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Economy & Market Valuation

The first quarter of 2019 demonstrated the impact that Federal Reserve decisions can have on the US stock market. The Federal Reserve increased interest rates four times in 2018 and indicated in December 2018 that it will be keep on increasing interest rates in 2019. As a result, the US stock market dropped almost 20% in 4Q of 2018. Then, in January 2019, the Federal Reserve took an about turn and said that it will be patient in increasing interest rates, indicating that it will not increase interest rates. That gave a major boost to the US stock market. The US stock market went up by almost 14% in the first quarter of 2019. The consensus view now is that the Federal Reserve will not raise interest rates in 2019. One of the after effects of the Federal Reserve decision was that the yield curve inverted in the early part of 1Q 2019. Yield curve inversion is considered as a leading indicator of recession. All recessions in recent times have been preceded by a yield curve inversion but all yield curve inversions have not been followed by recessions. Yield curve inversion has given false positives as well. February and March of 2019 brought better economic news. The forecast of US GDP growth rate for the first quarter 2019 has been revised upwards. The estimate of 1Q US GDP growth rate is now trending towards 2%. In addition, China had launched an economic stimulus towards the end of 2018. This had a positive impact on the Chinese economy. Recession chatter is dying down for now. As of now, yield curve inversion, as measured by the graph of the 10-year minus 2-year treasury yields, is no longer inverted. All these factors have pushed the US stock market close to all time highs. The US stock market is within 2% of its all-time high as measured by the S&P 500. Everything looks positive right now. But does that mean there will not be another drop in the stock market? No. What could cause such a drop? Any change to status quo view of interest rates can again cause the US stock market drop. Any indication of pickup in inflation, could cause the Federal Reserve to indicate that it will again start increasing rates. Such a scenario could cause a sharp drop in the US stock market.

We have increased the cash position in client portfolios as the stock market is close to its all-time high. We have trimmed some of the winners that are considered to be economically cyclical companies. We will deploy this cash at the appropriate time. We will continue to be invested in companies with secular organic growth trends, that are growing cashflow, such as Mastercard and Visa. We may trim or add to these positions depending upon the market level. We may add similar companies to the portfolio if we find a good entry level. We will be keeping a watchful eye on the economic indicators and are always looking for opportunities.