

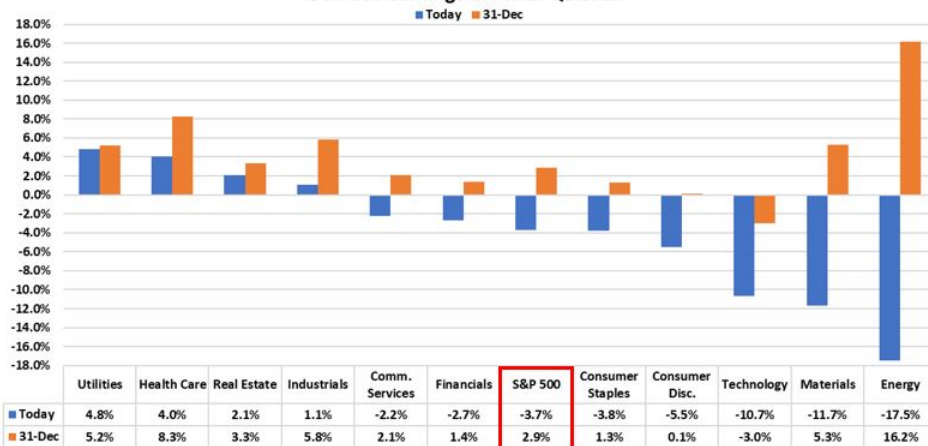
# Q2 2019 LOOK AHEAD

## Disclaimer

*Certain information in this presentation constitutes forward-looking statements. Due to various risks, uncertainties, and assumptions made in our analysis, actual events or results or actual performance of the markets covered by this presentation may differ materially from those described. The information herein reflects our current views only, is subject to change, and is not intended to be promissory or relied upon by the reader. There can be no certainty that events will turn out as presented. Data are from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.*

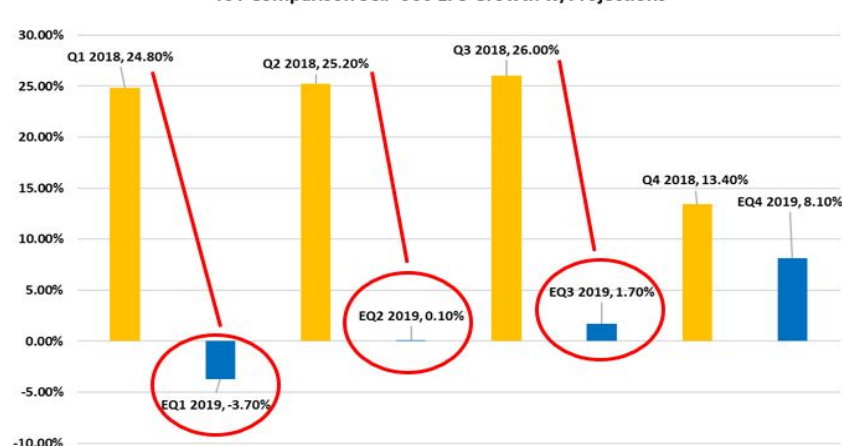
# Entering an Earnings Recession

S&P 500 Earnings Growth: Q1 2019



Source: FactSet

YoY Comparison S&P 500 EPS Growth w/Projections



Source: FactSet

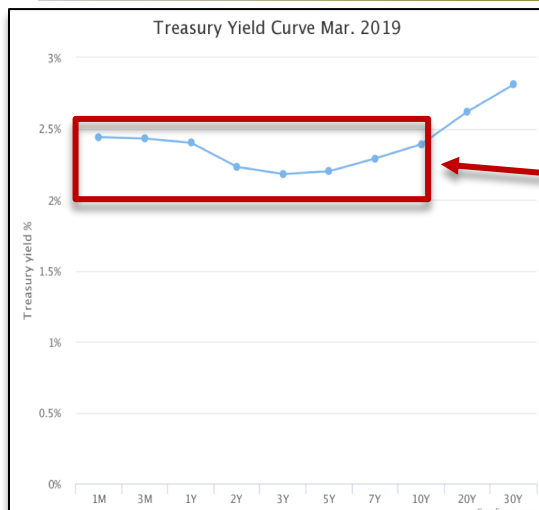
S&P 500 Performance During Last Earnings Recession



Source: S&P Dow Jones Indices (S&P Global), Multpl.com

- ❑ It's likely we'll see an earnings recession in 2019; the first time analysts are expecting negative earnings growth since 2016:
  - ❑ Q1 earnings expected to decline -3.7%
  - ❑ Q2 earnings may also be negative; analysts project growth to be only 0.10%
  - ❑ Earnings should pick back up to positive growth in Q3
- ❑ Investors should note the hurdle rates for corporate earnings growth remain extremely high; the majority of 2018 saw growth in excess of 24%
- ❑ Earnings recessions don't always lead to negative stock market returns; the last earnings recession (Q1 2015 – Q3 2016) stocks returned 2.4%, but more importantly, the following twelve months saw stocks appreciate 16.19%

# Inversions and Recessions



The Treasury yield curve, between 3-months and 10-years, inverted for the first time since 2007 on Friday, March 22, 2019

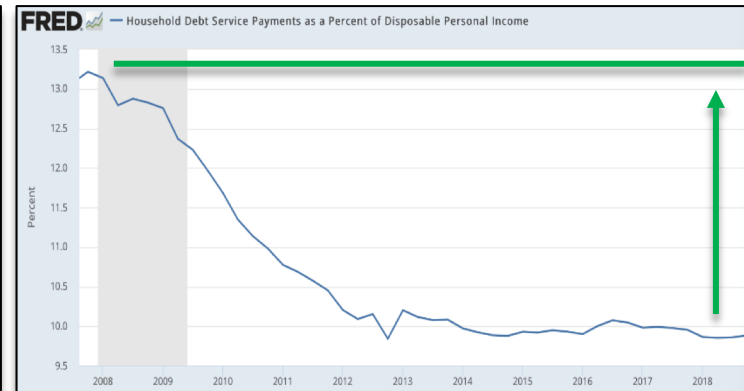
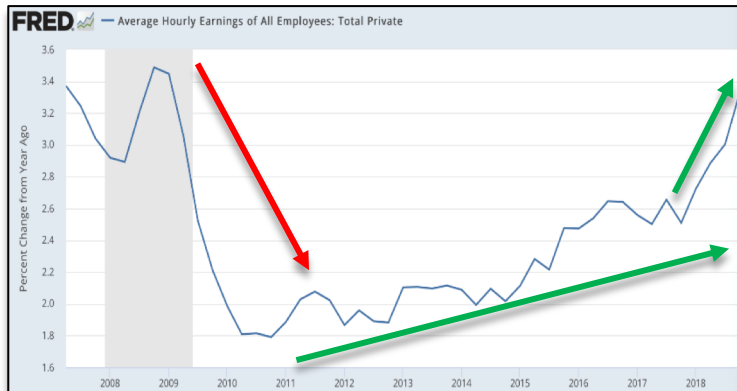


S&P 500 Performance After YC Inversions				
First Day Curve	S&P 500 Performance (%)			
Inverted	One Month	Three Month	Six Months	One Year
1/11/66	0.43	-1.73	-6.38	-10.64
5/31/73	-0.66	-0.67	-8.57	-16.84
10/31/78	3.36	7.28	9.16	9.31
3/27/89	6.54	13.03	18.77	17.53
9/10/98	0.43	18.86	31.28	37.90
1/17/06	0.34	0.19	-3.78	11.51
3/22/19	?	?	?	?
<b>Average</b>	<b>1.74</b>	<b>6.16</b>	<b>6.75</b>	<b>8.13</b>
<b>Median</b>	<b>0.43</b>	<b>3.73</b>	<b>2.69</b>	<b>10.41</b>

- While every recession has been preceded by an inverted yield curve, not all inversions in the yield curve have led to recessions
- Irrespective of whether or not a recession is to follow the most recent inversion in the yield curve, both the average and median returns over a one, three, six, and twelve-month period have been positive

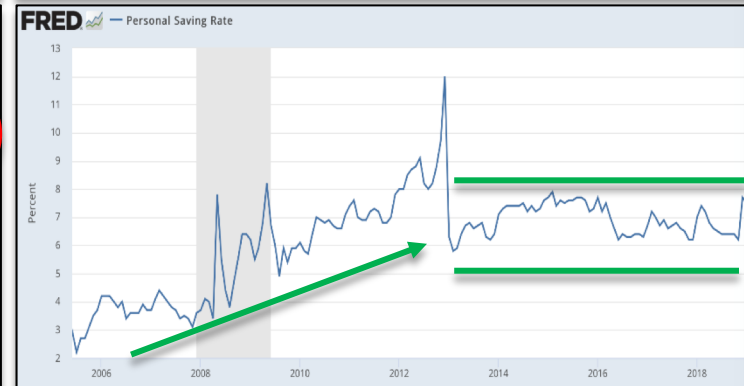
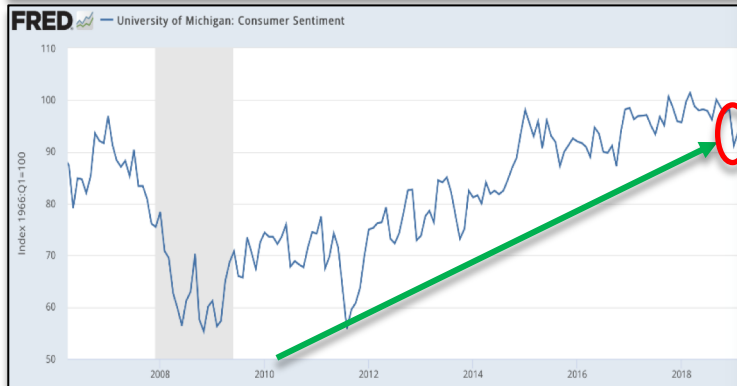
# U.S. Consumer Strength

Wage  
Growth:  
3.3%



Household  
Debt Service  
Payments as  
a % of  
Disposable  
Personal  
Income

Consumer  
Sentiment



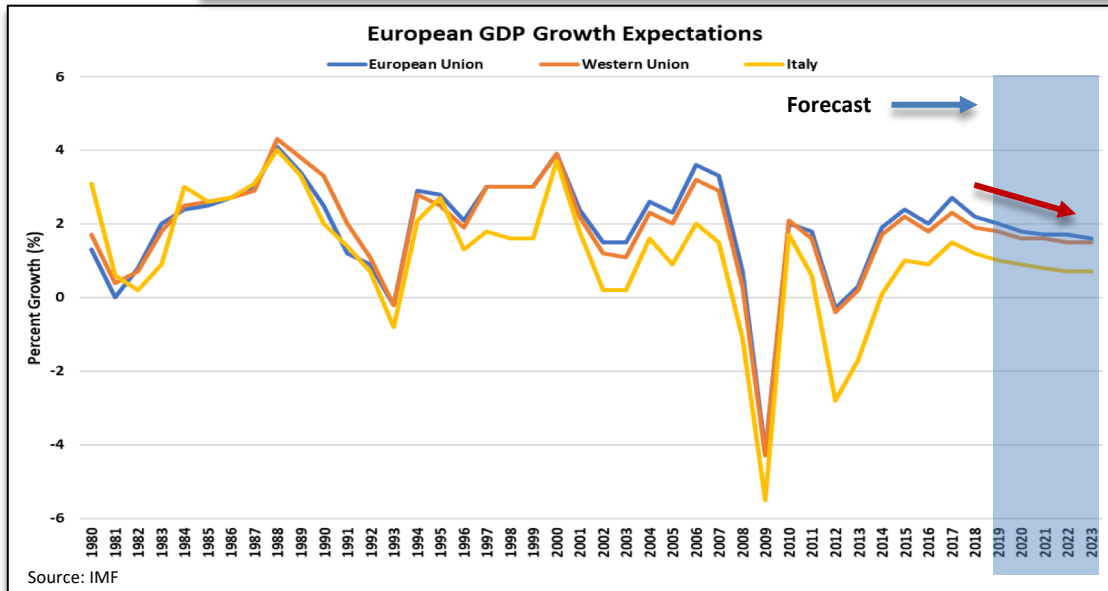
Personal  
Savings Rate

- ❑ Wage growth continues to increase at a rate above 3 percent, further supporting the consumers' appetite to spend
- ❑ Consumer Sentiment remains at elevated levels; however, we have seen a slight break below trend which suggests that the consumer is more cautiously optimistic, yet still likely to continue their appetite for spending
- ❑ A return to peak levels of debt service payments as a percent of disposable income could add \$5 – \$6 trillion in consumption over the next 10 years
- ❑ After the government change in calculating the Personal Savings Rate, it shows limited declines over the past five years, further suggesting that the U.S. consumer has ample room to increase spending; prior to the change in calculation, the Personal Savings Rate matched the lows recorded prior to the Great Financial Crisis

# International Developed Markets

## ***ECB Response to Slowing Growth:***

*"The Governing Council now expects the key ECB interest rates to remain at their present levels (0%, 0.25%, -0.40%) at least through the end of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term." – Mario Draghi, President of the ECB*



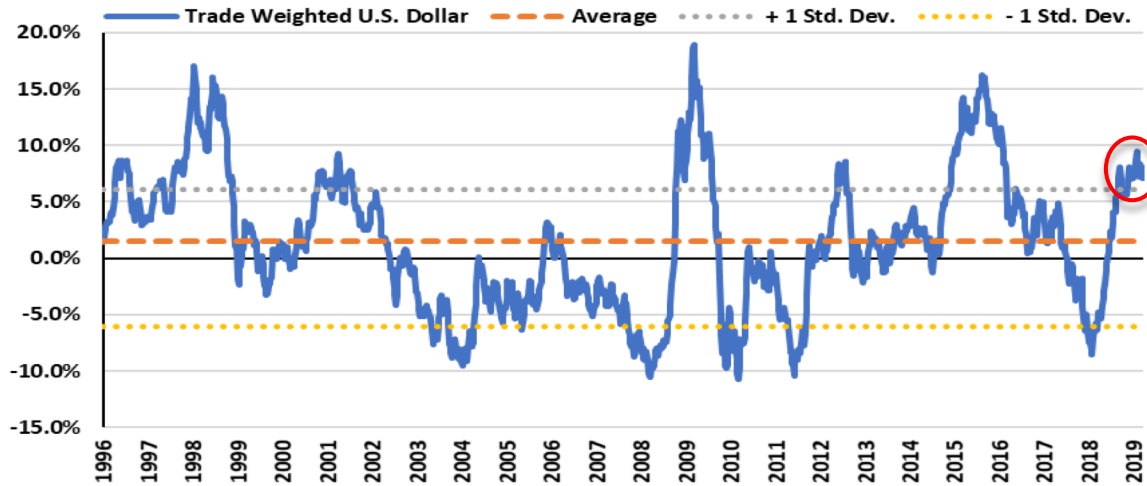
- ❑ Europe is poised for slow growth going forward; Southern European countries like Italy are projected to slow GDP growth to under 1.5 percent by 2023, according to the IMF, and the ECB is responding through continued accommodative interest rate policies
- ❑ BREXIT is done; Parliament voted down another one of Theresa May's BREXIT deal and it failed
- ❑ Earnings in Europe have lagged its global counterparts for much of the last decade; heading into late innings of the economic cycle, there is no data that supports Europe outperforming its global counterparts





# Emerging Markets (EM)

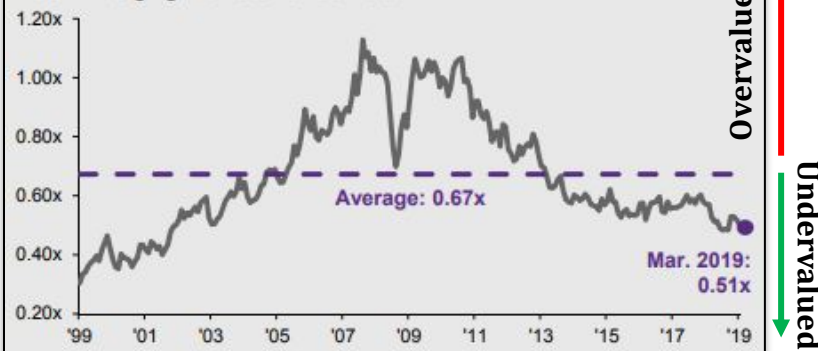
Mean Reverting the Strength of the U.S. Dollar



Source: Federal Reserve Bank of St. Louis

Countries	Vulnerability	USD debt* (% of GDP)	Nov. 16- Nov. 18 currency movement (%)	Current account balance (% of GDP)
Turkey	High	27%	-44%	-5.7%
Argentina	High	25%	-58%	-3.7%
Chile	Medium	34%	-6%	-2.5%
Mexico	Medium	22%	-5%	-1.3%
South Africa	Medium	10%	-7%	-3.2%
India	Medium	4%	-9%	-3.0%
Brazil	Medium	10%	-13%	-1.3%
Indonesia	Medium	17%	-14%	-2.4%
China	Low	4%	-3%	0.7%
Russia	Low	12%	-4%	6.1%
Malaysia	Low	12%	-	2.9%

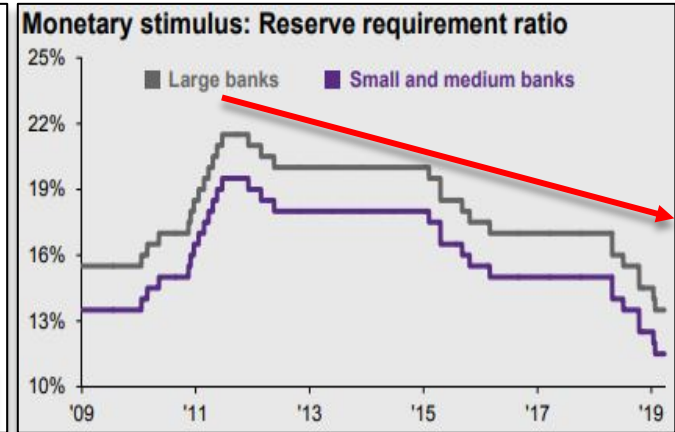
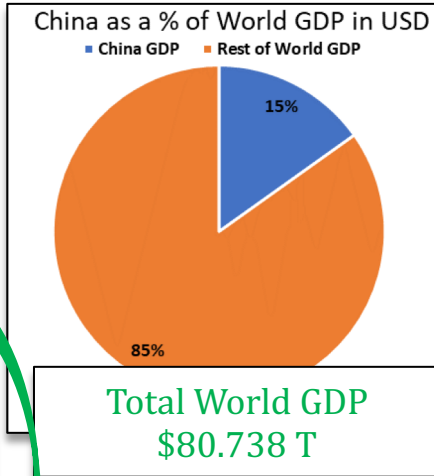
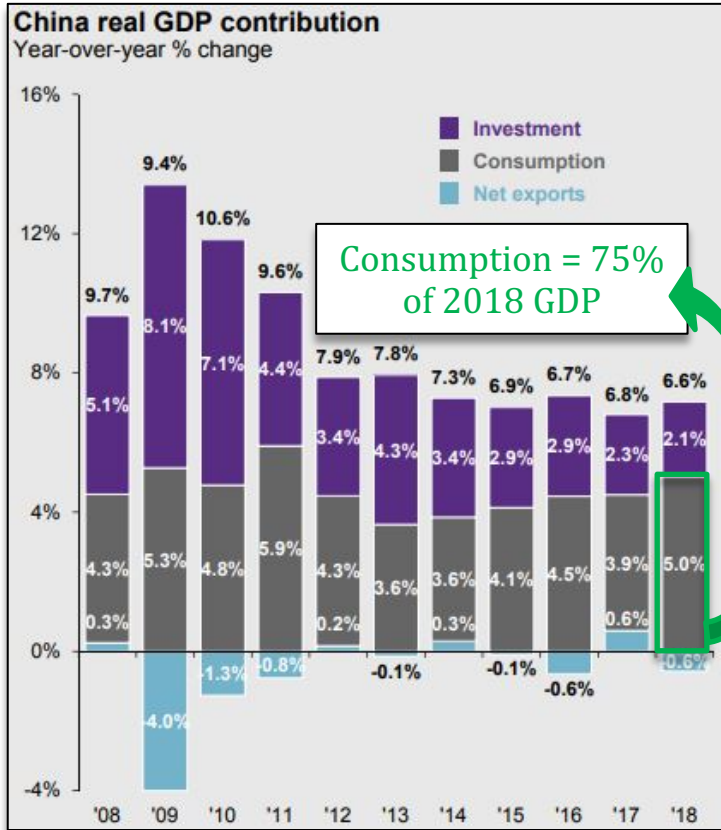
Relative price-to-book ratio  
MSCI Emerging Markets vs. S&P 500



- ❑ Data continues to support a weakening U.S. dollar in 2019 for two reasons:
  1. Using data going back to 1996, the strength of the U.S. dollar has reached a potential inflection point at the one standard deviation level above its mean
  2. The Federal Reserve is no longer anticipating any additional rate hikes in 2019, further supporting the case for a weakening U.S. dollar
- ❑ A weakening U.S. dollar will make interest payments cheaper for emerging market countries with dollar denominated debt
- ❑ Countries with medium-to-high USD debt as a percent of GDP (outlined, in red above) will benefit most
- ❑ Together, these countries make up 54.9% of the Emerging Markets Index which should help to increase valuations

Data Source: Bloomberg, Federal Reserve Bank of St. Louis FRED- <https://fred.stlouisfed.org/series/TWEXB#0>, [https://am.ipmorg.com/blob-gim/1383407651970/83456/MI-GTM\\_2019\\_Final%20Updated.pdf?segment=AMERICAS\\_US\\_ADV&locale=en\\_US](https://am.ipmorg.com/blob-gim/1383407651970/83456/MI-GTM_2019_Final%20Updated.pdf?segment=AMERICAS_US_ADV&locale=en_US), <https://www.pwc.com/gx/en/issues/economy/global-economy-watch/december-2018.html>. Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

# China Slows

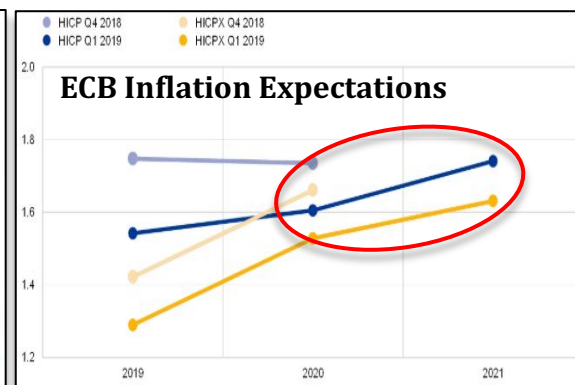
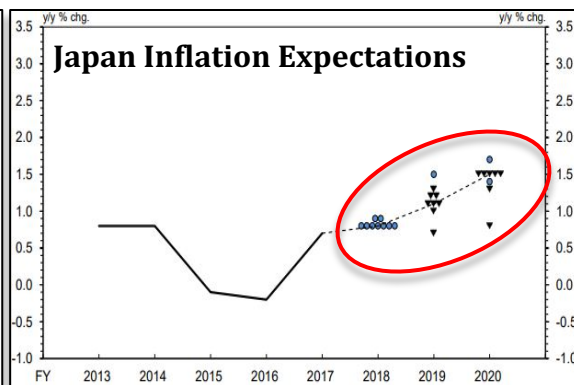
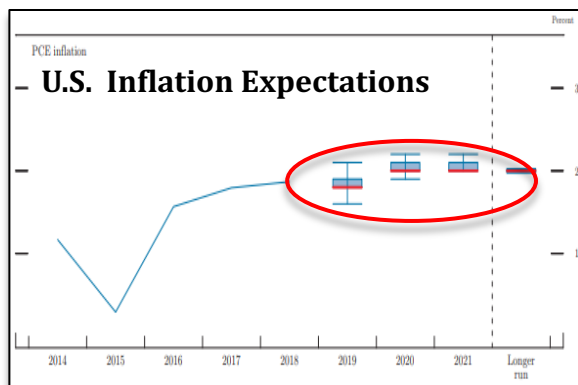


- ❑ 75% of China's GDP comes from its consumption; with China now 15% of the world's total GDP, the Chinese consumer carries a material weight on overall consumption trends
- ❑ In spite of slowing growth (consistent with China becoming more developed), China has been providing a mix of stimulus to ease the rate at which its economy slows:
  - ❑ Tax cuts
  - ❑ Infrastructure spending – China's Belt & Road Initiative further expands into Europe after President Xi Jinping cuts deals with Italy, Croatia, Czech Republic, Hungary, Greece, Malta, Poland, and Portugal
  - ❑ Lowering interest rates
  - ❑ Cutting the reserve requirements for large, medium, and small banks



# Central Banks - The New Public Utility

## “Interest Rate Projections”



**Fed Funds Rate Implied Probabilities**

Meeting	Hike Prob	Cut Prob
05/01/2019	0.0%	4.7%
06/19/2019	0.0%	19.8%
07/31/2019	0.0%	24.6%
09/18/2019	0.0%	44.5%
10/30/2019	0.0%	49.8%
12/11/2019	0.0%	61.6%
01/29/2020	0.0%	66.8%

**BOJ Rate Implied Probabilities**

Meeting	Hike Prob	Cut Prob
04/25/2019	0.0%	2.0%
06/20/2019	0.0%	6.7%
07/30/2019	0.0%	16.0%
09/19/2019	4.4%	15.2%
10/31/2019	3.5%	31.1%
12/19/2019	3.4%	34.0%

**ECB Rate Implied Probabilities**

Meeting	Hike Prob	Cut Prob
04/10/2019	4.7%	0.0%
06/06/2019	4.6%	1.7%
07/25/2019	4.6%	1.8%
09/12/2019	4.2%	9.7%
10/24/2019	4.1%	11.9%
12/12/2019	4.0%	13.4%

- ❑ Inflationary pressures across the globe have simply abated; expectations for inflation north of 2% is almost nonexistent across major central banks
- ❑ Central Banks are on the brink of stepping back into the land of accommodation; should they step in, their actions are likely to promote deeper global inflation in the form of wage inflation

# Mean Reversion Dashboard

Style Current P/E as a % of 20-Yr Avg. P/E

	Value	Blend	Growth
Large	101.6%	104.0%	104.9%
Mid	100.6%	103.7%	104.8%
Small	90.1%	104.7%	123.0%

Regional Fwd P/E as a % of 10-Yr Avg. Fwd P/E

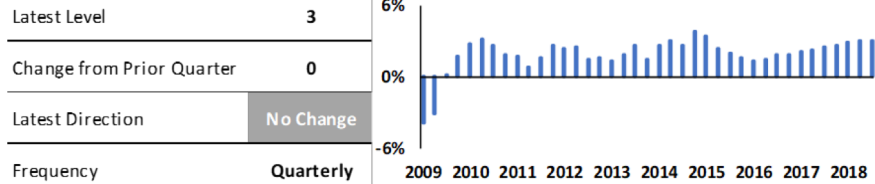
ACWI	EAFE Index	EM Index	United States	Germany	U.K.	China	Brazil	India	Russia
104.6%	97.9%	105.6%	107.9%	97.1%	98.2%	108.1%	95.1%	132.2%	92.3%

Sector Fwd P/E as a % of 20-Yr Avg. P/E

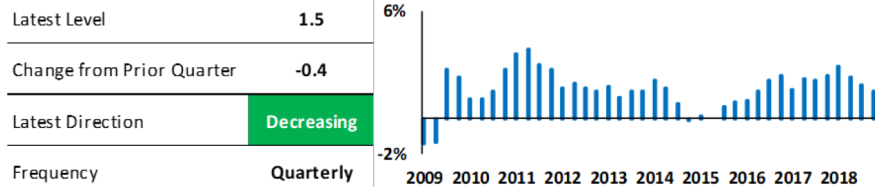
Financials	Technology	Health Care	Industrials	Energy	Cons. Discr.	Cons. Staples	Comm. Services	Utilities	Real Estate	Materials
89.7%	90.7%	94.0%	96.9%	103.4%	116.2%	111.9%	95.6%	130.3%	126.1%	111.4%

# Economic Dashboard

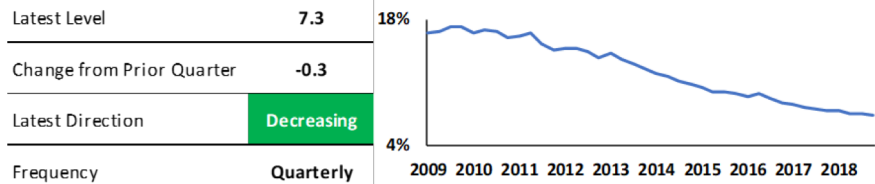
## U.S. GDP Growth As of 12/31/2018



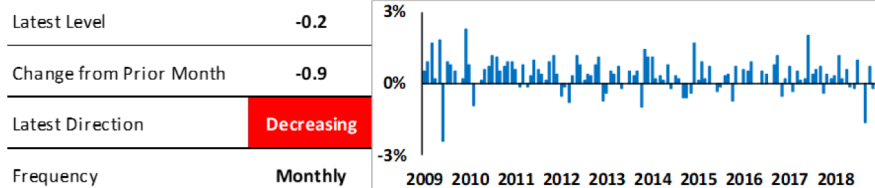
## U.S. Inflation As of 3/29/2019



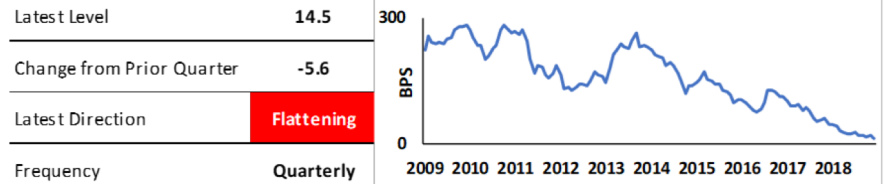
## U.S. U-6 Unemployment Rate As of 3/29/2019



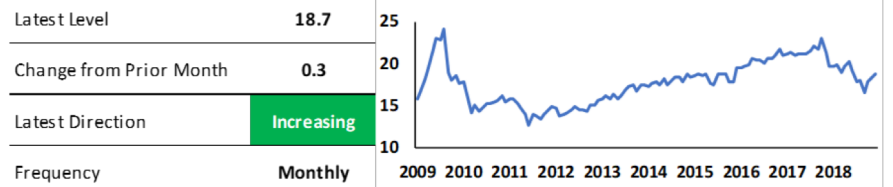
## Retail Sales As of 2/28/2019



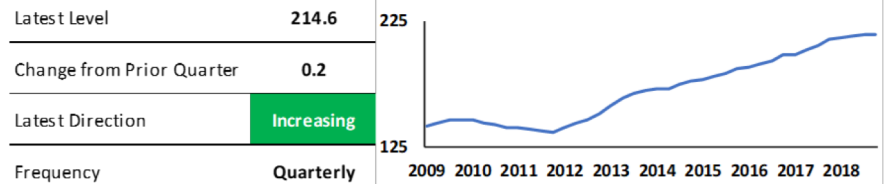
## U.S. Treasury Spread 2-Yr vs. 10-Yr Spread As of 3/29/2019



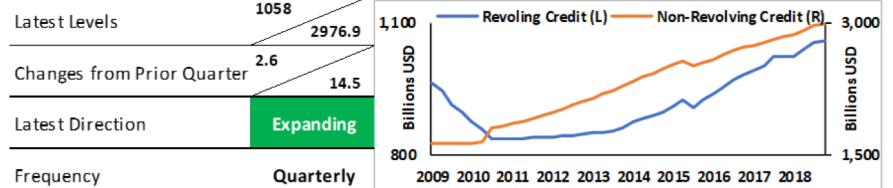
## S&P 500 P/E Ratio As of 3/29/2019



## Schiller Home Value Index As of 3/29/2019



## Credit: Revolving / Non-Revolving As of 3/29/2019



# Our View and Recommendations

## Our View

- ❑ Economic indicators still remain relatively positive for the United States, despite an inverted yield curve and declining retail sales numbers
- ❑ As the yield curve continues to flatten, be mindful that, on average, rolling three-month periods of flattening has led to double-digit forward-looking returns for stocks
- ❑ The U.S. is entering a transition zone for corporate earnings, whereby an earnings recession is likely around the corner; however, this isn't always bad news for stocks, but do expect more 1% +/- trading days
- ❑ Expect China and the rest of the Emerging Markets to rally on a weaker U.S. dollar and better clarity on trade, especially with further stimulus coming out of China
- ❑ International Developed Markets are likely to struggle going forward due to slower growth and less impact from stimulus
- ❑ Inflation is likely to continue moderating across the globe
- ❑ Central Banks should stay in the spot light and provide clues to help protect asset prices; it's crucial to monitor Q2 Central Bank activity closely
- ❑ With forward-looking returns getting smaller by the day, investors are likely to stretch for return through private equity and other U.S. Growth assets

## Recommendations

- ❑ Maintain U.S. equity exposure, yet be prepared to pivot more to Emerging Markets if an earnings recession stretches beyond Q2 2019
- ❑ Continue portfolio weightings toward Small Cap equities; +/- 2% of policy targets
- ❑ Tilt to Growth vs. Value
- ❑ Slight overweight in Emerging Markets and China
- ❑ Rebalance Developed Markets to policy
- ❑ Remain active in Fixed Income, but be mindful of where you sit in the capital structure and the covenants associated with what you own; it's time to be higher in credit quality until better opportunities arise
- ❑ Continue to favor moderate durations close to the benchmark as Fed action will likely dictate the shape of the yield curve going forward
- ❑ Look for opportunity in noncorrelated assets to help mitigate risk and reduce beta in the overall portfolio

# THANK YOU

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