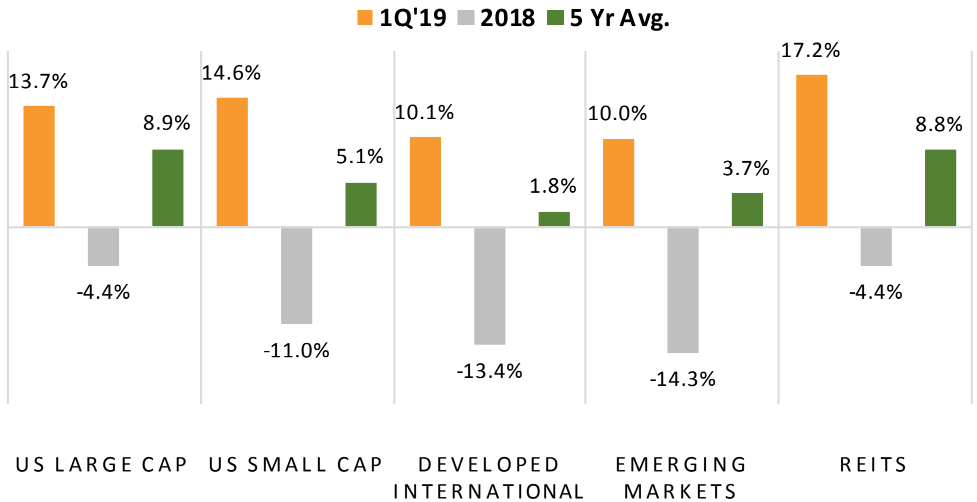
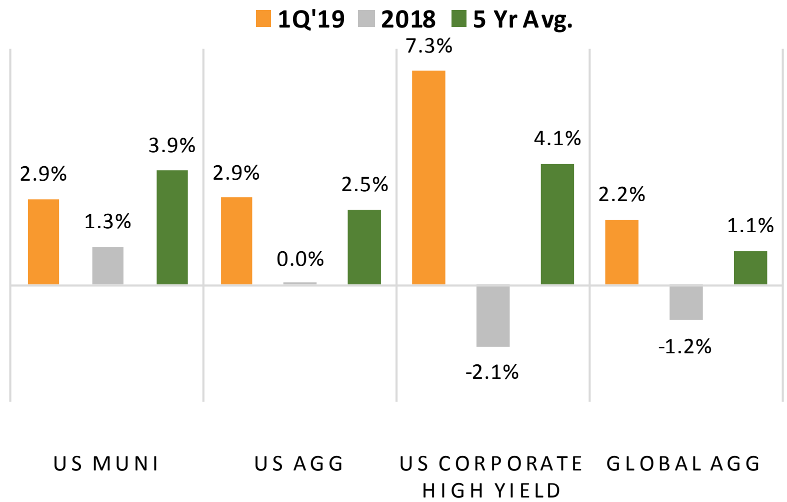
1Q'19 Market Update

EQUITY MARKETS



FIXED INCOME MARKETS



- After a tumultuous Q4'18, equity markets embark in a V-shaped recovery in Q1'19 with strong returns across all major equity asset classes. After narrowly staving off a bear market last quarter, the market close on 03/08/19 marked the 10th anniversary of one of the greatest bull markets in history. The Fed's reversal on monetary policy and continued hopes of a trade deal with China aided in the recovery in equity prices.
  - The **S&P 500** was up +13.7% in Q1, a near parabolic move upward after being down -13.5% last quarter.
    - Even after the market's recovery, the S&P 500 trades at a reasonable forward earnings multiple of 16.4x vs. 20-year average of 15.8x.
    - Returns were up for all sectors in the S&P for the quarter. **Technology** led the way up +19.9%, while **health care** was the relative worst performer, still up +6.6% for the quarter.
      - As for valuations, the **financial** sector looks to be the most relatively attractive sector trading at only 11.3x forward earnings, vs. its 20-year average of 12.6x.
- Other equity asset classes such as **US Small Cap** equities and **REITs** had better relative performance vs. the S&P 500, up +14.6% and +17.2% YTD, respectively.
- While posting strong returns, international markets continued their 10-year trend of underperforming US equities, with **EAFE** up +10.1% and **EM** up +10%.

- After declaring that the fed funds rate was a "long way from neutral" in Q4'18, Chairman Jerome Powell completely reversed course in early Q1'19 by stating the Fed would likely pause hiking rates for 2019. Not only did the Fed signal the end of three years of monetary tightening, it also surprised the market when it announced a plan to end its balance sheet runoff plan later this year.
  - The Fed's change of heart didn't just influence equity returns. The change in monetary policy led to a pull back in long-term rates, assisting in capital appreciation of every major fixed income asset class in the quarter.
- With higher yields due to lower credit quality, the added return from falling rates added to **US Corporate HY** returns, which outpaced all other fixed income asset classes with a +7.3% return in the quarter.
- Municipal bond supply was down again to start 2019, aiding in the +2.9% returns seen in the **US Muni** bond market during the quarter, which on an after-tax basis exceeded the returns seen in the **US Agg.**
  - Interestingly, this trend is not new. Municipal bonds have experienced returns over the past 5 years that have exceeded the taxable US Agg bond market on average.

Sources: Zephyr StyleADVISOR

Market conditions and trends will vary. Past performance is no guarantee of future results. Investments cannot be made in an index

Underlying indices are S&P 500® Index, Russell 2000® Index, MSCI EAFE, MSCI Emerging Markets Index, FTSE NAREIT All Eq REITs Index, Barclays Municipal Bond Index, Barclays U.S. Aggregate Bond Index, Barclays U.S. Corporate High Yield Bond Index and the Barclays Global Aggregate Bond Index.

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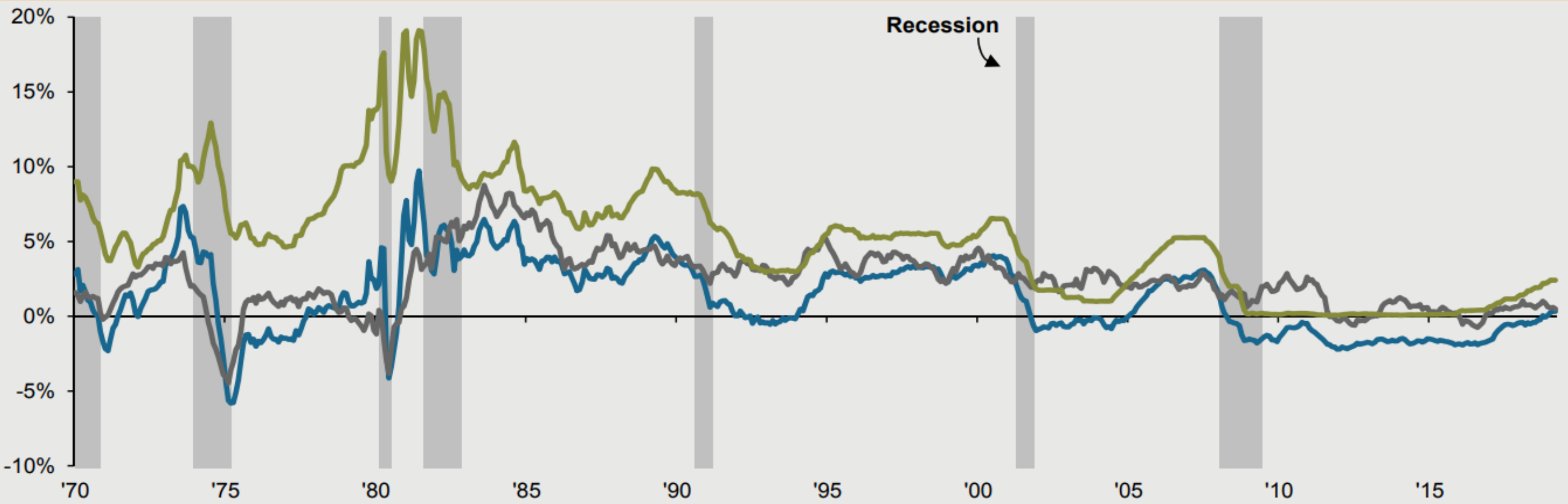

Rates as of ending month of rate hiking cycle

	Jul. 1984	Feb. 1989	Feb. 1995	May 2000	Jun. 2006	Average of past five cycles	Mar. 2019
Nominal federal funds rate	11.23%	9.36%	5.92%	6.27%	4.99%	7.55%	2.41%
Core CPI	5.21%	4.70%	2.97%	2.38%	2.64%	3.58%	2.08%*
Real federal funds rate	6.02%	4.66%	2.95%	3.89%	2.35%	3.97%	0.33%
Real U.S. 10-year Treasury	8.17%	4.47%	4.50%	4.06%	2.46%	4.73%	0.49%

- Real GDP growth was strong in **Q4’18 with 3% YoY growth**. With the benefits from tax reform forecasted to fade, GDP is expected to slow to 2% this year and plateau until the end of the economic expansion. While GDP growth of less than 3% seems low, the average Real GDP growth has been 2.7% historically going back to 1970s.
- Forecasted weaker economic growth is one reason the Fed’s reversal of policy in early 2019 may make sense. There is a strong barrier to the Fed raising rates from here, but there is just as strong a barrier to the Fed cutting rates, which would signal more economic weakness than expected and may cause panic in financial markets. Regardless, the **Fed’s desire to have a “soft landing”** in the next economic contraction is evident given their willingness to adjust monetary policy if the data supports it.
  - Given the Fed’s pause in 2019, some have considered that the Fed was too tight in its previous three years of tightening. However, the data suggests the opposite when compared to previous cycles. The graph above details that the **current state of interest rates is significantly lower than the average of the past 5 cycles.** However, unlike previous cycles the Fed’s tightening is not restricting people from borrowing given how low real rates are.
  - Even after the Fed’s tightening, the **real fed funds rate is only at 0.33%.** This illustrates not only how slow of a recovery this has been but also how low levels of inflation have been, especially given how accommodative the Fed was. Because of low real rates, historical signals of forecasted economic weakness such as a yield curve inversion (which we currently have), may not be perfect signals for future economic weakness.

Sources: Bureau of Labor Statistics, FactSet, Federal Reserve, J.P. Morgan Asset Management, JPM GTM Q2’19

*Notes: Rates as of end of month cycle based on monthly averages. *Latest core CPI reading is as of February 2019.*