SilverOak

WEALTH MANAGEMENT LLC

First Quarter 2019 Market Summary

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First Quarter 2019 Market Summary

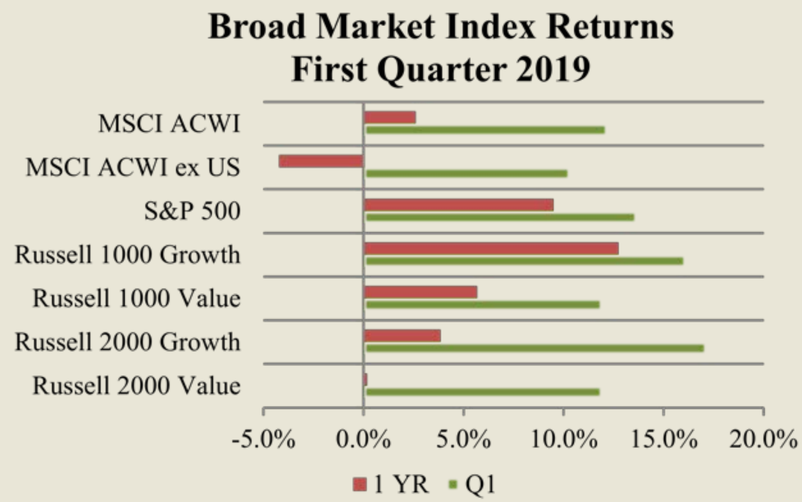
The end of the first quarter 2019 capped one of the best starts to a year in decades, leaving investors with a sunny disposition as springtime emerges. This was in stark contrast to the tumultuous market that ensued in the fourth quarter of 2018, when global equity markets were down 10-20%. The swift rebound was likely stronger than most people expected and it may feel like the fourth quarter sell-off is a distant memory.

The last two quarters are a reminder that short-term market timing is unattainable - markets can go up more than you think and likewise, go down more than you think. Fourth quarter returns were worse than economic fundamentals would suggest, while first quarter returns were much better than the fundamentals, which have weakened recently. Improved investor sentiment and the indication of less restrictive monetary policy going forward has fueled markets. Taking the past two quarters together there was a lot of action, but overall the markets are back where they started, near the all-time highs set in September of 2018.

The Federal Reserve has significantly changed their policy and rhetoric over the past 3-6 months. In October, the Fed's plan was to continue reducing their balance sheet and to raise interest rates four times by the end of 2019. After a large correction in the equities markets at the end of 2018, the Fed acknowledged that economic data such as job growth, retail sales and business capital expenditures has slowed. In March, the Fed announced they do not expect to raise rates in 2019 and they will stop reducing their balance sheet by October. This is significant because monetary policy is going from restrictive to a more neutral stance. The market has wanted the Fed to be more dovish and they got their wish. With the Fed providing a "backstop", investor's fears have eased and they have taken on more risk, just as they have done each time the Fed has provided stimulus over the past ten years. It seems we are back to a situation where good news is good news and bad news is good news. Under this environment, equities could grind higher with muted volatility.

U.S. large company stocks, represented by the S&P 500 Index, were up 13.7% during the first quarter of 2019. U.S. small company stocks, represented by the Russell 2000 Index, had positive returns of 14.6%. The markets have a lot of faith that the Fed will extend this expansion by being accommodative. In this "low economic growth" environment, growth stocks have been favored and thus outperformed again in the first quarter. However, the rally has been broad based across all sectors.

International stocks, represented by the MSCI ACWI ex US Index, were up 10.3% for the quarter. Growth in many international countries was weak coming into this year, with a downturn in global manufacturing and trade being a major cause. This has largely remained the same story; however, some Asian countries have seen growth pick up in March. China has been stimulating their economy, which should have a multiplier effect across many developed and emerging market economies. Central banks around the world have eased similarly to the Fed, supporting global markets.



For the quarter, the Bloomberg Barclays U.S. Aggregate Bond Index, which represents a broad basket of bonds, was up 2.9%. Interest rates dropped considerably, boosting bond prices and returns. The Fed did not raise rates during the quarter and are not likely to hike rates for the rest of the year. In fact, the market is anticipating the Fed's next move is to cut rates. Credit spreads tightened as investor sentiment rebounded, thus leading to strong returns in credit-sensitive bond sectors. Fixed income and equity markets are showing mixed signals. Stocks and credit oriented fixed income have performed very well year-to-date while bond yields have fallen, reflecting a cautionary view due in part to worsening economic data trends.

First Quarter 2019 Market Summary (continued)

Much talk has been made recently in the media about the yield curve inverting during the quarter. Typically, long-term rates have higher yields than short-term rates. When the opposite occurs, the yield curve is inverted. The yield curve is often viewed as a leading indicator for economic strength, as all U.S. recessions since the 1960s have been preceded by a yield curve inversion. It is important to note though, that there have also been "false positives" during that timeframe, and an inversion is not a requirement for a recession. However, there is still a rationale for why it matters. When the yield curve is inverted, banks cannot borrow short-term and lend long-term. This tightens financial conditions, which negatively impacts the economy.

The yield curve is an example of a leading indicator, which is useful in assessing economic and market conditions. SilverOak's Market Dashboard combines many of these indicators, such as economic data (employment, housing, manufacturing, etc.), corporate earnings, credit spreads, valuations and sentiment indicators. It is important to note that a single indicator does not forecast imminent doom, nor should any one indicator be used as an automatic actionable trigger. Leading indicators reflect a story, and it is up to those using the data to determine the narrative. With an amalgamation of data points, an investor can form a more educated view of the market conditions and determine where they want to be on the risk spectrum. At SilverOak, we help clients make sense of this vast and often tangled expanse of information and chart a clear path through based on their own individual goals and objectives.

The markets are likely pricing in future economic improvement and accommodative monetary policy. However, the pace of equity gains we saw in the first quarter will not be sustainable. The first quarter's gains annualized would be 50-60%; returns of that magnitude are very unlikely and thus it is reasonable to assume returns will be lower for the rest of the year. Despite the improvement in sentiment, the risks to the market did not disappear. In addition, the amount of fiscal deficit and an accommodating monetary policy this late in an economic cycle is uncommon.

Given we are likely in the later stages of this economic cycle, combined with recent mixed economic signals, we believe it is prudent for investors to focus on managing the issues that are controllable: reviewing long-term portfolio allocations, shoring-up personal balance sheets and cash flow statements, avoid taking excessive risks or extending leverage beyond what is reasonable, etc. If you have already completed these items, then sit back and watch the theatre unfold knowing that you are well positioned.

HIGHLIGHTS

MACROECONOMICS

- The Bureau of Economic Analysis released the third estimate of fourth quarter 2018 real GDP, an annual rate increase of 2.2% from the preceding quarter. The first quarter advanced estimate increased to an annual rate of 3.2%.
- The University of Michigan Consumer Sentiment Index final reading for March was 98.4, which was essentially flat vs. the fourth quarter. Though, consumer sentiment remains at very strong levels.
- The ISM Manufacturing Index trended lower during the quarter, finishing at 55.3 in March. While the Index has come down since it peaked in August 2018, the Index level is still strong. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- In March, the Conference Board Leading Economic Index increased 0.4% month-over-month to 111.9. The Index had paused over the past six months; however, the preliminary March reading indicates a resumption in growth.
- The price of WTI Crude Oil was $60.19 at the end of March, which is 33.3% higher than $45.15 at the end of December. The price of Brent Crude Oil increased 34.3% in the quarter to $67.93. The price of oil recovered some of the losses from 4Q as supply remains disciplined.
- In March, headline CPI increased 1.9% year-over-year. Core CPI, which does not include food and energy, had a 2.0% increase. Inflation remains subdued, much like it has been the past decade.

HOUSING

- The housing sector softened in 2018 as higher interest rates and home prices caused affordability to decline. However, interest rates have declined since late 2018, and March housing data came in stronger than previous months.
- Preliminary existing home sales increased in the quarter with a monthly average annualized rate of 5.21 million units from 5.14 million units in the fourth quarter. Though, the March annualized rate is 7.0% lower than the 5.60 million units in March 2018. Unsold home supply remains at low levels.
- The preliminary existing home sale prices for March were 3.8% higher than the levels of one year ago. Prices have been trending up since the beginning of 2012, though the recent year-over-year gains have softened the past few months.
- New home sales have been weak since mid-2018; however, the March sales saw an increase. There appears to be housing demand if interest rates and home prices remain contained.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose over 2.9% year-over-year in February. Of the locations in the Index, home prices in San Francisco, Seattle, Phoenix, Las Vegas, and Denver have risen the most since the 2011.

EMPLOYMENT

- The labor market has generally been healthy. The job growth rate has slowed slightly, as employers are having difficulty finding workers with the required skills. Wages growth is the strongest it has been in a decade.
- During the quarter, nonfarm payrolls averaged a healthy 180,000 jobs added per month.
- The unemployment rate was essential flat at 3.8% during the quarter.
- Initial Jobless Claims have been decreasing since 2009 and dipped to lows last seen in 1969, reflecting a tight labor market.

DOMESTIC CORPORATIONS

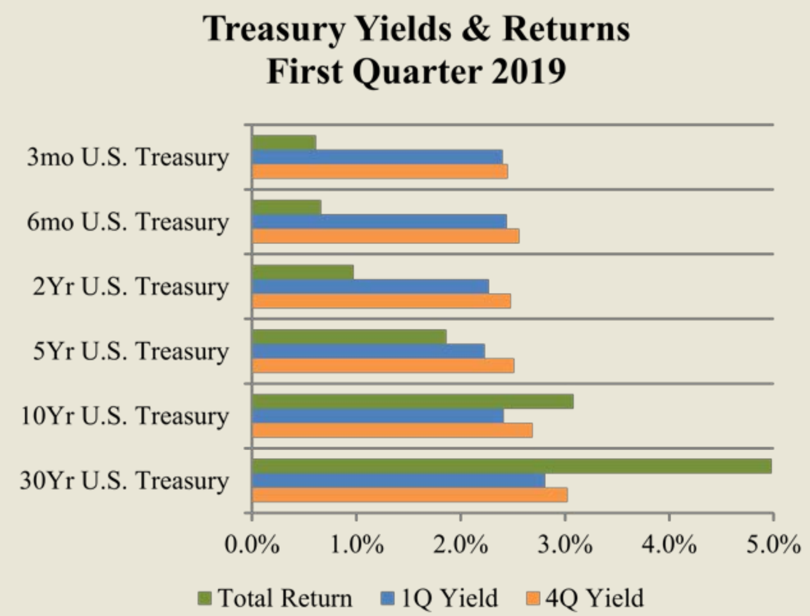
- Corporate operating earnings in the fourth quarter 2018 were higher than the previous year. However, estimates for 1Q and 2019 have been reduced as corporate confidence has been tempered in part due to China/U.S. trade discussions.
- Operating profit margins remain well above historical averages though they have retreated the past few quarters. Margins have benefitted from lower taxes but have yet to be pressured by increased interest rates and modest wage inflation.
- U.S. equity forward P/E multiples are near historical averages while trailing P/E multiples are above historical averages.

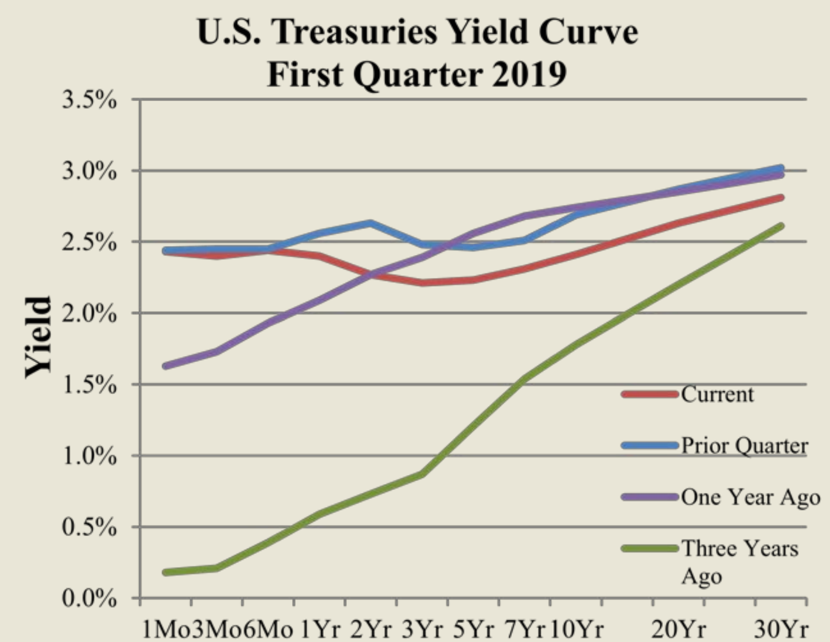
FED POLICY

- The Federal Open Market Committee (FOMC) reversed course and released a dovish statement during their March meeting. The Fed decided to maintain the federal funds at a target range of 2.25% - 2.50%. In addition, they reduced their projections for interest rate hikes from two in 2019 to zero while also lowering their economic growth and inflation expectations for the year. The biggest surprise in the statement release for investors was when the Fed announced they will stop reducing their balance sheet in September.
- The Fed cited growing global risks, a slowing U.S. economy and subdued inflation as reasons for the change in policy.
- The market reacted favorably to the policy change and it contributed to the strong rally in risk assets during the quarter.

FIXED INCOME

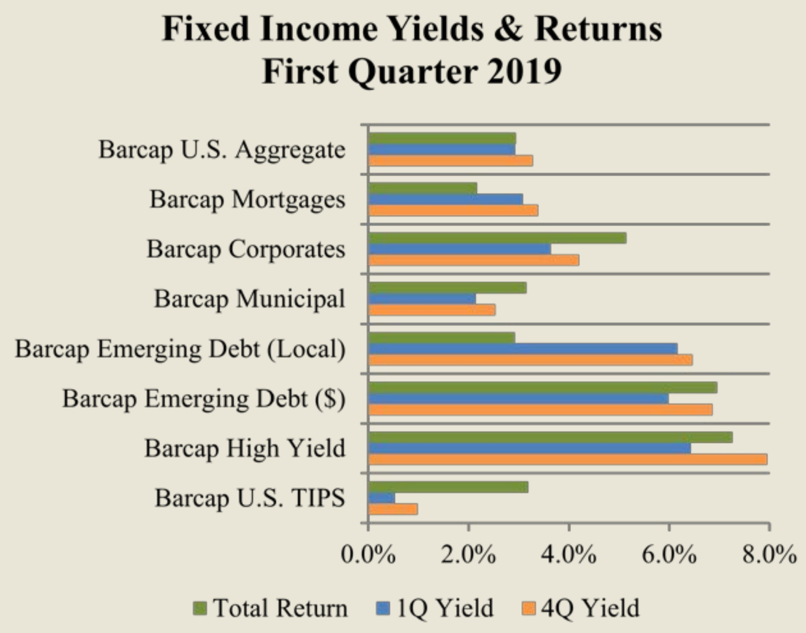
- During the first quarter, long-term U.S. Treasury bond yields decreased due to market expectations of weaker economic growth. This caused the yield curve to flatten and even briefly invert for a few days in the 3Mo. to 10Yr. spread.
- Short-term interest rates are controlled or heavily influenced by central banks, where-as long term interest rates are controlled by market forces and economic growth.
- The brief yield curve inversion received a lot of press during the quarter as it is often used as an economic indicator. Historically, the yield curve has flattened as the Fed raises interest rates and the business cycle matures. The yield curve has inverted typically a year prior to the majority of the U.S. recessions over the past 50 years. However, the yield curve can remain relatively flat for extended periods without inverting, such was the case in the mid-1990s. Thus, the shape of the yield curve should be monitored but should not be the single reason for portfolio activity.

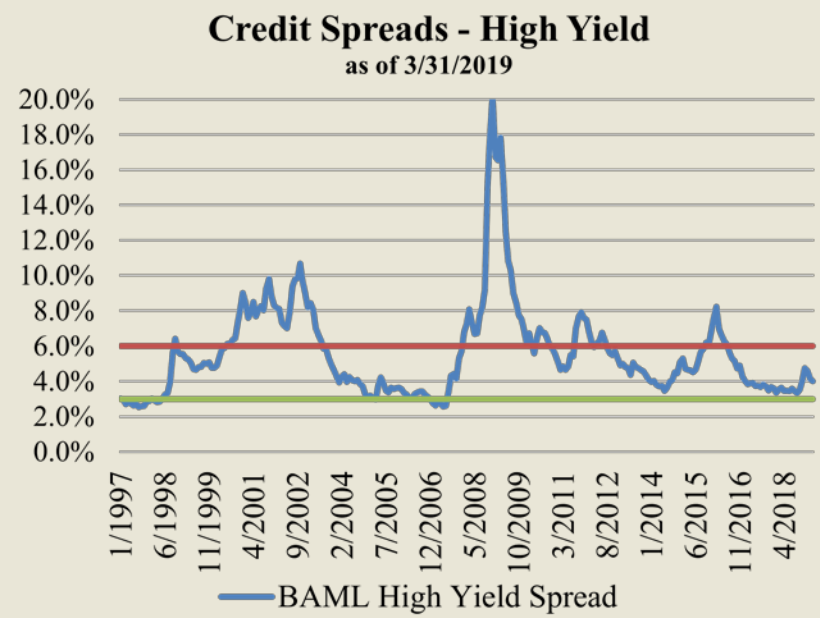




FIXED INCOME (continued)

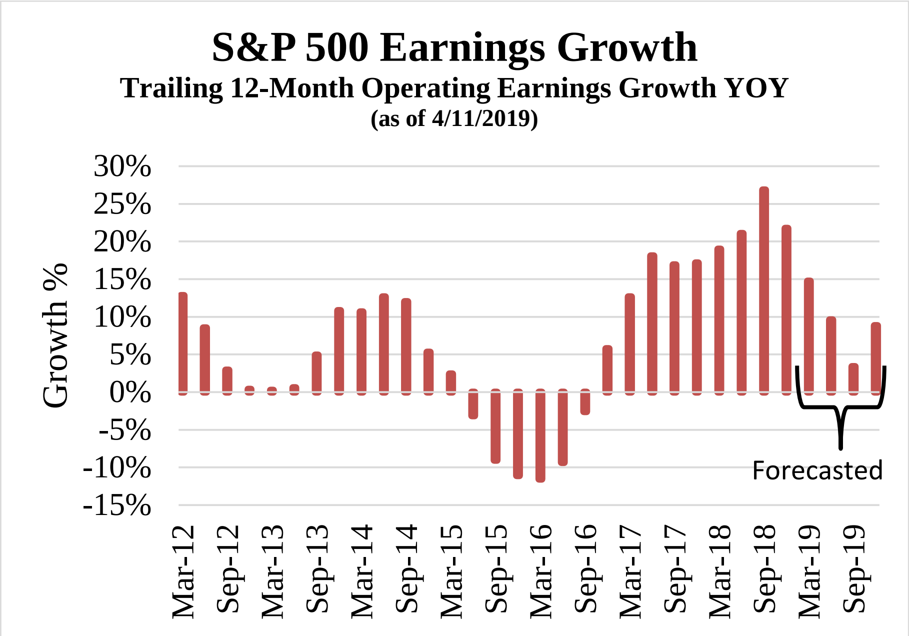
- During the quarter, the Barclays U.S. Aggregate was up 2.9% as interest rates fell.
- After rising in fourth quarter, credit spreads narrowed in the first quarter as investor sentiment improved. This led to stronger returns in sectors with more credit risk, such as corporates, high yield, and emerging market.
- Municipals saw very strong inflows year-to-date.
- Yields fell globally as well as many countries globally have had challenged economic environments. Rates will likely remain range bound due to low growth and inflation around the world.
- Despite investors' willingness to accept greater credit risk, fundamentals in the investment grade corporate and high-yield sectors remain mix. There is a high amount of leverage in the system; however, defaults remain low.

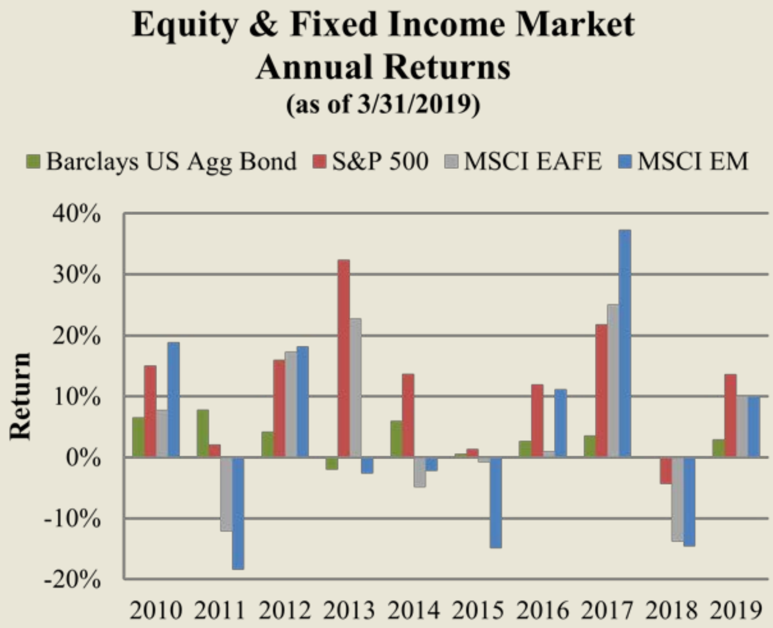


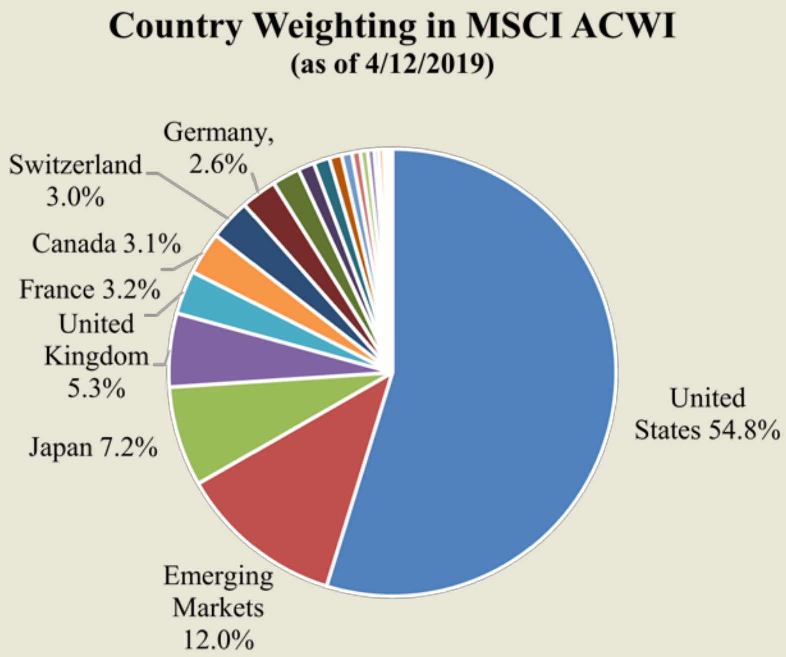


EQUITIES

- Market sentiment rebounded considerably during the quarter, which led to strong returns for equities. Investors cheered as central banks around the world paused on "normalizing" monetary policy and instead became more accommodative to support their markets.
- S&P 500's first quarter returns were the best quarterly returns in a decade.
- The bond market and the stock market seem to be telling different stories. There is a Wall Street adage of "Don't fight the Fed", which is the script the equity markets seem to be following by moving to risk-on when the Fed became more accommodative. However, the bond market seems to be following economic data as yields have fallen alongside growth. When yields fall and the yield curve flattens that typically signals a difficult environment.
- S&P 500 earnings estimates for 2019 have fallen from over double-digit growth to mid-single-digit growth.

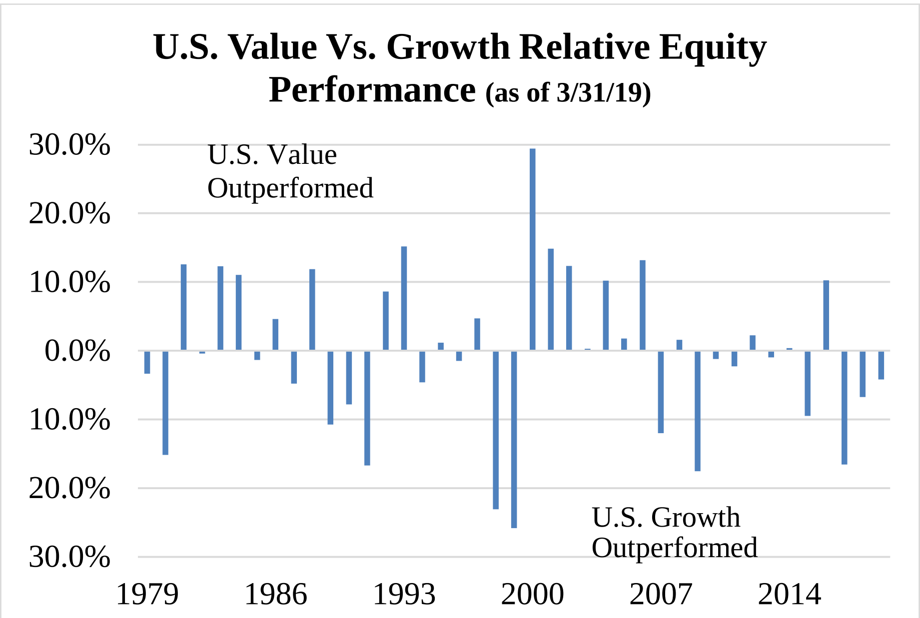






DOMESTIC EQUITIES

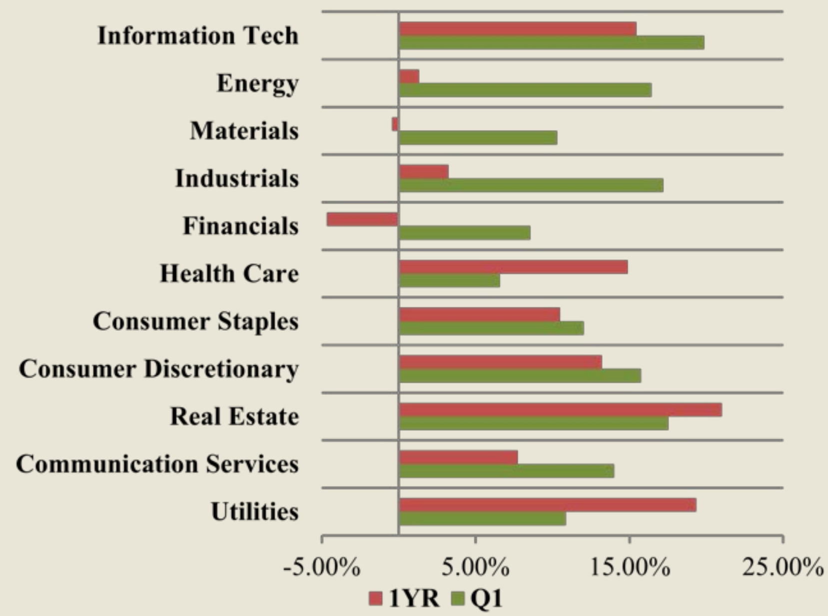
- The Russell 1000 Index, comprised of large and mid-capitalization stocks, posted a total return of 14.0% during the first quarter. On a year-over-year basis, the Russell 1000 Index has increased 9.3%.
- Small capitalization stocks, as represented by the Russell 2000 Index, posted a total return of 14.6% during the first quarter. On a year-over-year basis, the index has increased 2.1%.
- The market recovery was broad-based across sectors. However, growth companies continued their outperformance of value stocks.
- Economic data is softening, though still expansionary. The U.S. consumer, which accounts for 2/3 of the U.S. economy, appears to be in good shape – low unemployment, rising wages and lower debt service levels. In addition, semiconductors, which are often looked at as a global trade indicator, have recently reached new highs.



Russell 1000 Growth TR vs. Russell 1000 Value TR

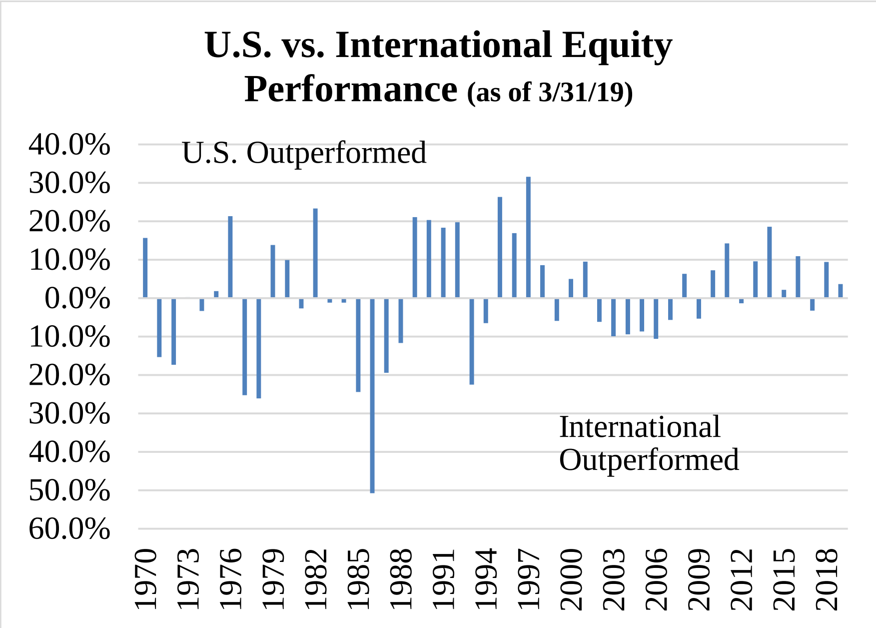
First Quarter 2019 Returns			
	Value	Core	Growth
Mega Cap		13.5%	
Large Cap	11.9%	14.0%	16.1%
Mid Cap	14.4%	16.5%	19.6%
Small Cap	11.9%	14.6%	17.1%
Micro Cap	10.4%	13.1%	16.0%

U.S. Equity Market Returns by Major Sector
(Securities in S&P 500, First Quarter 2019)

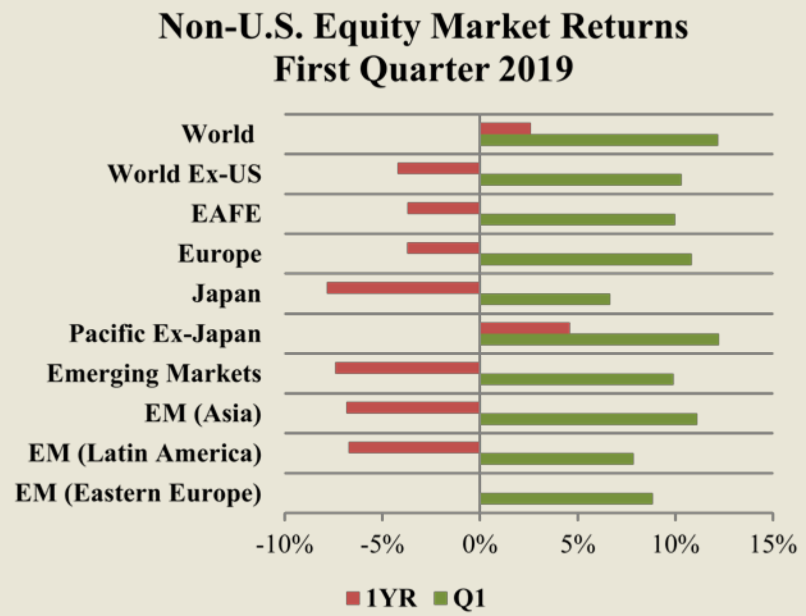


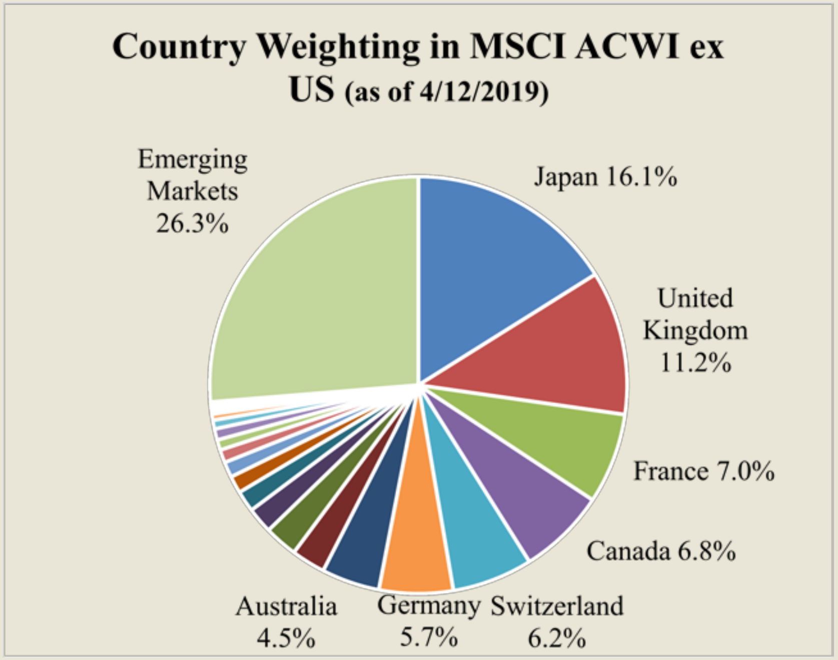
INTERNATIONAL EQUITIES

- Developed international stocks, as represented by the MSCI EAFE, were up 10.0% during the quarter. However, on a year-over-year basis, the EAFE is down 4.2%, performing worse than U.S. domestic equities. Brexit negotiations, Italy's budget issues and lower global trade have pressured international returns.
- Emerging market stocks, as represented by the MSCI Emerging Markets Index, increased 9.9%. Over the past year, growth in China has slowed; however, the Chinese government is taking steps to stimulate their economy by cutting rates and taxes. Strength in China would likely lead to better economic conditions in the rest of Asia and exporting European nations.
- Valuations of the broad international markets appear more attractive than in the U.S. However, investors have been favoring the U.S. as it has a higher percentage of secular growth companies.



S&P 500 TR vs. MSCI EAFE NR





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