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CHARTWELL REVIEW

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The only major asset classes that produced positive returns during the quarter were short-dated T-bills, unhedged non-US Aggregate and Emerging Market bonds, and Emerging Market stocks. The U.S. stock market endured a technical correction, with the S&P 500 index falling 10.2% in just nine days from its all-time high on 1/26/18. It has since rallied back, but still remains off by 6.5%. Market action was a tale of two cities, as an explosion to the upside in January was followed by an even larger and sharper decline in February.

If that sounds like a big increase in volatility, you'd be right. But this is clearly definitional; it wasn't as volatile as it seemed. It was a relatively normal weak quarter, following a very good and completely abnormal prior year. For the quarter, the market reflected a gain or loss of >1% during 38% of trading days. The 38% was above average (21%), but five years during the last ten were above 30%. In comparison, only 3% of days in 2017 were up or down >1%. In the prior 60 years, since 1957, there had been just three other less volatile years, with the last one being 1965.

Recency bias is the condition where stock market participants evaluate their portfolio performance based on very recent results **or** on their *perspective* of recent results. This can easily lead to incorrect conclusions that ultimately lead to incorrect decisions about how the stock market behaves.

When we're watching a bull market run along (which this one has for a very long time), people tend to forget about the cycles where it didn't. As far as recent memory tells us, i.e., our 2017 experience, the market should keep going gradually up with little interruption.

The recent bout of share price volatility is a function of financial markets attempting to recalibrate stock valuations. The level of perceived volatility was heightened because we've been lulled into a false sense of security following an extended period of calm in the markets. Even minor changes in sentiment following a steep run in prices can cause a sharp price decline, followed by a period of elevated volatility.

Figure 1: Index Benchmarks

Market Index	Trailing Returns *				
	1Q 18	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
S&P 500	(0.8)	14.0	10.8	13.3	9.5
U.S. Top-cap Stocks	(0.8)	14.7	11.4	13.6	9.4
U.S. Mid-cap Stocks	(0.5)	12.2	8.0	12.1	10.2
U.S. Small-cap Stocks	(0.1)	11.8	8.4	11.5	9.8
Non-US Stocks (**EAFE**)	(1.5)	14.8	5.6	6.5	2.7
Non-US Stocks (**Emerg**)	1.4	24.9	8.8	5.0	3.0
3 mo. T-Bills	0.4	1.1	0.5	0.3	0.3
U.S. Aggregate Bonds	(1.5)	1.2	1.2	1.8	3.6
High Yield Bonds	(0.9)	3.7	5.2	5.0	8.1
Global Aggregate Bonds	1.4	7.0	3.1	1.5	2.6
Consumer Prices	*1.2*	*2.4*	*1.9*	*1.4*	*1.6*
Bloomberg Commodity	(0.4)	3.7	(3.2)	(8.3)	(7.7)
MSCI World Real Estate	(3.6)	6.7	3.8	5.6	4.6
Chartwell 65/35 Global	(1.4)	9.6	6.7	7.3	6.4

Figure 2: Average Mutual Fund Returns

Fund Category	Trailing Returns *				
	1Q 18	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
U.S. Large-cap	(0.3)	14.7	9.5	12.5	9.1
U.S. Mid-cap	0.2	13.1	7.7	11.3	9.4
U.S. Small-cap	(0.6)	10.8	7.9	10.8	9.5
International Lg. Cap	(0.7)	16.2	6.3	6.8	3.2
International Sm. Cap	0.9	23.5	10.7	10.0	6.9
Emerg. Mkt. Equity	1.9	22.7	8.6	4.8	3.3
Balanced/Hybrid	(1.0)	7.6	5.0	6.5	6.2
General Bond	(1.3)	1.5	1.4	1.9	4.2
High Yield Bond	(0.7)	3.4	4.2	4.1	7.0
Hedge Funds, Equity	0.7	9.8	5.3	5.7	3.9

*Annualized trailing returns for periods ending 3/31/18.

Economies, Economics, Prices, and Policy

	3/2018	3/2017
CPI - headline, y-o-y	2.4%	2.4%
CPI - core, y-o-y	2.1%	2.0%
Real GDP Growth*	2.3%	1.5%
Total Employment (000's)	154,877	152,628
Employment / Population %	60.4%	60.2%

** 2017 (estimated) vs. 2016, y-o-y*

The American economy continues to expand, and the final 4th quarter numbers were moderately favorable. Real GDP increased by 2.3% in 2017, compared with an increase of 1.5% in 2016. Still too low, but better.

The 2.9% increase in real GDP in the fourth quarter reflected robust contributions from business and residential fixed investment, personal spending, and government spending. A weak quarter of inventory building compared unfavorably to the robust 3rd quarter, and nicked GDP growth by 1.3%. A highly negative import/export mix reduced GDP by 1.2%.

Figure 3: Breaking Down 4th Quarter* Real GDP

Factor	% Change from Preceding Period 4Q '17*	3Q '17	2Q '17	1Q '17
Real GDP Growth	2.9%	3.2	3.1	1.2
Nominal GDP Growth	5.3	5.3	4.1	3.3
Real Final Sales	3.4	2.4	2.9	2.7
Personal Spending	4.0	2.2	3.3	1.9
Private Investment	4.7	7.3	3.9	*(1.2)*
- Fixed, Businesses	6.8	4.7	6.7	7.2
- Fixed, Residential	12.8	*(4.7)*	*(7.3)*	11.1
*- Chg. In Inventories **($bn)***	*$16*	*$42*	*$5*	*$0*
Export growth	7.0	2.1	3.5	7.3
Import growth	14.1	(0.7)	1.5	4.3
Government Spending	3.0	0.7	(0.2)	(0.6)

** BEA final estimate on 3.28.18*

The first official estimate of 1st quarter real GDP growth won't be out until April month-end. Based on economic data released year-to-date, the Atlanta Fed's "GDPNow" forecast of Q1 growth is down to a disappointing 2.0%, from 4% at the beginning of February. As weak data has been released the "Blue Chip" consensus forecast has also dropped, from nearly 3% to just above 2%.

The pace of payroll jobs growth remained robust, and 605k jobs were created in Q1 compared to 611k in Q4. The household survey reflected a huge increase of 1.1 million jobs during the quarter, but an unchanged 4.1% unemployment rate as the labor force grew sharply.

Consumer inflation rates bubbled up in the quarter. The Fed's March meeting focused on containing inflation, rather than how it could be increased to 2%. The latter goal looks to have been achieved.

- ⇒ **"Headline" CPI** rose 1.2% during the 1st quarter, and was up 2.4% year-over-year. This was the same y/y increase observed in March 2017;
- ⇒ **"Core" CPI** (*ex-food & energy*) rose 1.2% during the quarter, and 2.1% during the past year.
- ⇒ The headline **Producer Price Index** for final goods and services rose a robust 1.4% during the quarter, and 3.0% the past year. The core PPI *ex-food & energy* also advanced 3.0% during the past year.

On the monetary policy front, the Fed raised the upper limit of its target Fed Funds rate by 25bps, to 1.75%. It has signaled three more raises in 2018, which will bring the base rate above current consumer inflation rates.

The Fed continued to *not* roll over some of its maturing mortgage bond portfolio. This action is still expected to liquefy $170 billion of the Fed's mortgage holdings in 2018. Spreads on mortgage-backed securities have been slightly pressured due to the demand downshift.

The 2017 Tax Cuts and Jobs Act hasn't had much time to impact the economy. There aren't indications yet that people are spending their reduced Q1 estimated tax payments. We'll see from Q1 earnings reporting season whether companies attribute its impact as a significant factor. Our sense is that this year's impact will be primarily observed in the second half of the year.

In March, Congress passed, after 1 hour of open debate, the 2,232-page Consolidated Appropriations Act 2018, funding the government through the end of this fiscal year (9/30/18). It's the spending bill follow-up to the two-year Bipartisan Budget Act 2018 Congress passed in February, which will increase federal spending by almost $300 billion *above* previously forecasted limit. Unsurprisingly, the Federal debt ceiling was suspended.

The Congressional Budget Office released its analysis of the combination of tax cuts and spending increases. Despite optimistic projections of near-term economic growth, the CBO expects the fiscal deficit to jump to over $800 billion this year, to over $1 trillion by fiscal 2020, and continue over $1trn for each of the following five years. Federal debt is forecast to rise to 100% of GDP. These are huge numbers by historical standards.

Finally, the tariff skirmish began (not a war yet). In speaking to date with institutional investors, our takeaway is that this issue is not yet registering much with them despite the entertaining rhetoric in the press. That's because the *confirmed* new tariff numbers, at $50 billion, are so small. Total US/China goods trade was $630 billion last year. Total US/World goods trade was $3.9 trillion. The concern investors have is how far this lose/lose activity will go before it abates.

Bond Yields Up; Returns Down

Not much black ink for bonds in the first quarter. In fact, Figure 4 reflects that only one *domestic* category, leveraged loans, was positive. Unhedged non-US bonds and local currency EM bonds had big quarters, gaining 2.5-3.5%. Finally, although the entire US high yield index lost 0.9%, the worst credits (C&D-rated) returned 5%. Overall, it took an entirely non-mainstream strategy to profit from bonds in the quarter.

Per Figure 4, the past year and three years have been quite challenging for investors in investment grade US$ bonds. IG Credit bonds had the best performance, but only a 2.2% annual return. Winning investments have been bank loans, high yield bonds, and EM bonds.

Short-term Treasuries saw their yields once again rise in tandem with March's 25bps increase in the Fed Funds rate. Yields from 3-months to 5-years were higher by 40bps, leading to losses in all but very short maturities. The benchmark 10-year Treasury closed the quarter with a y-t-m of 2.74%. That was a 33bps rise in the quarter, which was enough to push its total return to a 2.4% loss.

Analysts were predicting that long-term yields might soar in 2017 due to a surge in growth and inflation. While short-maturity yields have risen along with the Fed Funds rate, longer-term yields have certainly not soared during the past year. The 10-year's yield is up just 35bps, and the 30-year yield has *declined* 5bps. Thus, the primary bond yield curve (2yr - 30yr) has flattened by 1.1%. This isn't surprising, since neither growth nor inflation has been especially robust during the past year.

Investment grade credit bond spreads widened modestly in the quarter. Adjusted for optionality, IG Corporate bonds traded to a spread of 109bps above Treasuries, up from 93bps at the end of December, and 123bps at the end of 2016. We see in Figure 5 that "BBB" Credit bond yields rose by nearly 50bps, to 4.07%. As a result of this widening, the investment grade credit index modestly underperformed the high quality Aggregate index by 0.3% in Q1. During the past *year* investment grade credit has been decidedly the best sector of the domestic Aggregate index. Treasuries have been the worst, closely followed by mortgage-backed securities.

HY bond yields rose by 50bps in the quarter, and are up the same amount over the past year. Thus, returns for the quarter were off. Trailing return performance has been decidedly better than investment grade bonds during the past 1-5 years (Figure 4). The higher credit quality and very short duration leveraged loan sector comes close to high yield bond returns and appears better positioned looking forward due to lower interest rate risk.

Hard currency and US$-hedged non-US bonds underperformed when spreads widened and the Dollar dropped. EM $-bond yields rose 50bps, leading to a 2% loss in Q1. However, non-$ EM bonds gained a robust 3.4%, and have returned 14.4% during the past year.

Figure 4: Primary Bond Sector Returns (%)

Index	1Q '18	1 Year	3 Years	5 Years
US Aggregate Bond index	(1.5)	1.2	1.2	1.8
US Gov't/Credit: (1-3yrs)	(0.2)	0.2	0.7	0.8
US Treasury: Long	**(3.3)**	3.5	0.4	3.3
US TIPS (1-10yrs)	(0.4)	0.4	1.2	(0.1)
Mortgage-Backed (MBS)	(1.2)	0.8	1.1	1.8
CMBS	(1.2)	1.3	1.6	2.2
Asset-Backed (ABS)	(0.4)	0.6	1.2	1.2
Inv. Grade US Credit	(2.1)	2.6	2.2	2.8
Leveraged Loans	**1.4**	**4.8**	**4.5**	**4.4**
US High Yield Credit	(0.9)	**3.7**	**5.2**	**5.0**
Municipal Bonds, broad	(1.1)	2.7	2.3	2.7
Global Aggregate, ($ hdgd)	(0.1)	2.5	2.0	2.9
Global Credit, ($ hdgd)	(1.2)	2.8	2.5	3.2
Emerg. Mkts Bonds (US$)	(1.7)	**4.3**	**5.8**	**4.7**

Figure 5: Fixed Income Yields – 1st Quarter 2018

(YTM, % p.a.)	Mar-18	Dec-17	Mar-17	Dec-13	*1-Year Change*
US Treasuries					
3-month	1.71	1.39	0.76	0.07	***0.95***
2-year	2.27	1.89	1.26	0.39	***1.01***
5-year	2.57	2.20	1.93	1.74	***0.64***
10-year	2.74	2.41	2.39	3.01	***0.35***
30-year	2.97	2.74	3.02	3.94	***(0.05)***
BarCap Aggregate	3.12	2.72	2.61	2.49	***0.51***
BBB Credit	4.07	3.59	3.71	3.88	***0.36***
AA Credit	3.13	2.70	2.59	2.25	***0.54***
Agency MBS	3.30	2.91	2.91	3.26	***0.39***
Emerging Mkts ($)	5.76	5.26	5.46	5.88	***0.30***
US High Yield	6.35	5.84	5.85	5.93	***0.50***
UST30yr - UST2yr	0.70	0.85	1.76	3.55	***(1.06)***

Figure 6: Sovereign Bond Yields, selected countries

10-year yields (%)	Mar-18	Dec-17	Mar-17	Dec-13	*1-Year Change*
Switzerland	0.09	-0.10	-0.07	1.25	***0.16***
Japan	0.00	0.04	0.06	0.71	***(0.06)***
Germany	0.50	0.45	0.34	1.94	***0.16***
Britain	1.50	1.25	1.17	3.29	***0.33***
Spain	1.20	1.50	1.69	4.22	***(0.49)***
Italy	1.87	2.07	2.30	4.09	***(0.43)***
United States	2.74	2.41	2.39	3.01	***0.35***
Australia	2.66	2.68	2.73	4.23	***(0.07)***
Poland	3.22	3.30	3.54	4.34	***(0.32)***
China (5 year)	3.66	3.88	3.07	4.49	***0.59***
Greece (new bonds)	4.37	4.08	6.95	8.57	***(2.58)***
India	7.33	7.32	6.75	8.85	***0.58***
Russia	8.13	8.13	8.13	7.88	***0.00***
Brazil	7.87	8.62	9.85	13.21	***(1.98)***

US Stocks Rollover

Early 2018 market returns were feast or famine, as a January-for-the-record-books gave way to a dismal February and March. By the end of January, the domestic stock market was up 7.5%. Returns were bolstered by excitement over the prospective impact of the 2017 Tax Cuts and Jobs Act, as well as anticipation of a pickup in investment that should boost economic growth for the US and its trading partners. Then, in a case of "no good deed goes unpunished," strong US employment growth for January and a small one-month jump in real wages (reported early February) spurred fears that we might be exiting the Goldilocks period for one of “too hot” growth and rapidly rising interest rates. A swift and sharp sell-off ensued, and investors experienced the first market correction (over -10%) since February 2016.

Then, the market again turned sharply positive, rising 8% during the next 30 days (which calls into question the reasons behind the initial sell-off), only to sell-off again by over 7% through the end of the quarter.

Figure 7: U.S. Equity Market - Size/Style Returns

	1Q '18	1-year	Trailing 3-yrs	5-yrs
Growth				
Large Cap	1.4	21.3	12.9	15.5
Mid Cap	2.2	19.7	9.2	13.3
Small Cap	2.3	18.6	8.8	12.9
Value				
Large Cap	-2.8	7.0	7.9	10.8
Mid Cap	-2.5	6.5	7.2	13.3
Small Cap	-2.6	5.1	7.9	10.0

When the dust finally settled, the broad US stock market (Russell 3000 index) had declined a very modest 0.6% on a total return basis for the quarter, but did so in a highly uncomfortable fashion.

In terms of market cap and style, growth stock indices continued to sustain their outperformance over value. Growth stock portfolios earned positive returns of nearly 2% across the size spectrum, with small-cap stocks leading the way up. Conversely, value stock portfolios lost nearly 3%, with large-caps leading the way down.

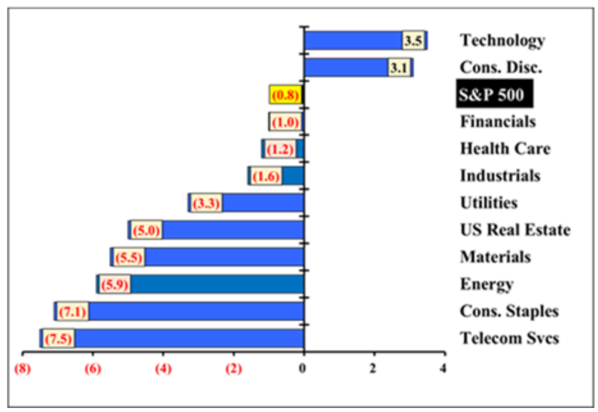
As we look back further, the same growth stock advantage holds true for the trailing 1-, 3-, 5-, and 10-year periods. It seems to us this is largely a function of sector weights. The large/mid Russell 1000 Growth index is 70% made up of info tech (39%), consumer discretionary (19%) and health care (12%) stocks. These sectors are the only ones to have produced double-digit returns over the past 10 years, and account for only 30% of the Russell 1000 Value index.

The domestic stock market has been driven by two things – a favorable earnings growth outlook and simple optimism that the advance will keep going (i.e., momentum). You’ll recall we previously cited the Q4 survey by the University of Michigan that a record 66% of Americans believed the stock market would climb in 2018. We’re wondering what that percentage is now.

Very large-cap stocks (the R200 index) posted a total return of -0.8% in Q1, and rose nearly 15% over the past year. The skew was heavily toward growth, as Figure 7 reflects. Very large-cap *value* stocks returned -3% and +7%, respectively, during those two periods.

Small/mid-cap stock indices again produced mixed results in Q1. Small/mid stocks outperformed large-caps for the quarter, but underperformed for the full year. One theory is that very large companies are much more exposed to global trade factors, which heated up in Q1.

Figure 8: US Sector Returns –1st Quarter 2018



Sector performance dispersion across the large-cap market was 11% (info tech vs. telecomm services). Only two sectors of the S&P 500, tech and consumer discretionary, posted positive returns. During the past 12 months, large tech stocks are up 28%, while telecom and consumer staples are off -6% and 1%, respectively.

Figure 9: One-year Trailing P/E Ratios – Mar. 2018

	Value	Blend	Growth
US Large	16.9	21.0	26.4
US Mid	17.8	20.7	25.6
US Small	19.5	22.3	26.0
EAFE		**14.3**	
Emerg. Mkts		**14.7**	

Emerging Markets Top Developed Markets

International stocks pulled back in the first quarter as concerns over rising interest rates, inflation pressures, and trade tensions between the US and China escalated. Volatility returned with a vengeance, leaving developed market results negative for the quarter. Emerging markets fared better and finished in positive territory. Primary developed foreign market returns (MSCI EAFE) dropped -1.5%. Canada fell a large -7.4% as energy prices fluctuated during the quarter. The World ex-US index declined -2.0%.

Figure 10: International Equity Markets – Returns

	U.S. Dollar Returns (%)		Local Currency Returns (%)	
thru 3/31/18	1Q '18	1-Yr	1Q '18	1-Yr
World ex-USA	**(2.0)**	**13.9**	**(4.3)**	**5.0**
- MSCI Growth	*(1.6)*	*16.3*	*(3.7)*	*7.4*
- MSCI Value	*(2.5)*	*11.7*	*(4.9)*	*2.7*
- Europe	(2.0)	14.5	(4.3)	2.0
- Pacific, ex-Japan	(3.7)	8.4	(2.8)	7.6
- Japan	0.8	19.6	(4.8)	14.2
- United Kingdom	(3.9)	11.9	(7.3)	(0.2)
Int'l Small Caps	**(0.5)**	**21.2**	**(3.0)**	**12.4**
Emerging Mkts	**1.4**	**24.9**	**0.7**	**22.0**
- EM Asia	*0.8*	*27.0*	*0.6*	*24.7*
- EM Europe	*2.1*	*21.3*	*2.1*	*18.2*
- EM Lat Amer	*8.0*	*19.3*	*6.0*	*20.2*
- EM BRIC	*2.2*	*29.9*	*2.8*	*31.5*

In US$ terms, European stocks declined -2% in Q1, despite signs of ongoing economic improvements. These were trumped by concerns of a global market sell-off, rising US interest rates, and a strengthening euro. In local currency terms, European markets were off -4.3%.

Euro-zone GDP growth rose 2.7% YoY in Q4, the fastest pace in a decade and on par with US growth. The unemployment rate fell to 8.6%, the lowest level since December 2008. These, and other positive indicators, drove the euro up 2% versus the US dollar, while the pound soared by nearly 4%. Smaller countries in the region outperformed, including; Finland (8.2%), Italy (5.4%) and Portugal (3.1%.). Germany dropped -3.6% due to concerns about its export-led economy. France struggled, but stayed in the black (+0.3%). The UK market fell sharply in sterling terms, down -7.3%. The pound's appreciation cut US$ losses to -3.9%.

The Pacific region dropped less than Europe in Q1, driven by a surging yen that appreciated 6% versus the US$. As a result, Japanese equities (+0.8%) were the top performing developed market. The strong yen and escalating trade "war" rhetoric pressured exporters.

Japan's economy posted its eighth consecutive quarter of growth (1.6%, annualized), marking the country's fastest expansion in more than two years. Inflation continued to accelerate slowly, rising 1.5% in February.

Equities of other developed markets in the region fell, led by Australia (-6.2%), pulled down by weak performing large banking stocks and New Zealand (-5.1%). Hong Kong (-1.4%) stocks dropped, as a 53% plunge in Kingston Financial largely offset positive returns from Macau-based casino operators.

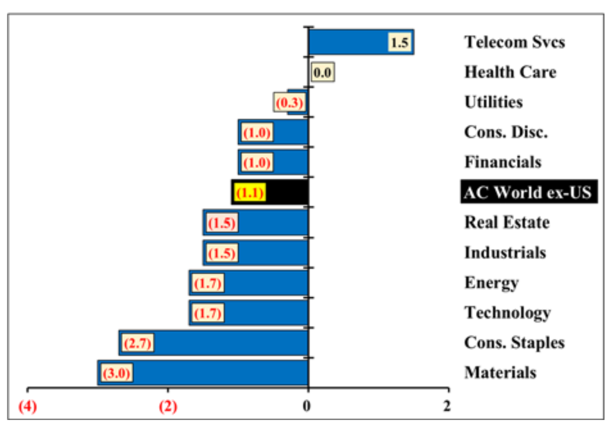
Defensive sectors, especially consumer staples, telecom, materials and energy, led the market lower; all sectors posted negative results.

The ECB and BOJ left interest rates unchanged, despite signs of significant economic improvement. Extending the trend from 2017, the US Dollar fell against the euro, yen, British pound, and most other currencies. Currency translation effects boosted returns for Dollar-based investors, as they have substantially during the past year.

Emerging market stocks (up 1.4%) rose for a fifth consecutive quarter, fueled by steady growth in China (and other developing countries), higher oil prices, and the weaker US dollar. Chinese stocks rose 1.8%, despite rising US-China trade tensions and some selling pressure on tech-giant Tencent (flat for Q1). Alibaba rose 6%. Banking shares also rose as the Chinese government rolled out measures to curb non-bank lending activities.

Indian stocks lagged despite signs that economic growth was picking up again. Asset quality issues at large state-owned banks and relative valuations for Indian equities put downward pressure on the market. Russia (+9.4%) and Brazil (+12.4%) were the biggest EM winners, as oil prices rose and signs of improving economic conditions emerged. S&P raised Russia's credit rating to investment grade in February; Sberbank rose 13%. In Brazil, the central bank cut the benchmark interest rate to a record low and signaled the possibility of further cuts as inflation remained tame. Shares of Petrobras soared 38%.

Figure 11: Ex-USA Sector Returns (1st Qtr 2018)



Back Page Perspectives

The near-term earnings outlook has only gotten better this year. The current estimate of Q1 S&P operating earnings is $35.83/share. The estimate four months ago was 5.5% lower. If Q1 earnings come in as currently forecast, they will be 24% higher than 1Q17. If 2018 earnings come in as currently forecast ($156) they will be 25% above 2017 earnings. And, 2017 was 17% above 2016. Finally, of the 117 companies that had reported Q1 earnings as of 4/23, ninety-one beat their estimates. It is hard to imagine a more favorable corporate earnings environment than the current one.

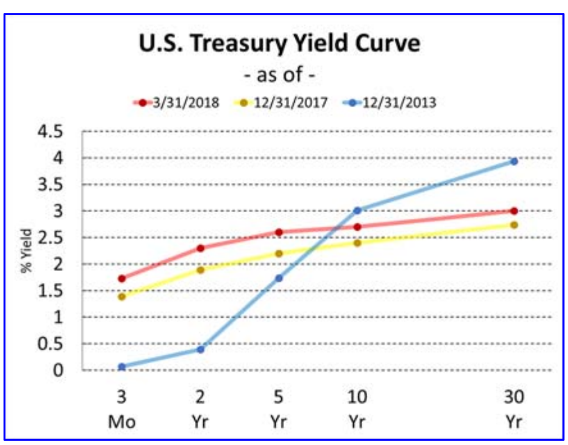
Which is one reason that the market's volatility this year is of such concern. With earnings moving from strength to strength, why has the market developed a severe case of the shakes?

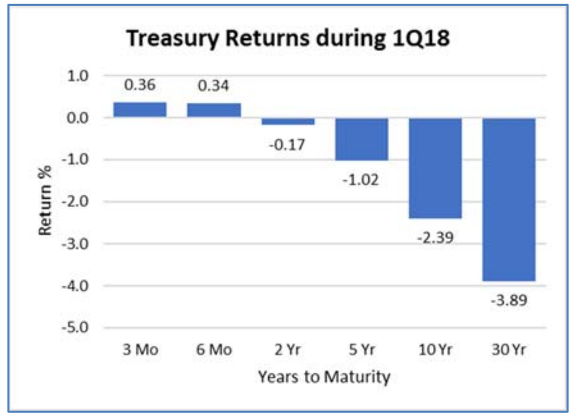
We discussed the B-word last quarter. Like early 2000, perhaps we're on the edge of a bear market. Maybe 1/26/18 was the peak. If so, the average bear market since WWII has bitten hard during the first three months, down 9% from the peak. In a sense, we saw that in February. Then, markets are choppy for the next 3-5 months (seem familiar?), before heading down an additional 10% and closing out the first year off 20%. The worst bear market in the past 70 years fell 42% during the twelve months after the peak.

It's very hard to see all that coming in the current environment of global economic growth, robust earnings growth, near-record low unemployment, and low rates.

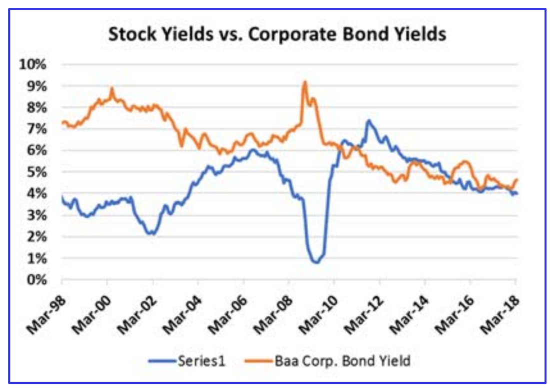
What do we mean by low rates? Didn't rates pump up during the quarter? Isn't that what caused all the downside volatility? Take a look at the below set of yield curves. The Treasury yield curve rose in parallel during the quarter, but long-term rates are not out of control. Higher, for sure, but at or below current inflation levels all the way out to 5 years.

If the Fed keeps real rates (nominal yields – inflation) below 1%, recessions don't arrive. Perhaps the volatility has been spurred because investors don't trust the Fed will do that.





The above chart reflects what happens when interest rates rise just 35bps from low levels. The losses aren't pretty. And, if everyone expects rates to keep rising, these losses will re-occur. Will investors re-allocate from increasingly profitable stocks in order to own weak returning investment grade bonds? Will higher bond yields "crowd out" stocks in investor portfolios? To help answer these questions, the following graph charts the earnings yield of the S&P 500 over time compared to the yield on BBB bonds (which was 4.1% at quarter's end).



Here's our bold statement for the quarter: If policy makers in Washington, Beijing, et al don't screw up the global economy, we think it will take 6+% investment grade bond yields to compete with the broad stock market, which has now traded down to a current PE just a bit below 20 (i.e., an earnings yield just above 5%).

The problem the market has is underwriting that policy risk. We think that's what happened in Q1. Not January's report of a 2.6% one-year increase in wage rates.

The probability of continuing uncertainty underscores the importance of diversification.

Sell high, buy low. See you next quarter!

Natalka Bukalo
Richard Shaffer, CFA