

## ECONOMIC OUTLOOK

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### *Summary*

The November payroll report was very strong across the board and reinforces recent Federal Reserve statements that the economy is “in a good place”. That is a far cry from earlier this year when concerns of a long and drawn out trade war and noticeable signs of global economic weakness were feeding the fears of an imminent recession. Although the negative forces of business uncertainty remain high, labor market resiliency has been one of the hallmarks of this business expansion.

While the myriad of employment related surveys and indices can be volatile month-to-month, longer-term trends help to paint a clearer picture of the current state in the labor market. For example, last week’s layoff statistics posted their largest decline in seven months and the readings were near the lowest in 50 years. That is quite a remarkable development. Conversely, the monthly ADP National Employment Report missed estimates widely and printed a 67,000 job gain where 135,000 was expected. This was followed by the US Labor Department’s November nonfarm payroll report which highlighted a 266,000 job gain and a 41,000 upward revision to September and October’s numbers.

In order to paint a clearer picture and provide a more holistic view of the U.S. labor market, it can be appropriate to view the intermediate data points that average the monthly series. The Non-Farm payroll report 3-month average is running at 205,000 jobs and the 6-month average payroll is running at 196,000 jobs. These numbers compare to the yearly 3-month and 6-month average **low** payroll growth figures of 135,000 jobs and 139,999 jobs, respectively. This indicates that the longer-term payroll trends are strengthening, while we potentially inch closer to some form of trade war détente. This could set us up for trend growth in the 2% GDP area for 2020, while maintaining a fully employed workforce.

### *Positives*

Nonfarm payroll growth was 266,000, while 180,000 was expected

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Private sector payroll growth was 254,000, while 178,000 was expected

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The unemployment rate (3.5%) matched a near 50-year-low, while wages increased 3.1% Y-O-Y

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### *Negatives*

ISM Manufacturing Index printed 48.1, posting four consecutive months of sub 50 readings

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Factory orders were soft last month, while the prior month was revised lower

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Personal income was unchanged M-O-M, a 0.3% gain was expected

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## EQUITY OUTLOOK

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### *Summary*

U.S. equity markets continued to climb the wall of worry in November. The S&P 500 rose 3.6% adding to the impressive 27.7% gain for the year and headed into the month of December which has historically been one of the better performers. Domestic gains were broad with Russell 1000 Growth and Russell 1000 Value indexes posting 4.4% and 3.1% increases respectively. Smaller U.S. companies participated with the Russell Midcap Index rising 3.6% and the Russell 2000 advancing 4.1%.

Information technology, health care and financials all posted 5.0% or greater returns in November. With interest rates climbing slightly during the month, only the rate sensitive real estate (-1.9%) and utilities (-1.8%) sectors posted negative returns.

In spite of much optimism concerning U.S.-China trade negotiations, international equity markets failed to keep pace with domestic stocks. The developed MSCI EAFE Index climbed a relatively modest 1.1% while the MSCI Emerging Markets Index fell 0.1%.

As we look to the closing month of 2019 and further into 2020, we hear a lot of skepticism from investors and professional market pundits. But what is there to be so worried about? Domestic economic data points have rebounded strongly and the threat of a recession appears to have faded for the time being. The last round of corporate earnings beat expectations and forward guidance was reasonable considering the trade uncertainty. The Federal Reserve is on hold for the foreseeable future and we expect few surprises from them. Perhaps most importantly, the American consumer is as steadfast as ever with the lowest unemployment rates in over 60 years and wage gains showing some momentum.

There are some reasons to be concerned, no doubt. Washington is complicated but that's hardly a new development and markets have historically powered through the beltway noise. Additionally, corporate America has always found a way to adapt.

The length of this market expansion has led to an increase in skeptics. This helps give us more confidence that the current market expansion is likely to continue into 2020.

### *Positives*

Resilient U.S. consumer and labor markets

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TINA – There Is No Alternative (to equities)

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No more Fed surprises...we hope

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### *Negatives*

Equity valuations are somewhat stretched

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### *Unknowns*

Signs of trade progress but a very long way to go

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## FIXED INCOME OUTLOOK

### *Summary*

Markets continued to react to the ebb and flow of trade negotiations in November but yield curve changes were moderate compared to the extreme moves seen earlier in the year. When news was optimistic that the U.S. and China could reach at least a slimmed-down deal that would avert new tariffs, risk markets rallied and bond yields moved higher. When stories emerged that talks had stalled, the opposite occurred. Overall, yields edged upwards across the curve with the 2-year and 10-year Treasury notes adding 9 basis points (bps) to end the month at 1.61% and 1.78%, respectively. The 30-year Treasury bond yield also increased but by only 3 bps to end at 2.21%. The move higher caused returns to be negative across all tenors of Treasury notes. Investment-grade corporate bonds still delivered positive returns for the month as credit spreads narrowed by about 5 bps in aggregate.

After digesting the three cuts in the overnight rate since July, investors widely expect that there will be no additional action taken at this month's Fed Open Market Committee meeting. In fact, based on the futures market for the Fed Funds rate, there is less than a 50% chance for any change in the overnight rate until July of 2020. The recent message conveyed by many Fed officials, including Chairman Powell, has made it clear that they would prefer to allow inflation to run higher than their 2% asymmetric target for an extended period before taking action and increasing rates. They have also indicated that if the economic environment deteriorates, or trade confrontations provide incremental risks to the sustainability of the historically long expansion, they remain ready to take action as needed. Their statements imply an outlook where the overnight rate can only go lower in the next few years.

Given an asymmetric outlook for the overnight rate, we believe the 2-year yield should be no higher than the midpoint of the current Fed Funds rate policy (1.50% to 1.75%) and will likely move below the range on the first whiff of

economic weakness or trade turmoil. As long as the optimism remains, the curve should retain some sort of positive slope. We believe the low end of the range for the 2-year to 10-year slope should be about 15 bps, and if a trade deal gets done and optimism returns, we could see a slope of 40 bps to 50 bps. Based on this quick analysis, we would expect the 10-year yield to stay within the range of 1.60% to 2.10% for the next few months at least. In the first week of December, it was very near the midpoint.

Credit spreads have tightened significantly since the beginning of the year, but unless recessionary concerns increase, there is little reason to expect a significant period of underperformance for investment-grade corporate bonds. Demand for debt from large, high-quality issuers has been exceptionally strong in the past few months and we see little reason for that to abate any time soon.

### *Positives*

Asymmetric policy where the Fed will only lower rates in the next few years

Inflationary pressures likely to remain muted

### *Negatives*

Yields climbing around the world with less negative yielding debt

Modest growth has returned to some parts of Europe

### *Unknowns*

Tariffs and trade negotiations with China

Trump impeachment proceedings