

This month's Market Minute reflects the views of Clearstead's Research Team and was composed by Anna Rathbun .

OVERVIEW

Volatility arrived in the form of a Tweet from @realDonaldTrump at the onset of the month. The markets were led to believe that the talks between China and the U.S. were progressing through the first four months of the year, but on May 5th, President Trump's threat of increase in tariffs on Chinese goods revealed that there were significant differences between the two parties. To end the month, Mr. Trump announced plans to impose tariffs on all goods from Mexico, signaling the return of the President's hardline stance on trade. Suddenly, the prospect of a protracted trade war has become more realistic, and the fate of the updated NAFTA deal uncertain. The calm of the global markets was disrupted as trade tensions dominated the headlines, and risk assets saw the first down month of 2019.

Underneath the trade news, global growth remained intact so far, although showing signs of weakness in various pockets. In the U.S., certain areas, such as manufacturing, housing, and retail sales, continued to be challenged, while the employment picture remained a bright spot¹. China's growth story, which is watched closely by the markets as the second largest economy in the world, is expected to be influenced by the ongoing trade dispute with the United States. China's official Purchasing Managers' Index registered at 49.4, signaling a temporary contraction², but looking ahead, a significant slowdown in China has implications for growth throughout the world. Finally, the newly pledged tariffs on goods from Mexico will also have economic consequences that may go beyond the Mexican and American borders.

DOMESTIC EQUITY

As of May 31, 2019

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	-6.3%	-3.8%	7.5%	4.0%
S&P 500	-6.4%	-2.6%	10.7%	3.8%
Russell 2000	-7.8%	-4.6%	9.2%	-9.1%
Russell 1000 Growth	-6.3%	-2.1%	13.7%	5.4%
Russell 1000 Value	-6.4%	-3.1%	8.5%	1.4%
WTI Crude Oil	-16.3%	-11.0%	17.8%	-20.2%

The ascent of the equity markets during the first four months of the year had priced in relatively positive prospects on international trade, including the talks between China and the U.S., and certainly no anticipation on the trade relationship with Mexico. It was no surprise then, that equities reacted negatively to the news of discord. Stocks across the capitalization fell, with large caps (S&P 500) returning -6.4% and small caps (Russell 2000) posting -7.8% in returns. Technology stocks were hit hard, given the particular focus on tech intellectual property in the China trade negotiations and the national security concerns surrounding Huawei. Beyond the headlines, however, the earnings scenario was generally good. Although negative earnings growth was expected for Q1, companies have reported earnings growth that are on average 5.3% above estimates to date³. At this point in time, we still have expectations of earnings growth in the mid-to-high single digits for the calendar year and view the equity markets as fairly valued.



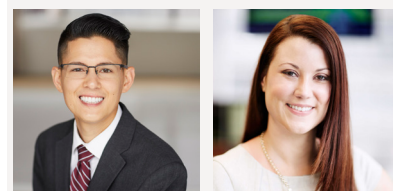
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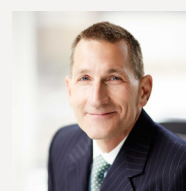
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INTERNATIONAL EQUITY

As of May 31, 2019

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	-5.4%	-2.9%	7.1%	-6.3%
MSCI EAFE	-4.8%	-2.1%	7.6%	-5.7%
MSCI Emerging Markets	-7.3%	-5.3%	4.1%	-8.7%
MSCI EAFE Small Cap	-5.3%	-2.4%	8.0%	-11.9%

The international markets had also priced in a friendly relationship between U.S. and China, and with the tariff news on China and Mexico, foreign markets were also pressured. Although the strength of the dollar was a headwind for returns on developed markets, the MSCI EAFE sold off less than the S&P 500, buoyed by a steady earnings season. Emerging markets, however, sold off sharply in May, mainly by a drop in Chinese equities as a response to the deteriorating trade talks and later driven by Mexican equities. It remains to be seen how the trade scenarios will pan out in the next several months, but at this time, international equities are also viewed as reasonably valued.

FIXED INCOME

As of May 31, 2019

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	1.8%	1.8%	4.8%	6.4%
BarCap Global Aggregate	1.4%	1.1%	3.3%	3.1%
BarCap US High Yield	-1.2%	0.2%	7.5%	5.5%
JPM Emerging Market Bond	0.6%	0.7%	7.3%	6.9%
BarCap Muni	1.4%	1.8%	4.7%	6.4%

The risk-off mentality that pervaded the equity markets was also reflected in the fixed income world. Concerns around slowing global economy and anxiety regarding the China and Mexico trade issues prompted investors to seek safety. The 10-year U.S. Treasury yield fell steadily from 2.50% at the end of April to 2.13% at the end of May, the lowest point of the month. Spreads widened for both credit and emerging market debt as the risk-off mode advanced, but in a slow-growth, low-inflation, and low-rate environment, we believe that risk assets are fairly valued at these levels.

CLOSING

The themes that played a central role in the volatility of 2018 have returned to shake the markets. Although the Fed has paused raising rates for the foreseeable future, geopolitical uncertainties including trade disputes, as well as concerns surrounding the growth momentum, never really went away. Looking forward, we see continued challenges around the Brexit issue, a trade friction with the E.U., and populist sentiments around the world causing a bit of angst for investors. As we have reminded investors in previous Market Minute publications, volatility should be expected as the markets try to negotiate the risks around geopolitical tensions and conflicting information surrounding the global growth momentum. In times of increased uncertainty in the latter stages of the economic cycle, a more defensive posturing of the portfolio and prudent rebalancing discipline can help investors navigate through the volatility.

Sources:

¹ ISM, Markit, National Association of Realtors, U.S. Census Bureau, Bureau of Labor Statistics

² China Federation of Logistics and Purchasing, May 31, 2019

³ FactSet Earnings Insight, 5/31/2019

Disclosures

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