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## Stocks roar back

### Key highlights:

- Stocks have performed well in 2019, erasing most of the losses sustained in the fourth quarter of 2018.
- We think there are three potential drivers: policy changes by the Federal Reserve (the Fed), a nearing resolution to the trade impasse between China and the U.S., and company earnings.
- However, caution is the watchword.

The old adage about March coming in like a lion seems to be ringing true as we start to near spring, with wintry weather suddenly returning to the Northeast. Similarly, equities, which had fallen dramatically near year-end, have roared back since their sell off in December. We think there are a number of factors driving this trend. However, we are still cautious following this most recent market rebound.

### Three main factors

Looking more closely at equities over the last three months, we feel that there are three factors that have helped stocks charge back into the black in 2019.

#### (1) A change in mindset

Since the Fed announced its rate hike in December, Chairman Jay Powell has largely walked back his remarks regarding the need to tighten monetary policy further. In early January, Powell's public comments suggested that the central bank was following a data-driven approach, and that its actions regarding interest rates could range from tightening to loosening policy in the months ahead. This change in tone to a more dovish approach was significant and to some market observers, suggested that the "Bernanke put" (perhaps now the "Powell put") had returned, as the Fed now appears poised to support a valuation floor for equity markets. Finally, the Fed's shrinking of its balance sheet ("quantitative tightening") seems under review, rather than on "automatic pilot", an approach which had created concerns in the market.

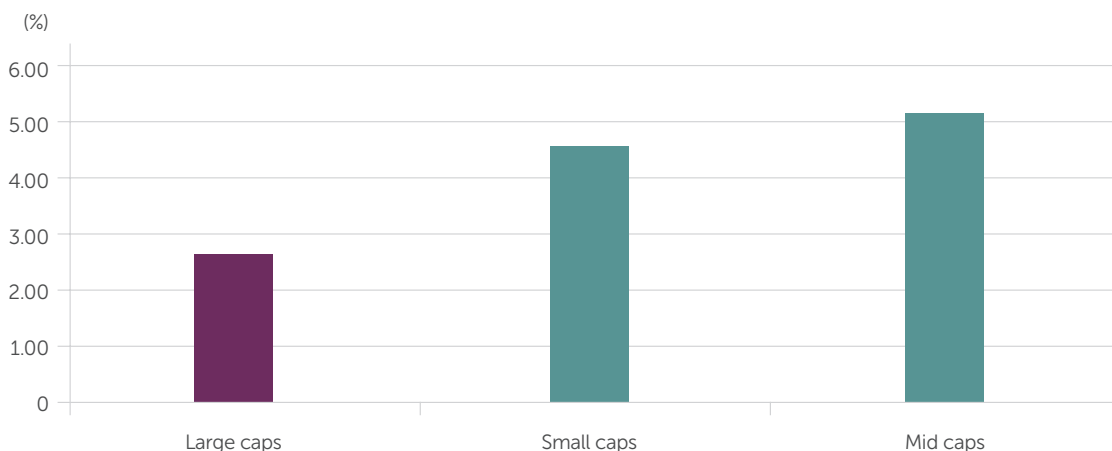
#### (2) Hope rises

Ongoing trade negotiations between the U.S. and China have offered some encouraging developments that a resolution can be reached as various media outlets have reported that a mutual agreement has been reached by the two parties. One newspaper reported that "[d]espite the remaining hurdles, the talks have progressed to the extent that a formal agreement could be reached at a summit between President Trump and Chinese President Xi Jinping, probably around March."<sup>1</sup>

#### (3) Large-cap stocks taking a back seat

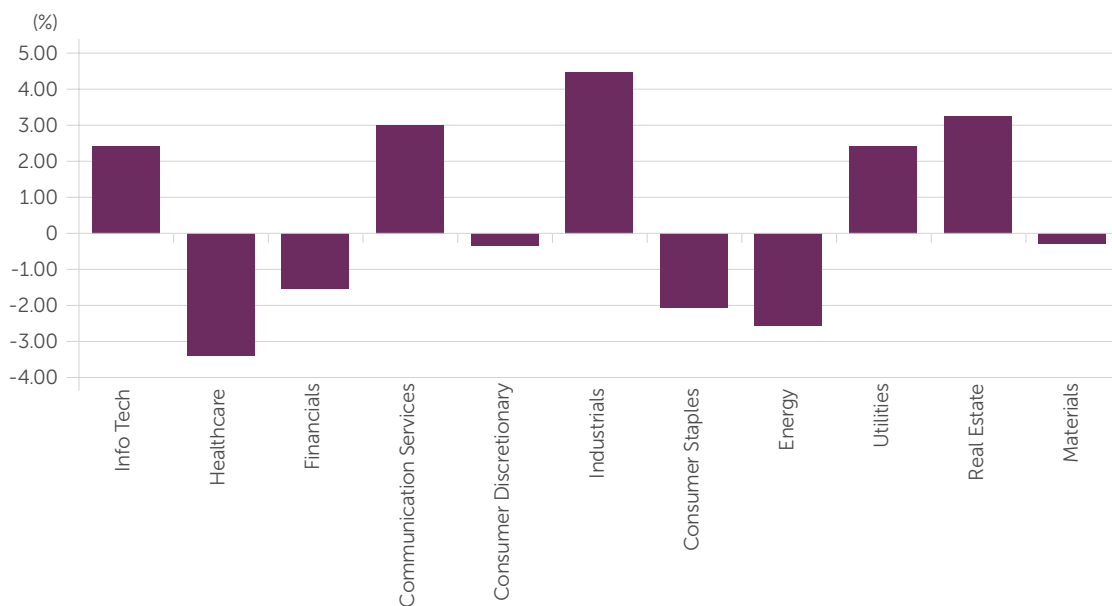
Small- and mid-cap stocks have mainly led the early year rally (see *Exhibit 1*). We also think it is worth noting that the breadth of this rally looks fairly broad, with most sectors contributing to the upward movement, as illustrated in *Exhibit 2*.

### Exhibit 1: Small and mid caps leading the equity rebound Three-month returns ending 2/28/19



Source: Morningstar, 2/28/19. Large caps represented by Russell 1000 Index, small caps by Russell 2000 Index, and mid caps by Russell Mid Cap Index.

### Exhibit 2: Broad-based rally since December Three-month sector returns ending 2/28/19

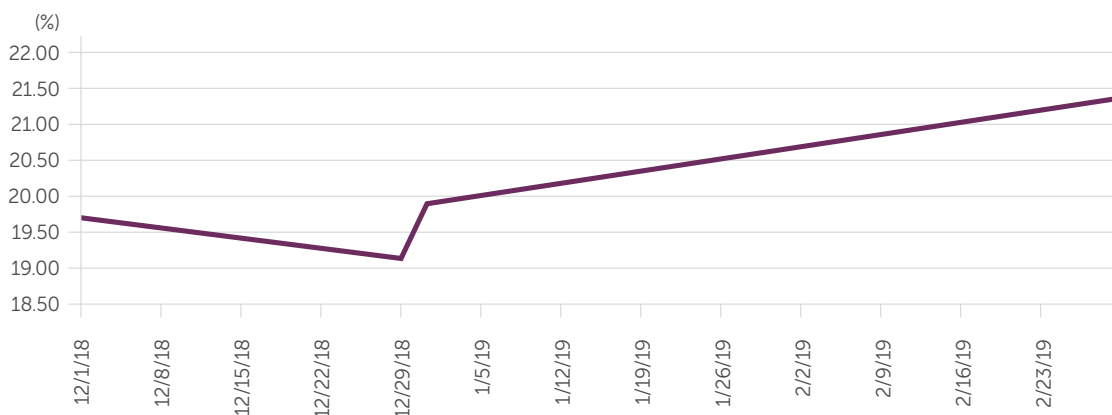


Source: Bloomberg, 2/28/19. S&P 500 Index sectors shown.

#### What does this mean for investors?

The recent market rally has primarily been based upon an expansion of multiples (see *Exhibit 3*), not higher company earnings. In addition, the market has priced out a fair amount of risk over the last several months, and we think it may be vulnerable to a burst of bad news, for example, adverse headlines surrounding Brexit or U.S.-China trade negotiations. With that in mind, we feel a healthy dose of caution is warranted in the days ahead.

### Exhibit 3: Multiples bounce up in the first quarter S&P 500 price-to-earnings ratio (12/1/18-3/1/19)



Source: Quandl, 3/5/19.

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