Courier Capital, LLC
Registered Investment Adviser
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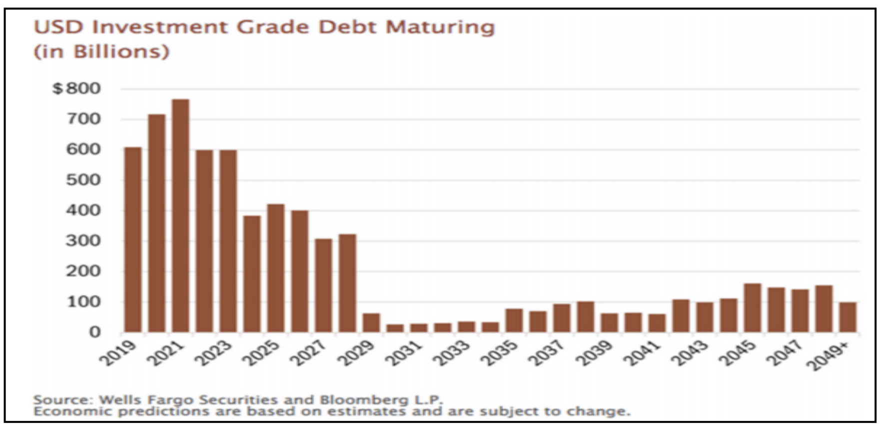
Market Review & Update

SPRING 2019

What a difference a decade can make. In March 2009 we were finally exiting the harshest economic recession in decades thanks in part to the quantitative easing policies of the Federal Reserve (Fed) and central banks around the globe lowering interest rates to zero and below. Ten years on however the central banks are still finding their way trying to exit their zero interest rate and bond buying strategies that helped economies and markets recover. As we saw in the fourth quarter of 2018, equity markets that benefited greatly from the low interest rates engineered by the central banks were not pleased with the future interest rate increase path expressed by the Fed chief. The equity markets reacted to the Fed policy pronouncement, along with other concerns emanating from Washington (government shutdown, China trade deal, etc...), and promptly demonstrated their dislike through increased volatility and a sharp pullback. As these concerns have been alleviated to various degrees the markets are recovering and the focus is moving again to corporate earnings and forecasts.

What bears watching is the reaction of the bond markets as we move towards a more normalized interest rate environment. As Jim Grant is fond of saying, "Interest rates are the traffic signals of a market economy. Turn them all green (or, for that matter, red), and errors and pile-ups abound." Governments, households, and corporations have been able to borrow at historically low interest rates. US Corporations have taken advantage of these favorable rates and over the last decade corporate debt in the US has increased by more than 200% with much of that coming due in the next five years (see chart below). Couple this with expanding federal deficits and the seeds are sown for additional increases in interest rates generally.



Internationally, net of inflation there is not one positive real interest rate to be had at any point along the government yield curves of Germany and Japan and only one such rate along the French government yield curve at the 30 year maturity point. According to Bloomberg, over $7 trillion of bonds worldwide are priced to yield less than zero in nominal terms. So why are we watching the potential rise in interest rates with a wary eye? We have never seen an unwinding of a global quantitative easing program starting at an interest rate of zero (or even non-zero!) combined with an ever increasing supply of government debt and corporate refinancing. Staying in shorter term maturities to earn an above-inflation rate of return while protecting principal remains the most appropriate strategy for fixed-income investors in this environment.

On the economic front, US Gross Domestic Product for the fourth quarter of 2018 came in stronger than expected at 2.6%. For all of 2018 real GDP grew 2.9% with the economy showing great resilience across most economic sectors and inflation holding below the Fed target of 2%. Wages are growing smartly at 3.5% year-over-year and the unemployment rate has fallen to 3.8% with over 7.5 million job openings and only 6.5 million unemployed individuals seeking work further exposing strength not just in the jobs market but the economy in general.

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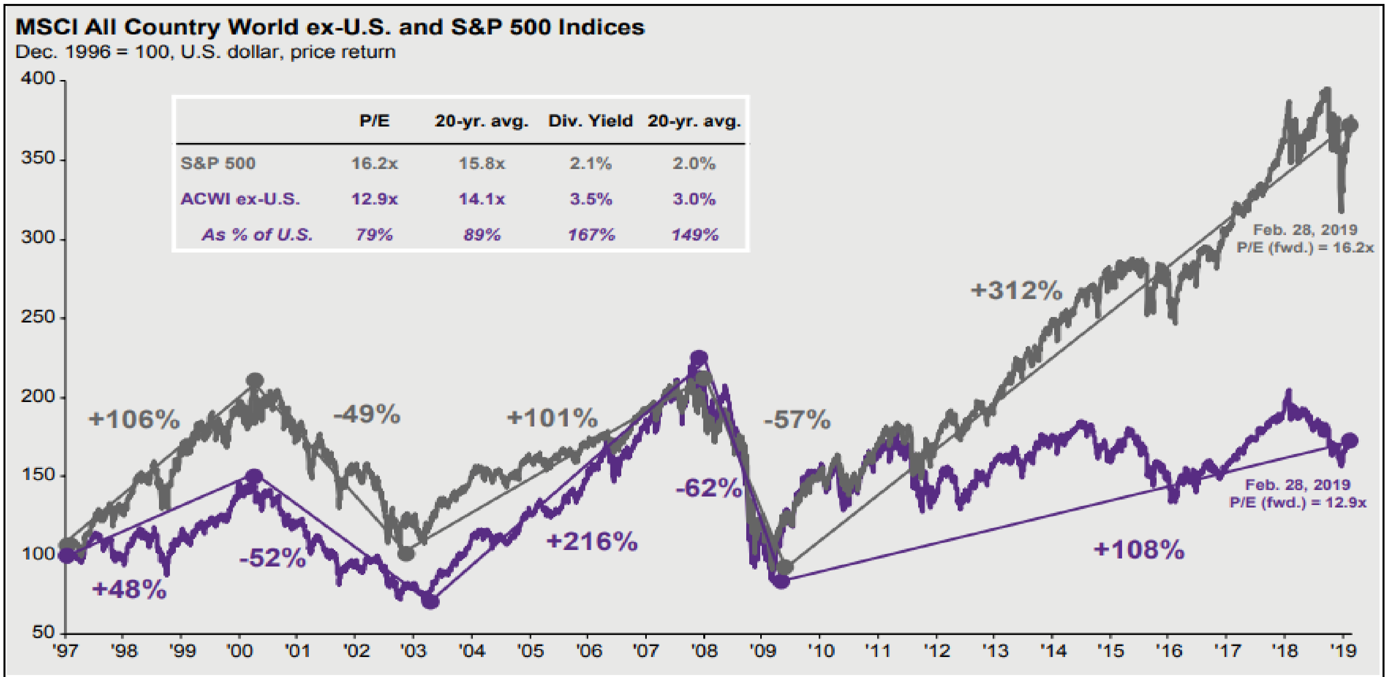
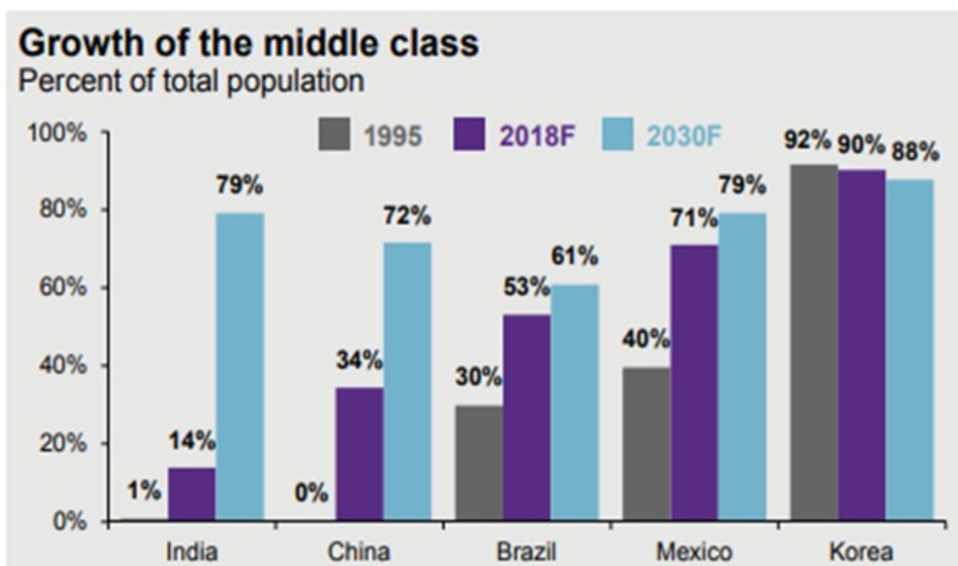
On the back of this economic strength, the US stock markets have consistently outperformed their foreign counterparts since the recovery began which has led to an interesting valuation gap (chart below). International equity markets are sitting at lower valuation metrics while providing higher dividend yields than current US equity markets.



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.

In addition, the middle class population in each of the emerging market economies of India and China is projected to grow to a majority of their populations (chart below) creating the potential for a massive consumer class between these two countries greater than that of the US and Europe combined. These features deserve an investor's attention to international markets going forward.

Finally, investors lost a giant of democratizing investing, John "Jack" Bogle, who passed away January 16, 2019 at the age of 89. John Bogle founded Vanguard and created the individual investor version of the index fund which dramatically lowered the cost of investing. His optimism about staying invested for the long run and belief in the ability of returns from businesses helping the average investor was exemplified in many quotes: "The message is clear: in the long run, stock returns depend almost entirely on the   reality of the investment returns earned by our corporations. The perception of investor's, reflected by the speculative returns, counts for little. It is economics that controls long-term equity returns; emotions, so dominant in the short-term, dissolve. The idea that a bell rings to signal when investors should get into or out of the market is simply not credible. After nearly 50 years in this business, I do not know of anybody who has done it successfully and consistently."



Source: Brookings Institute

We'll talk to you soon.