to the market's near-term direction.

Have a great Spring and beginning to the Summer! ☺ -Bob