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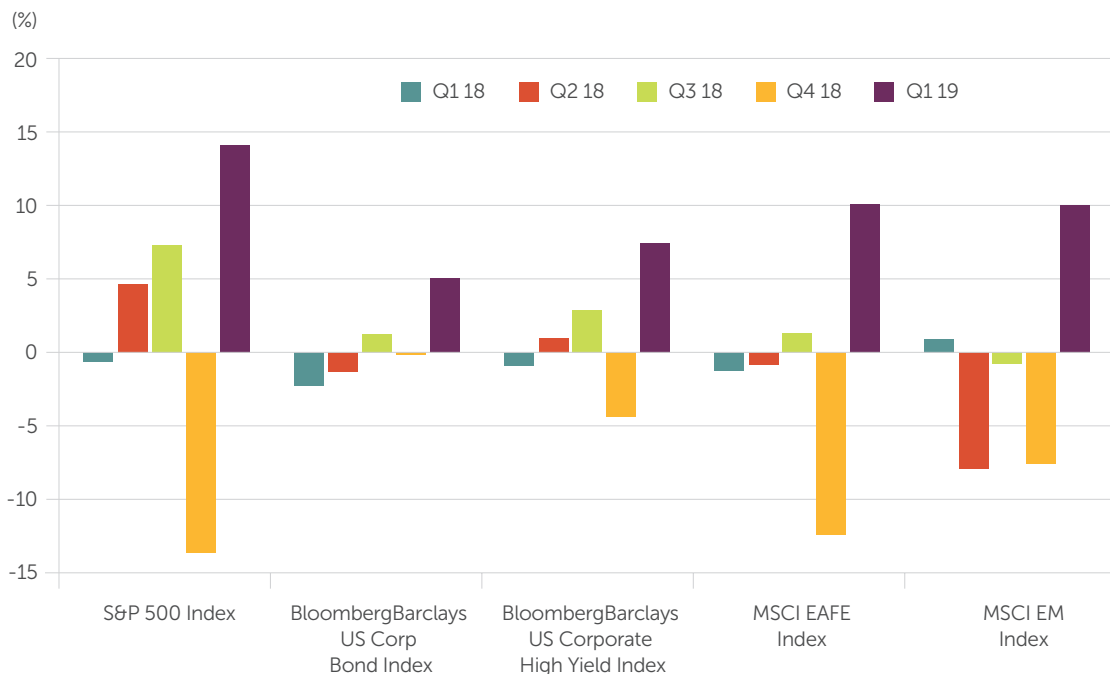
A shift to risk on

Key highlights:

- Equity and bond markets have rallied nicely since January, shifting into a risk-on posture.
- Credit spreads have narrowed while default levels remain contained.
- Caution should be exercised going forward

Investors seem to be shifting into riskier assets, symptomatic of the “risk-on” sentiment that is now apparently growing amongst some investors. With the Federal Reserve seemingly standing on the sidelines for the moment given its most recent meeting announcement, along with interest rates moving lower this year, the appeal of riskier securities has clearly grown. This sentiment has impacted equity markets as both the S&P 500 Index and NASDAQ have recently reached all-time highs, following the fourth quarter’s sell-off. In fact, looking at *Exhibit 1*, many major asset classes have enjoyed a nice rebound compared to the four prior quarters.

Exhibit 1: Risky assets look better these days
Year-to-date index returns as of 3/31/19

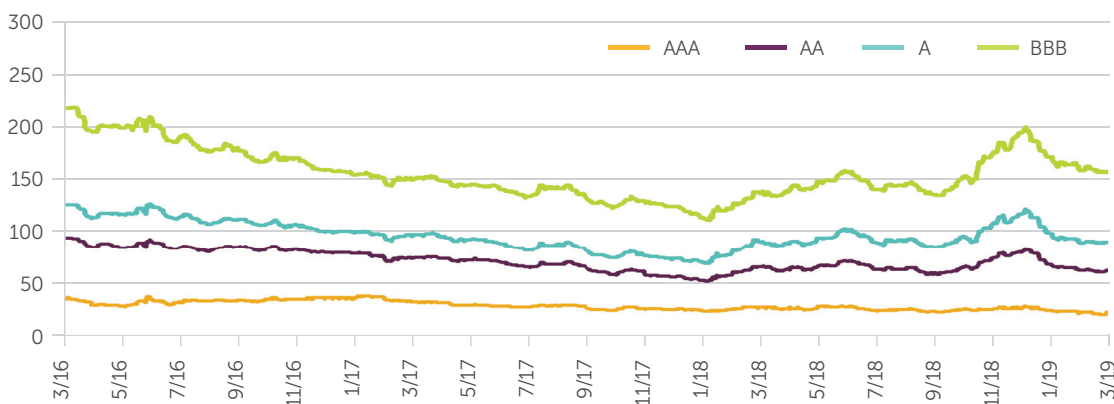


Source: Morningstar, 3/31/19.

What about risk?

One of the best indicators for gauging the creditworthiness of fixed income securities is their spreads—or additional yield—compared to U.S. Treasuries. As *Exhibit 2* shows, since the beginning of 2019, both investment grade and non-investment grade bonds have seen a significant decrease in spreads from their 2018 highs. Such narrowing suggests that investors have become less concerned about the abilities of issuers to pay back their borrowings, a positive market dynamic.

Exhibit 2: Spreads have narrowed since January 2019 US option-adjusted spreads (investment grade)



Source: Bloomberg, 3/31/19. Based on Bloomberg Barclays US Credit Aaa Index, Bloomberg Barclays US Credit Aa Index, Bloomberg Barclays US Credit A Index and Bloomberg Barclays US Credit Baa Index.

US option-adjusted spreads (high yield)



Source: Bloomberg, 3/31/19. Based on Bloomberg Barclays US Corporate High Yield Index.

Default risk

Given the level of spreads, it is not surprising that default rates have been quite low in the investment grade corporate bond market for some time, averaging 1.47% of all outstanding issues.¹ In the non-investment grade sector, the trailing 12-month high yield default rate for U.S. bonds was 2.8% in December 2018, a low level, especially when considering the universe of issuers in this sector.² Hence, defaults do not appear to a major short-term concern.

Sectors leading the charge

What areas have the market have rallied recently? Looking at investment grade sector performance on a year-to-date (YTD) basis, Telecommunications was the strongest performer for the first quarter of 2019, returning 6.69%. This was due to a combination of a shortage in new supply, longer-dated maturities outperforming and a high average credit quality in the sector. Energy has also been a strong performer this year with returns of 6.29%. This was driven by the rise in oil prices and the solid credit profile of the sector. High yield investors in particular were rewarded by the surge in oil as energy is the largest sector in that market. Media was another sector with strong returns so far this year (6.13%).

¹ Moody's, Credit Markets Review and Outlook, 1/24/19. Period measured is for 32 years ending 12/31/18.

² Ibid.

What does this mean to investors?

We suggest that, although equity and fixed income markets have performed well this year, a certain level of caution should be exercised. Economic data has been mixed this year, especially outside the U.S., and corporate earnings are likely to be less supportive going forward. Optimism can be altogether fleeting, especially when market momentum changes sharply. Investors need only recall the December correction.

These views represent the opinions of the Chief Investment Officer and are not intended as investment advice or to predict or depict the performance of any investment. These views are as of the close of business on April 24, 2019, based on the information available at the time and are subject to change at any time based on market or other conditions. We disclaim any responsibility to update such views.

All investing involves risk, including possible loss of principal. Equities are subject to market risk (the risk that the entire stock market will decline because of an event such as deterioration in the economy or a rise in interest rates), as well as special risks associated with investing in certain types of stocks, such as small-cap, global and international stocks. International investing may be volatile and involve additional expenses and special risks, including currency fluctuations, foreign taxes and geopolitical risks. Emerging and developing markets may be especially volatile. Fixed income investing includes interest rate risk and credit risk. Interest rate risk is the risk that bonds will decrease in value as interest rates rise. As a general rule, longer-term bonds fluctuate more than shorter-term bonds in reaction to changes in interest rates. Credit risk is the risk that bonds will decline in value as the result of a decline in the credit rating of the bonds or the economy as a whole, or that the issuer will be unable to pay interest and/or principal when due. There are also special risks associated with investing in certain types of bonds, including liquidity risk and prepayment and extension risk, or investing in high yield (junk) bonds. There are additional risks associated with the use of derivatives. **Past performance does not guarantee future results.**

The Standard & Poor's 500 Index (S&P 500) is a capitalization-weighted index of 500 stocks. The Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

The Bloomberg Barclays US Credit Index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities. The Bloomberg Barclays US Credit Aaa Index, Bloomberg Barclays US Credit Aa Index, Bloomberg Barclays US Credit A Index and Bloomberg Barclays US Credit Baa Index are, respectively, composed of Aaa, Aa, A and Baa rated securities.

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The MSCI EAFE (Europe, Australia, Far East) Index is a free float-adjusted market capitalization index that is designed to measure developed foreign market equity performance, excluding the U.S. and Canada. The Index consists of 22 developed market country indices.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure emerging markets equity performance. The index consists of 24 emerging market country indices.

It is not possible to invest directly in an index.

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