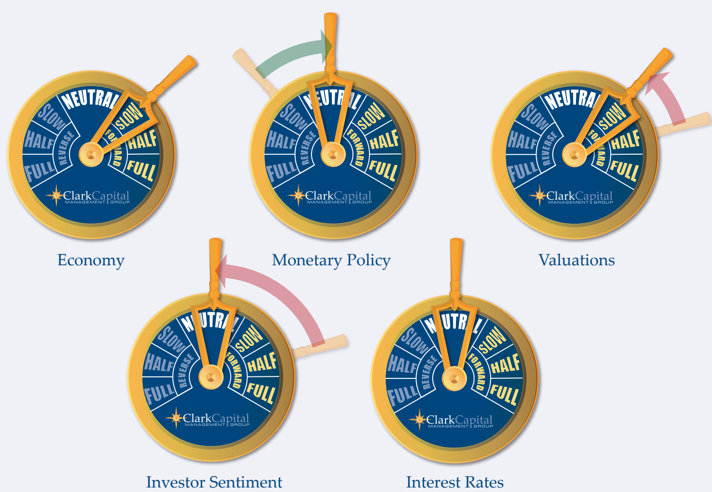
Clark Capital Management Group

Economic Review & Outlook

Video Transcript | First Quarter 2019

Thanks for joining me for a recap of the latest economic and capital market developments from the first quarter of 2019. So let's begin.

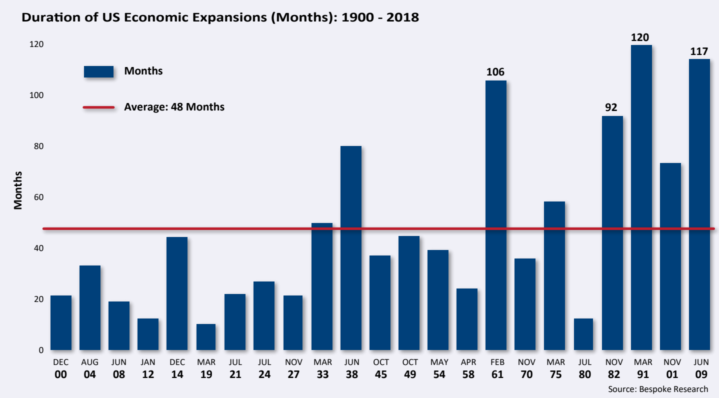
These gauges represent the five major areas that help shape our view for the overall economic environment, which in turn drives our expectations for the stock market.



As a reminder, 12:00 is neutral. Anything to the right of 12:00 is positive for stocks, anything to the left of 12:00 is negative. . We made adjustments to three of our five gauges this quarter, increasing one and reducing two. As a result, we currently have two gauges that are positive, and three that are neutral.

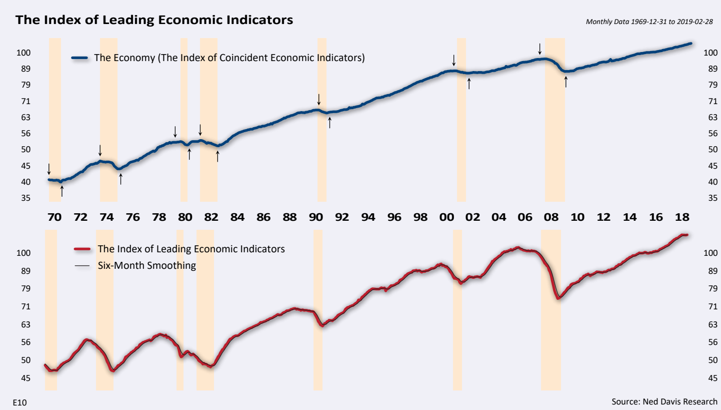
First let's discuss the U.S. economy, which we leave in a slow forward position. The current U.S. economic expansion is the second longest expansion since 1900, and come June, it will become the longest in more than a century.

With the final 4th quarter GDP numbers just recently coming in, overall economic growth looks like it was 2.9% for all of 2018. We continue to expect economic growth in 2019 for the U.S. economy, but we believe it will be closer to the growth rates experienced for most of the post-credit crisis period at just above 2%. Our expectation for GDP growth this year currently stands at 2.3%.



The economic indicators we follow that reflect the front edge of the economy continue to show growth, which keeps us positive about the economy overall in 2019. The Conference Board's Leading Economic Indicators Index (the red line on the bottom of this chart), continued to be elevated near all-time highs in the early part of the year.

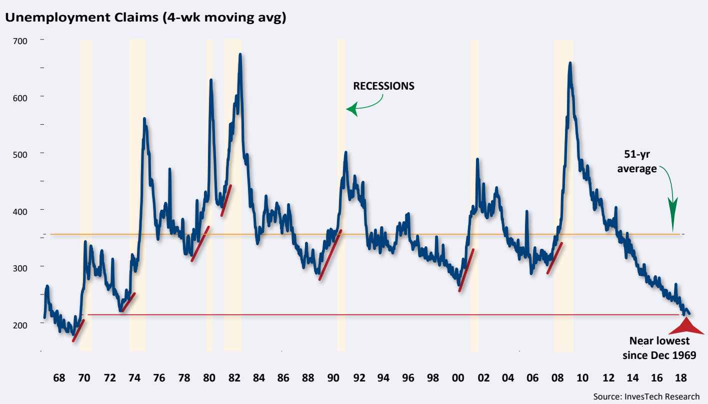
Since 1960, this indicator has historically rolled over about 11 months prior to a recession (16 months prior to the last three



recessions) and we have not seen that lower trend develop at this point.

Job market data looks solid as well as the weekly initial jobless claims continue to hover near their lowest or best levels since the late 1960's. Layoffs, which would be reflected in this reading, tend to turn up about 6 to 12 months before a recession and those indications are not present at this time either. As a consumption led economy, the job market and the financial health of U.S. consumers are keys to economic growth.

Both the leading economic indicators index and weekly initial jobless claims data suggest the U.S. economy has more runway for growth in 2019.



The flattening of the yield curve has been a developing story since the Fed began raising interest rates in December 2015. After 4 rate hikes in 2018, the curve became flatter and flatter and the dovish turn by the Fed in January, along with some global economic weakness, spurred buying of longer-dated U.S. Treasuries, which pushed interest rates down.

With that action in the first quarter, the yield curve inverted in late March when looking at the yields of the 3-month T-Bill and the 10-year U.S. Treasury for the first time since 2007 – historically a warning sign for the U.S. economy.) In fact, the yield curve has inverted prior to every recession since 1962, so this is an important measure to monitor.

However, to put it in perspective, other indicators from the credit market that you would expect to see during a period of worsening economic conditions, like widening spreads between high yield bonds and U.S. Treasuries, are not evident at this time. Furthermore, the inversion of the yield curve, similar to other indicators we follow, does not tend to signal that a recession is imminent. In fact, historically the yield curve has inverted anywhere from 9-24 months in advance of a recession.

Additionally, the Fed has already signaled that they are through raising rates for the time being. This is different than many of the prior periods of yield curve inversion as often the Fed continued to raise rates several more times after the yield curve had inverted. Here in early April, the yield curve has already moved back to a positive slope and the inversion we experienced in late March was very narrow and short lived.

We will continue to monitor the shape of the yield curve, but, at this point, other economic measures are not confirming this signal of caution. Overall, we believe the fundamental backdrop for the economy continues to look solid and we expect growth in 2019, but likely at a slower pace than experienced in 2018.

Yield Curve Leading Up to Recessions

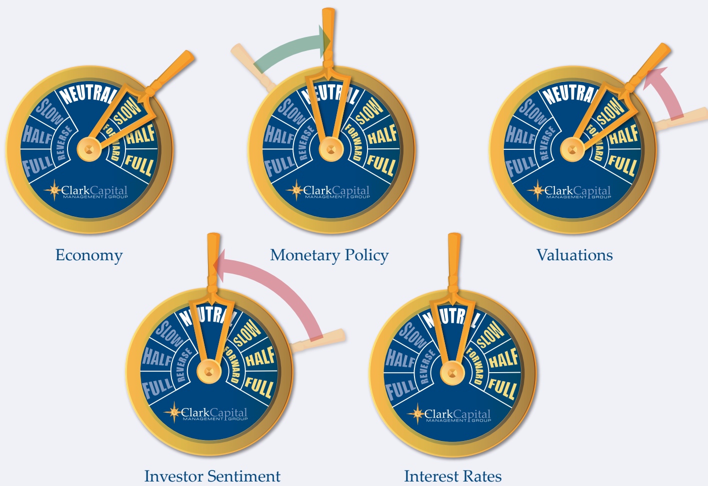
	Yield Curve (bps)	
Start of Recession	**At Start of Recession**	**52- Week Low**
12/31/1969	-13	-45
11/30/1973	-61	-187
01/31/1980	-87	-208
07/31/1981	-20	-373
07/31/1990	61	-16
04/02/2001	72	-99
12/31/2007	79	-60
Current	9	-7

Source: InvesTech Research

The next gauge is Monetary Policy. We moved into the new year expecting we were near the end of this rate-tightening cycle, but thinking there could possibly still be one rate hike in 2019. One of the most noteworthy developments from late 2018 to early 2019 was the U-turn by the Fed from a more hawkish to a more dovish monetary policy stance. The Federal Open Market Committee doubled-down on that stance of patience at the conclusion of their meeting in March.

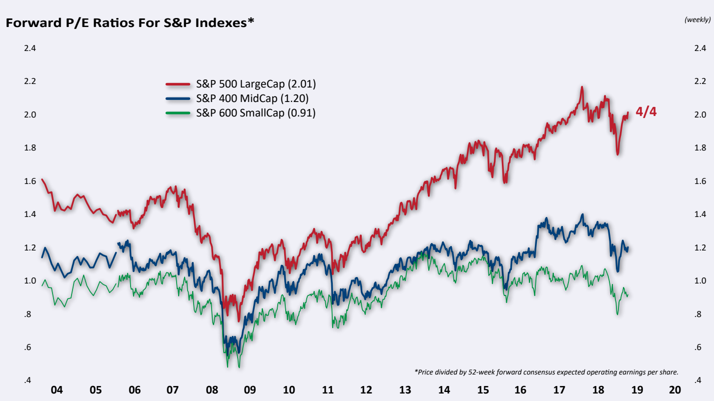
At the start of April, the market was forecasting a 0% chance of a rate hike through January 2020, but the probability of a rate cut grows as we move throughout the year and has now become a higher-probability event in 2019.

So, in a short period of time, the market has gone from a position where it was fighting the Fed as the Fed was still in a rate-hiking mode, to thinking the Fed had largely moved out of



the market's way due to its new more dovish stance. This has contributed to some of the positive equity market activity so far in 2019. Due to this shift in attitude by the Fed, we move the Monetary Policy gauge forward to a Neutral position heading into the second quarter.

Next are valuations. Stock market valuations plummeted in late 2018 as the equity market sell off culminated in late December. Now, with a double-digit recovery in the S&P 500 in the first quarter of this year, valuations have increased once again.



We still don't see an overvalued market at this point, but we want to acknowledge that valuations have moved up from about a 13.5 times earnings forward P/E ratio in late December to around a 16.5 times P/E ratio at the end of the first quarter.

Still not expensive, but not as cheap as it was at the end of 2018. Therefore, we move the valuation gauge back to a slow forward position. Earnings growth is expected to slow in 2019, but we still expect positive earnings this year and believe valuations are at a level that can continue to support equity market progress.

The next gauge is Investor Sentiment, which can be thought of as a measure of speculation. Sharp mutual fund outflows and overly pessimistic sentiment readings, driven by the equity market sell off in late 2018, compelled us to improve this indicator at the beginning of 2019 to a half forward position.

Recall that this is a contrarian indicator and when sentiment is overly dire or pessimistic, it tends to indicate the market is closer to a low; likewise, too much investor enthusiasm and over exuberance is often seen near market tops.

After some notable swings at the end of 2018 and the beginning of 2019, investor sentiment is pretty much middle of the road – not overly pessimistic and not overly optimistic. We therefore bring the Investor Sentiment gauge back to a Neutral position.

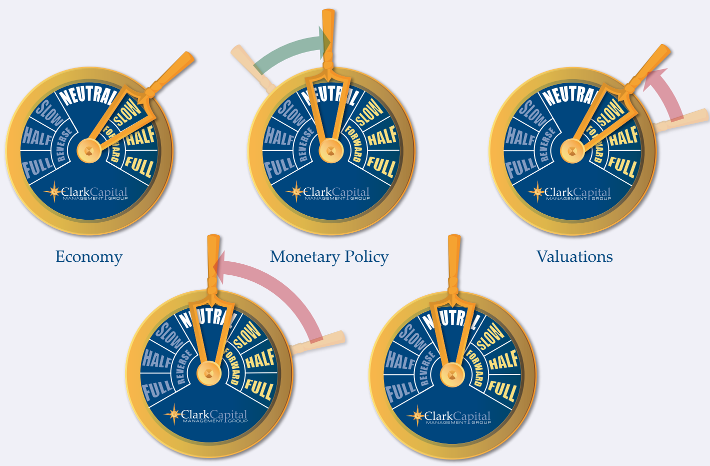
Our final gauge is interest rates, which we leave in a Neutral position. The yield on the 10-year U.S. Treasury moved up at the start of the year and then bounced around in pretty tight range between 2.6% and 2.75% for much of the first quarter.

However, following the FOMC meeting in mid-March, yields moved sharply lower as the Fed indicated it would likely not raise rates this year and it planned to end the roll off of bonds from its balance sheet later in the year as well.

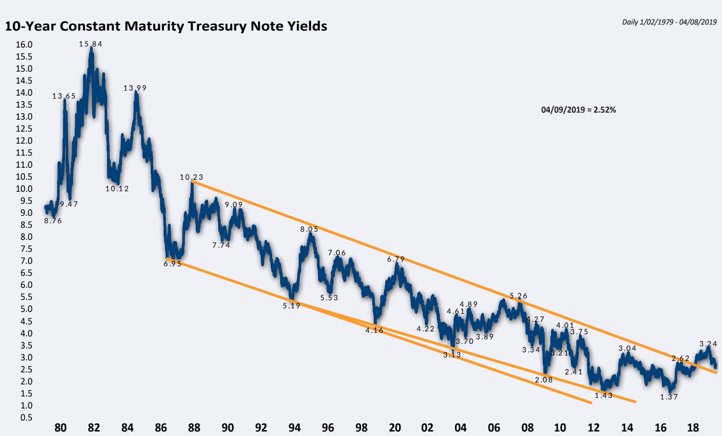
The yield dropped below 2.4% in late March, its lowest level since 2017, which drove the inversion of the yield curve late in the quarter. So, for our interest rate gauge, there are a couple factors to consider.

One is positive in that interest rates have moved lower, which reduces the cost of capital for borrowers, including a drop in mortgage rates, which helps home buyers and those that want to refinance. That can be a positive for consumers. However, the negative was the inversion of the yield curve as we have previously discussed. Putting those two considerations together, we decided to keep the Interest Rate gauge in its Neutral position believing overall, interest rates are still having a more neutral effect on the U.S. economy at this point.

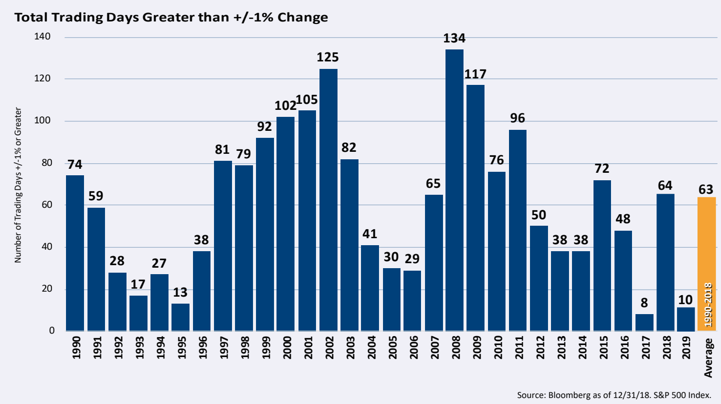
Interest rate levels are still low from a historical perspective,



but the shape of the yield curve is very flat after a brief stint in inverted territory late in the quarter. Monitoring the direction of interest rate moves and the shape of the yield curve will continue to be front and center issues as we move throughout the year.



Moving to the capital markets, what a difference three months can make. Investors endured one of the worst quarters since the credit crisis period in Q4 of 2018, only to be followed by one of the best post-credit crisis periods to begin 2019 and the best first quarter for stocks since 1998.



The 4th quarter produced 28 trading days in which the S&P 500 moved up or down by more than 1% with the majority of those being down. When the dust settled, the S&P 500 was off -13.52%. In the 1st quarter of this year, the S&P 500 had 11 1% trading days with most of those being up and this index gained 13.65% for the quarter.

The tech-heavy NASDAQ Composite, which did enter into an official bear market in the 4th quarter, rebounded strongly and advanced 16.8% in the first quarter to lead the major U.S. indices. International equities enjoyed strong returns as well, but not quite at the same pace as U.S. markets.

While we remain positive on stocks, we also continue to expect ongoing market volatility as we move throughout the year and such a strong recovery in a very short period of time could be met with higher volatility as the market settles into a trading range over the next few months.

Turning to bonds, with the Fed's shift in policy stance early in the year to a 2019 that will likely not see a rate hike, gains were enjoyed across the fixed income landscape in the first quarter. U.S. Treasuries performed well, but their performance didn't seem to reflect a "risk-off" attitude, and they more likely reflected a Fed that's on hold, so investors bought up those bonds.

Munis and corporate bonds enjoyed solids gains in the first quarter as well. During a quarter when equities shined, it was no surprise that high yield bonds had the best performance of the broad fixed income indices.

Putting this all together, the 1st quarter was a great start to the year across asset classes. U.S. stocks, international stocks and bonds throughout the fixed income spectrum enjoyed solid gains. Economic data continues to support an outlook that the U.S. economy will likely grow in 2019. We continue to favor stocks over bonds, and we believe the long-term secular bull market is still intact, driven by a solid economic backdrop. Our forecast for 2019, set at the beginning of the year for the S&P 500, remains at 2900.

Volatility will likely continue in 2019 as the trade situation with China goes through its final phases, Europe and the U.K. deal with what continues to be an uncertain Brexit outcome, earnings growth and the U.S. economy moderate from their strong pace of growth last year and the political divide in Washington shows no signs of improvement.

Ultimately, however, we think that fundamentals are what matter in the long run and the current fundamentals remain positive. During periods of elevated volatility, we believe it is imperative for investors to stay focused on their long-term goals and not let short-term swings in the market derail them from their longer-term objectives. No better example exists than the experience of the last 2 quarters…we believe time in the market is what matters, not trying to time the market.

Please contact your Investment Consultant to discuss how we can support your client reviews and how we can help you deliver successful outcomes to your clients.