Market Commentary

First Quarter 2019

Fredric P. Lutcher, CFA
Managing Partner

Thomas J. D'Auria, CFA
Managing Partner

What a difference three months can make. Our previous market commentary, penned at year end, described one of the worst quarters for US equities in a decade, rising interest rates, and an overall malaise among a large portion of the investing public. Sharp declines in equities - with the market putting in a low on Christmas Eve last year - had investors asking if they should be selling, even though US equities were down 20% in a three-month period.

Jumping ahead three months, we note markets (and investors) have done a 180 degree turn. During the first quarter of 2019, the S&P 500 increased by 13.6%, rebounding from the sharp decline in the previous quarter. While December 2018 was the worst December for US stocks since 1931, January was the best January for the S&P 500 since 1987. While investors feel better with the rebound, the sharp moves in both directions can be a bit disconcerting to some and show the effects of fear and greed overwhelming fundamentals. Fixed income yields declined during the quarter, continuing a trend that began in late 2018. The benchmark 10-year Treasury ending the quarter at 2.42%, meaningfully below the 2.68% rate at year-end 2018, and close to a 15-month low. During late March the yield curve temporarily inverted, meaning that short-term Treasury bills had a higher yield than 10-year Treasury notes. While some market pundits claim this portends a softening economy and even an upcoming recession, we point out the yield curve has flattened not because the Federal Reserve is continuing to raise short-term interest rates, but rather because inflation expectations are declining. This is a positive in our opinion.

The market movements of the past six months perfectly illustrate our belief in long-term investing, eschewing market-timing, and ignoring short-term fluctuations that are not correlated with fundamental changes. We wrote in our last commentary, "*while human emotion could lead investors to panic and sell when markets decline, staying invested for the long-term has historically been the smart move. The advantage of long-term investing is that it lowers volatility over longer periods of time. Short-term fluctuations seem random and unpredictable, but they are part of the normal ebb and flow of markets*." This strategy has worked for decades and we believe it remains that best method for building wealth over the long-term.

<u>Economic and Market Outlook</u>

While the economy continues to show significant growth characteristics, we acknowledge that the first quarter of 2019 will see a marked slowdown in GDP growth. Two factors account for the bulk of the slowdown. The primary factor is the five-week government shutdown that affected not only federal workers but also contract employees that get paid by the Federal government. Although they received their back wages after the shutdown ended, the disruption and uncertainty had obvious spending effects on a large number of workers. The second factor was the harsh winter weather across many parts of the US over the past few months. Heavy snowstorms, record cold temperatures, and wetter than usual winter months all had negative effects on housing and other construction related industries. We believe this will be a one-quarter aberration, with GDP moving back towards trendline growth in the second quarter. This rapid short-term slowdown will also affect corporate

29 Emmons Drive, Suite A-5 Princeton, NJ 08540
Tel 609-452-2100
Fax 609-916-1280

220 S Pleasant Street
Prescott, AZ 86303
Tel 928-521-5628
Fax 928-458-7100

© 2019 Tandem Investment Partners LLC. www.tandeminvestment.com All rights reserved.

earnings which will show minimal or slightly negative growth in the just ended quarter, before rebounding to grow in the mid-to high single digits for the remainder of 2019.

After a decline of nearly 40% during the fourth quarter of 2018, oil reversed course, rising sharply during the first quarter. From $45.41 per barrel at year end, the West Texas Intermediate benchmark climbed to $60.14 at the end of March. We note oil remains well below the $75 it reached early last fall. We continue to believe the fair price for oil remains in a range between $50-70 based on current supply and demand fundamentals in the global economy.

At its late-March meeting, the Federal Reserve meaningfully changed its interest rate outlook, with expectations for no interest rate increases during 2019. Only three months ago, the Fed was calling for two or three interest rate hikes this year, while we opined in our prior commentary that rates were unlikely to increase based on our view for continued muted inflationary pressures. The trajectory of the Federal Reserve's interest rate path was one major uncertainty we listed in our last commentary. Additionally, the long-awaited end to the Mueller probe was anti-climactic with no recommended charges against the President or anyone on his staff. Thus, two of the three issues we believed needed to be resolved to calm investor angst are behind us. The remaining issue that we hope will be resolved soon is a resolution of the trade spat with China.

Portfolio Positioning

Client portfolios remain positioned for continued, steady economic growth along with very modest inflationary pressures. We remain focused on companies with strong balance sheets, rising earnings, and diversified customer bases which should continue to do well in the current economic environment. As we have for several quarters, we continue to favor large, multinational corporations for their global reach and diversified product offerings. The Federal Reserve has moved its public stance on interest rates much closer to our viewpoint which reduces the risk for negative surprises. Based on current valuations and interest rates, along with our forecasts for economic growth and subdued inflation, US equities are near fair value.

Conclusion

Looking through the remainder of 2019, we believe positive economic fundamentals will continue with the economy growing at least into 2020. GDP growth rates will be lower than in 2019, but this is due to the reduced effects from the late 2017 tax cuts. After growing at 2.9% in 2018, we believe the US economy will show moderating growth through 2019 yet remain near trendline growth of about 2%. The volatility in equity markets during the previous quarter was largely due to a sharp decline in expected global economic growth rates. This was another in a cycle of "growth scares" that cause equities to sell off, and interest rates to decline despite minimal changes in fundamentals.

We always enjoy hearing from clients and find that enhanced communication fosters a better long-term relationship. We encourage you to call or email us if you have any comments or questions about your investment portfolio or any financial topics in general.

March 31, 2019

TANDEM
INVESTMENT PARTNERS

29 Emmons Drive, Suite
A-5 Princeton, NJ 08540
Tel 609-452-2100
Fax 609-916-1280

220 S Pleasant Street
Prescott, AZ 86303
Tel 928-521-5628
Fax 928-458-7100

© 2019 Tandem Investment Partners LLC. www.tandeminvestment.com All rights reserved.