CHARTWELL REVIEW

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On Hold ... HOLD ON!

One noteworthy anniversary and three major investment developments took place during the first quarter.

The former occurred on March 9th, when we celebrated the 10th anniversary of the stock market's recovery from the global financial crisis (GFC). Since bottoming at 666 on March 9, 2009, the S&P 500 index had risen to 2834 by the end of March. Adding dividends, that's a 15.92% ten-year annualized return, with only 6 corrections along the way.

The first major investment development of the quarter was the Federal Reserve putting itself "on hold" for an undefined period, but for which markets expect will be all of 2019 and well into 2020. The position was first elucidated by Chairmen Powell on January 4th, and then firmly clarified and extended in public speeches by Fed Governors throughout the quarter. So, expect no increases in the Fed Funds rate past 2.50% for the foreseeable future, and a fairly rapid wind down of the Fed's balance sheet reduction program. Why? Because the Fed projects economic growth in the US and globally will slow in 2019, and unemployment to rise. (Gulp)

The quarter's second major development is apparent from looking at Figure 1. Investor markets domestically and abroad had gangbuster quarters. Large and midcap stocks reflected better total returns in Q1 than they experienced losses in Q4 (small cap stocks did not). It was the best quarterly start to the year for stocks since 1987. We had previously remarked that 2018 was the year when "nothing worked." Well, Q1 was the quarter when everything did – stocks globally, bonds globally, commodities, and real estate.

The third major development was some rather sharp weakness in actual and forecasted corporate earnings. The S&P's 4th quarter operating earnings rose just 3.5% from a year earlier, after a forecast of +19% growth as late as December. First quarter earnings are now forecast to <u>decline</u> -4% year-over-year, for the first time since mid-2016. And 2019 earnings are now forecast to be only 3-5% above 2018's. Quite a drop from the +12% forecast last September. (Gulp)

Figure 1: Index Benchmarks

Market Index	Trailing Returns *				
	1Q 19	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
S&P 500	13.7	9.5	13.5	10.9	15.9
U.S. Top-cap Stocks	13.1	10.4	14.2	11.4	15.7
U.S. Mid-cap Stocks	16.5	6.5	11.8	8.8	16.9
U.S. Small-cap Stocks	14.6	2.1	12.9	7.1	15.4
Non-US Stocks (**EAFE**)	10.0	(3.7)	7.3	2.3	9.0
Non-US Stocks (**Emerg**)	9.9	(7.4)	10.7	3.7	8.9
3 mo. T-Bills	0.6	2.1	1.2	0.7	0.4
U.S. Aggregate Bonds	2.9	4.5	2.0	2.7	3.8
High Yield Bonds	7.4	5.9	8.7	4.7	11.2
Global Aggregate Bonds	2.9	4.5	2.0	2.7	3.8
Consumer Prices, p.a.	*4.8*	*1.9*	*2.2*	*1.5*	*1.8*
Blmbrg Commodities	6.3	(5.3)	2.2	(8.9)	(2.6)
MSCI World REITS	16.3	13.9	7.8	8.4	14.9
Chartwell 65/35 Global	10.5	4.5	8.9	6.1	10.5

Figure 2: Average Mutual Fund Returns

Fund Category	Trailing Returns *				
	1Q 19	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
U.S. Large-cap	12.9	6.9	12.0	9.1	14.8
U.S. Mid-cap	14.6	2.7	10.0	6.8	14.9
U.S. Small-cap	13.6	0.0	10.3	5.9	14.9
International Lg. Cap	10.8	(5.3)	7.0	2.5	9.2
International Sm. Cap	11.4	(11.4)	6.5	3.7	13.4
Emerg. Mkt. Equity	10.4	(9.0)	9.4	3.2	9.2
Balanced/Hybrid	8.5	4.0	7.2	5.2	9.7
General Bond	3.2	4.1	2.4	2.7	4.8
High Yield Bond	6.3	4.5	7.1	3.8	9.5
Hedge Funds, Equity	7.9	(0.1)	6.8	3.6	6.5

*Annualized trailing returns for periods ending 3/31/19.

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Economies, Economics, Prices, and Policy

	3.31.19	3.31.18
CPI - headline, y-o-y	1.9%	2.4%
CPI - core, y-o-y	2.0%	2.1%
Unemployment Rate	3.8%	4.0%
Labor Force (millions)	163.0	161.6
Employed (millions)	156.7	155.1
Employment/Population	60.6%	60.4%
Growth in Real GDP, (y-o-y)	2.9%	2.2%

Core inflation rose slightly less during the last twelve months than the prior period, while declining average energy and food prices allowed headline inflation to dip below 2%. However, these numbers both mask the fact that inflation "popped" in the first quarter, rising at annualized rates over 4%. The unemployment rate fell during the past twelve months because 1.6 million more people were employed; the labor force also grew, as did the participation rate and the employment-population ratio.

Figure 3: Breaking Down 4th Quarter* Real GDP

% Change from Preceding Period				
Factor	4Q '18	3Q '18	2Q '18	1Q '18
Real GDP Growth	2.2%	3.4%	4.2%	2.2%
Nominal GDP Growth	4.1	4.9	7.6	4.3
Real Final Sales	2.1	1.0	5.4	1.9
Personal Spending	2.5	3.5	3.8	0.5
Private Investment	3.7	15.2	(0.5)	9.6
- Fixed, Businesses	5.4	2.5	8.7	11.5
- Fixed, Residential	(4.7)	(3.6)	(1.3)	(3.4)
*- Chg. In Inventories **($bn)***	*$107*	*$93*	*($10)*	*$36*
Export growth	1.8	(4.9)	9.3	3.6
Import growth	2.0	9.3	(0.6)	3.0
Government Spending	(0.4)	2.6	2.5	1.5

** BEA final estimate on 3.28.19*

The 2.2% annualized increase in real GDP during Q4 was paced by a notable and unexpected slowdown in the growth of consumer spending for goods and services, and an increase in the decline of residential fixed investment. Business fixed investment increased moderately, and inventories continued to expand (not a surprise, given the weakness in personal spending, as goods remained on the shelf). Net exports did not detract from growth, after doing so rather sharply in Q3. Overall government spending declined, especially Federal non-defense consumption spending. Altogether, a weak report.

Consensus estimates of 1st quarter GDP growth remain positive. The Atlanta Fed's GDPNow forecast has recently increased sharply, to +2.8% growth for the quarter. It had been as low as 0.5% in early March. This compares to the most recent *Blue Chip* consensus estimate of 1.5%.

Businesses continued to hire during the first quarter, but the pace slowed. Payroll jobs rose by 541k, compared to 762k created in Q4.

Inflation rates in Q1 rose rather sharply compared to Q4, reversing what had been a declining trend –

⇒ **"Headline" CPI** rose 1.2%, or an annualized rate of 4.8%. Despite the jump, it has increased only 1.9% year-over-year;

⇒ **"Core" CPI** (*ex-food & energy*) rose 4.3% annualized during the quarter, but only 2.0% year-over-year.

⇒ The headline **Producer Price Index** for final goods and services rose 2.2% during the past twelve months. The increase was only 2.0% before food, energy, and trade. But, March alone was 60% of that.

On the monetary policy front, the Fed did not raise the upper limit target Fed Funds rate at the March meeting; it remains at 2.5%. The Fed's monthly statement provided clear inference that increases might be limited to only 25bps during the rest of 2019 and 2020 (markets immediately discounted that to a projected *decline* of 50bps). Real rates across the yield curve remained only modestly positive (approximately 0.50%).

Existing-home sales fell more than expected in March, to a seasonally adjusted annual rate of 5.21mm units. That was 4.9% lower than February's pace and 5.4% lower than one year ago. New housing starts fell to an annualized rate of just 1.14mm in March, the lowest level since May 2017, and down 14% year-on-year. Some shortfalls can be attributed to year-on-year weather differentials, but overall weakness in housing data is a potentially big concern.

After a 4th quarter increase, total industrial production (IP) slipped in Q1 at an annual rate of -0.3%. Manufacturing and mining production each dropped -1%. As a result, capacity utilization dipped to 78.8%, slightly down from December and below the long-term average of 79.8%. Low capacity utilization implies more pressure on margins.

Labor productivity increased at a seasonally adjusted annual rate of 1.9% in the fourth quarter of 2018. From the 4th quarter of 2017 to the 4th quarter of 2018, productivity increased 1.8%. This set the stage for an increase in *real* wages, which rose 1.3% from March 2018 to March 2019. A 1.3% increase in real average hourly earnings combined with no change in the workweek.

The IMF cut its global growth outlook to the lowest pace since 2009. Growth is seen as softer across all major rich-world economies. The IMF now forecasts the global economy will grow 3.3% this year (was 3.5% in January) and 3.6% in 2020. They forecast U.S. growth slows to 2.3% this year and 1.9% in 2020; Europe's expected 2019 growth was slashed to 1.3%, with the export-driven German economy quite weak. China (+6.3%; raised slightly) and India (+7.3%) are once again forecast to be the world's growth engines this year.

Treasury Yields Fall; Credit Spreads Narrow

Interest rates in most rich-world countries declined dramatically in the first quarter, as Figures 5 and 6 reflect. The Bond Vigilantes of old are back, but this time they are driving rates *down* as deflation concerns loom. Concerns over the global growth slowdown had led to a decline in sovereign yields during the 4th quarter of last year. This continued throughout most of the 1st quarter, with the 10-year US treasury rate declining by almost 30bps, and the Swiss, German, UK, and Spanish 10-year yields all dropping 25bps or more (The German bond now carries a negative 0.10% yield; the Swiss is at a negative 0.40%!).

As noted, the Federal Reserve put itself on hold during the quarter. The combination of continued job gains and a small slowdown in real wage gains has led investors to see little reason for the Fed to either raise or lower interest rates. With yield changes centered on falling term rates, the 3-mo/10-yr differential inverted slightly in March, before backing up to flat at quarter's end. In comparison, the differential was +1% a year ago and +1.6% two years ago. Interestingly, the 5yr/30yr curve has been steepening.

The overall result was a sharp gain for long-duration government bonds in Q1. The long Treasury index returned 4.7% in the quarter, while the long Gov't/Credit index returned a whopping 6.5%. This compared very favorably to only 1.2% for the short-term 1-3year Gov't/Credit index, and 2.9% for the Barclays Aggregate.

But the quarter wasn't only about falling term yields. In fact, it was more about credit spreads completely reversing themselves from the 4th quarter. All credit spreads from AAA through CCC had widened in the fourth quarter, and they all narrowed in the first. Corporate bonds were the strongest performing sector. The investment grade Barclays Credit index outperformed similar-duration Treasuries by 242bps, and returned 4.9%. Among corporate sub-sectors, industrials were the strongest performers, led by basic materials, communications, and energy issuers. Unlike during Q4, BBB-rated bonds outperformed A-rated bonds by 1.2%.

The retracement in yields was even greater in the higher credit risk sectors. The US High Yield index's yield-to-maturity dropped to 6.48% at quarter's end, down nearly 1.5% from December's end (Figure 5). This led to its robust 7.4% return for the quarter, completely erasing all 2H18 weakness, and resulting in a top notch one-year return of 5.9%. Adjusting for a relatively short duration of 4.5 years (the broad IG market's duration is 5.8 years), high yield bonds now trade at a 391bps spread over Treasuries. Similarly, US$ Emerging Markets' Bond yields came down over 60bps during the quarter, leading to a quarterly return of 7.0% and trailing one-year return of 4.2%. The weak link among less-than-investment-grade sectors was Bank Loans, which returned only 3.9% in the quarter, and now yield a chart-topping 6.85% at the end of March. If rates aren't rising, the relative attraction to floating rate Bank Loans versus HY Bonds is seen to be diminished.

Figure 4: Primary Bond Sector Returns (%)

Index	1Q '19	1 Yr	3 Yrs	5 Yrs
US Aggregate Bond index	2.9	4.5	2.0	2.7
US Gov't/Credit: (1-3yrs)	1.2	3.0	1.3	1.2
US Treasury: Long	4.7	**6.2**	1.5	**5.4**
US TIPS (1-10yrs)	2.6	2.7	1.5	1.5
Mortgage-Backed (MBS)	2.2	4.4	1.8	2.7
CMBS	3.2	5.5	2.6	3.0
Asset-Backed (ABS)	1.5	3.7	1.8	1.9
Inv. Grade US Credit	4.9	4.9	3.5	3.6
Leveraged Loans	3.9	3.4	5.1	4.1
US High Yield Credit	**7.4**	**5.9**	**8.7**	4.7
Municipal Bonds, broad	2.9	5.4	2.7	3.7
Global Agg., ($ hdgd)	3.0	4.9	2.8	3.6
Global Credit, ($ hdgd)	4.7	5.1	4.5	4.1
Emerg. Mkts Bonds (US$)	**7.0**	4.2	**5.8**	**5.4**

Figure 5: Fixed Income Yields – 1st Quarter 2019

(YTM, % p.a.)	Mar-19	Dec-18	Mar-18	Mar-17	*1-Year Change*
US Treasuries					
3-month	2.40	2.45	1.71	0.76	***0.69***
2-year	2.29	2.5	2.27	1.26	***0.02***
5-year	2.23	2.51	2.57	1.93	***(0.34)***
10-year	2.41	2.69	2.74	2.39	***(0.33)***
30-year	2.82	3.02	2.97	3.02	***(0.15)***
BarCap Aggregate	2.94	3.28	3.12	2.61	***(0.18)***
BBB Credit	4.03	4.65	4.07	3.71	***(0.04)***
AA Credit	2.99	3.37	3.13	2.59	***(0.14)***
Agency MBS	3.08	3.39	3.30	2.91	***(0.22)***
Emerging Mkts ($)	5.31	5.95	5.76	5.46	***(0.45)***
US High Yield	6.48	7.95	6.35	5.85	***0.13***
UST 10yr - 3Mo	0.01	0.24	1.03	1.63	***(1.02)***

Figure 6: Sovereign Bond Yields, selected countries

10-year yields (%)	*Mar-19*	Dec-18	Mar-18	Mar-17	*1-Year Change*
Switzerland	(0.40)	(0.15)	0.09	(0.07)	***(0.49)***
Japan	(0.10)	0.02	0.00	0.06	***(0.10)***
Germany	(0.10)	0.16	0.50	0.34	***(0.60)***
Britain	1.00	1.34	1.50	1.17	***(0.50)***
Spain	1.00	1.41	1.20	1.69	***(0.20)***
Australia	1.80	2.29	2.66	2.73	***(0.86)***
United States	2.41	2.69	2.74	2.39	***(0.33)***
Italy	2.50	2.70	1.87	2.30	***0.63***
Poland	3.00	2.75	3.22	3.54	***(0.22)***
China (5 year)	3.00	2.97	3.66	3.07	***(0.66)***
Greece (new bonds)	3.80	4.40	4.37	6.95	***(0.57)***
Brazil	7.30	7.22	7.87	9.85	***(0.57)***
India	7.30	7.35	7.33	6.75	***(0.03)***
Russia	8.30	8.81	8.13	8.13	***0.17***

Risk On! US Stocks Rise Sharply

The 2018 market turmoil that intensified during the 4th quarter, was almost completely reversed during the first. At quarter's end, the S&P 500 index had risen 20.6% from its December 24th trough of 2351. It has kept rising in April, reaching a new record high of 2933 (+24.8%). The NASDAQ Composite (a tech stock proxy), which entered bear market mode on 12/24/18 (down 23.6% from August), has also hit a new record (+31%) and exited what proved to be one of the shorter bear markets in history.

The S&P 500's 13.7% first quarter advance was the highest to start a year since 1987, putting the index on pace to return 67% in 2019. Investors are understandably euphoric, but no tree grows to the sky without interruption. Especially because the bounce has been entirely driven by multiple expansion, which are getting lofty once again. As noted, 4th quarter earnings revisions moved lower early in the period, and 1st quarter negative revisions have accelerated since the beginning of the year.

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

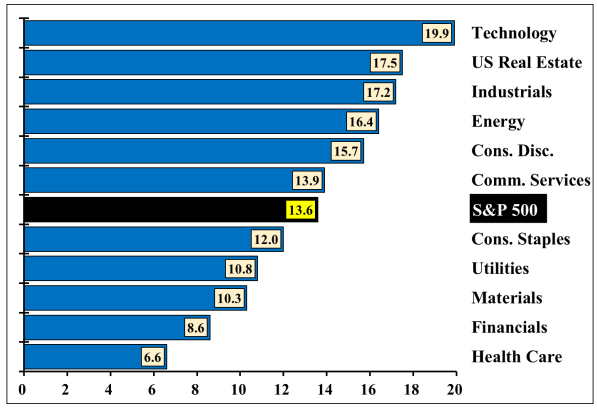
			Trailing		
	1Q '19	**1-year**	**3-yrs**	**5-yrs**	**10-yrs**
Growth					
Large Cap	15.1	13.2	17.0	14.5	17.5
Mid Cap	19.6	11.5	15.1	10.9	17.6
Small Cap	17.1	3.9	14.9	8.4	16.5
Value					
Large Cap	10.8	7.1	10.9	8.0	13.8
Mid Cap	14.4	2.9	9.5	7.2	16.4
Small Cap	11.9	0.2	10.9	5.6	14.1

In terms of cap size, the traditionally higher beta small/mid cap stocks once again held true to form. They outperformed across the style spectrum. Where this has completely fallen down is over the past twelve months, with large-caps returning 2-9% more than small-cap stocks. In fact, the rotation toward large-cap extends much further, with 2018, 2017, and 2015 all reflecting a rotation toward large-caps.

In terms of style, the first quarter was a risk-on market once again dominated by growth stocks. The Q1 performance of growth stocks exceeded value by 4-5% across the entire size spectrum. We've observed the same outcome during four of the last five calendar years, with 2016 being the only exception. The result is the longest and largest large growth long-term outperformance cycle in history, at 63 months.

Sector return differences in Q1 were once again dramatic, as Figure 8 reflects. The best performing S&P 500 sector was technology, up 19.9%, as equity investors rotated to the prospect of above average earnings growth in an otherwise slowing economy.

Figure 8: US Sector Returns –1st Quarter 2019



At the other end of the spectrum were financials and heath care, up "only" 7-9%. There is an irony in this; financials saw positive earnings growth in the 1st quarter due to a healthy consumer sector, and health care companies are expected to post solid revenue growth and margin expansion.

Drilling a bit more into style/sector returns, technology was the top performer in all value and growth indices. Real estate followed in large-caps, but energy was #2 among small and mid-caps. Crude oil prices bottomed at $45/bbl on 12/24 (that date again), and rose throughout the first quarter to close March at $60/bbl. The small and mid-cap energy sectors are dominated by "upstream" energy firms, the earnings of which are highly correlated with oil prices.

The market rally was fairly broad-based. The quarter's top five contributors to the broad market's return were Apple, Microsoft, Amazon, Facebook, and ExxonMobil. They accounted for only 15% of the overall Russell 3000's gain.

Trailing domestic P/E ratios at quarter's end were 14-19% higher than those observable at year-end. Emerging and developed markets P/E ratios rose 12% and 21%, respectively, in the quarter. The EM relative P/E remains at its lowest level in a decade.

Figure 9: Trailing P/E Ratios – March 2019

	Value	**Blend**	**Growth**
US Large	15.7	19.8	25.4
US Mid	17.3	19.4	23.5
US Small	15.8	18.7	23.2
EAFE		**14.9**	
Emerging Mkts		**12.6**	

International Markets – Didn't Hold Back

Global stocks rallied back strongly after the Q4 market sell-off. Signs of progress in US-China trade discussions and the US Federal Reserve placing its base interest rate on hold ignited the rally. Easing monetary policy in Europe and China provided additional support. International equities lagged domestic equities, but still posted double-digit advances and retraced much of the fourth quarter's declines. Both developed markets (MSCI EAFE) and emerging markets rose 10%, versus dropping -12.5% and -7.4%, respectively in the fourth quarter.

The energy-dominated Canadian market rose 15.3%; the same amount it fell in Q4, as oil prices jumped 30%. The broad MSCI AC World ex-US index rose 10.3%.

Figure 10: International Equity Markets – Returns

	U.S. Dollar Returns (%)		Local Currency Returns (%)	
thru 3/31/19	**1Q '19**	**1-Yr**	**1Q '19**	**1-Yr**
World ex-USA	**10.5**	**(3.1)**	**10.8**	**3.2**
- MSCI Growth	*12.4*	*(0.8)*	*13.0*	*5.6*
- MSCI Value	*8.5*	*(5.5)*	*8.6*	*0.7*
- Europe	10.8	(3.7)	11.6	4.3
- Pacific, ex-Japan	12.2	4.6	11.7	9.7
- Japan	6.7	(7.8)	7.6	(4.1)
- United Kingdom	11.9	(0.1)	9.4	7.6
Int'l Small Caps	**10.9**	**(8.6)**	**11.2**	**(2.9)**
Emerging Mkts	**9.9**	**(7.4)**	**9.8**	**(1.9)**
- EM Asia	*11.1*	*(6.8)*	*11.3*	*(3.9)*
- EM Europe	*7.6*	*(7.1)*	*5.9*	*6.5*
- EM Lat Amer	*7.9*	*(6.7)*	*7.5*	*5.3*
- EM BRIC	*14.0*	*(13.5)*	*13.5*	*0.3*

Within developed markets, Europe outpaced the Pacific region. Japan was the weak link in the Pacific region, rising only 6.6%. The Japanese economy has not had two consecutive quarters of GDP growth since 2017. In Q1, its exports dropped amidst lower Asian demand and weaker manufacturing.

In currency markets, the US dollar strengthened 2% versus the euro and 1% versus the yen. Despite the third defeat of a Brexit plan, the British pound rose 2% versus the US dollar, as a consensus to avoid a disorderly exit was expressed. Emerging market currencies were mixed – Brazil and South Africa weakened slightly, while Indonesia, Malaysia, and Mexico strengthened versus the US$.

The Pacific region *ex-Japan* outperformed European markets, gaining 12.2%. While Japan struggled to recoup Q4 losses, other areas of the Pacific region more than made up for their declines; Hong Kong jumped 15.6%, Australian stocks rose 11.4% in the quarter, and the New Zealand market rallied 16.7% after a -6.5% decline in Q4.

European markets rose 10.8% despite ongoing signs of slowing economic growth in the 19-member eurozone. The ECB boosted eurozone markets by announcing they would restart the bank's stimulus program in response to weakening economic data. In a major policy reversal, the ECB vowed to maintain negative interest rates through year-end and provide cheap loans to banks to encourage lending. Germany, the largest eurozone country, posted the weakest equity returns in Q1, rising only 6.9%. Smaller countries were the dominant performers, including Belgium (16.2%), Italy (14.6%), Netherlands (13.6%) and Switzerland (13.1%). The UK stock market advanced 11.9% as investors seemed to ignore the political turmoil caused by having no Brexit strategy.

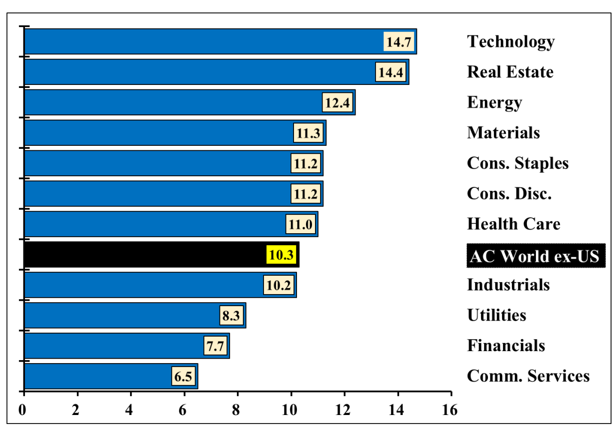
As with many other regions and countries, emerging markets advanced more in Q1 (+10%) than they fell in Q4 (-7.4%). From a regional standpoint, EM Asia (11.1%) led. EM Latin America (7.9%) and Europe (7.6%) posted similar results.

In Asia, Chinese stocks jumped 17.7% as hopes of averting a US-China trade war trumped slowing economic growth (its 2019 projected growth rate is 6%-6.5%). Chinese officials also took steps to ease credit and spur infrastructure spending to counter the slowing economy. Tech giants, Alibaba (33%) and Tencent (19%) powered index results. After lagging in the first two months of the year, Indian stocks finished the quarter strong (7.2%) as Prime Minister Modi's party gained support ahead of upcoming general elections as military tensions between India and Pakistan eased.

The two largest markets in Latin America, Brazil (8.1%) and Mexico (5.5%), rose less than smaller markets in the region, including Colombia (24.8%) and Peru (11.1%). Russia (+12.2%) propelled emerging European markets, as oil prices rebounded.

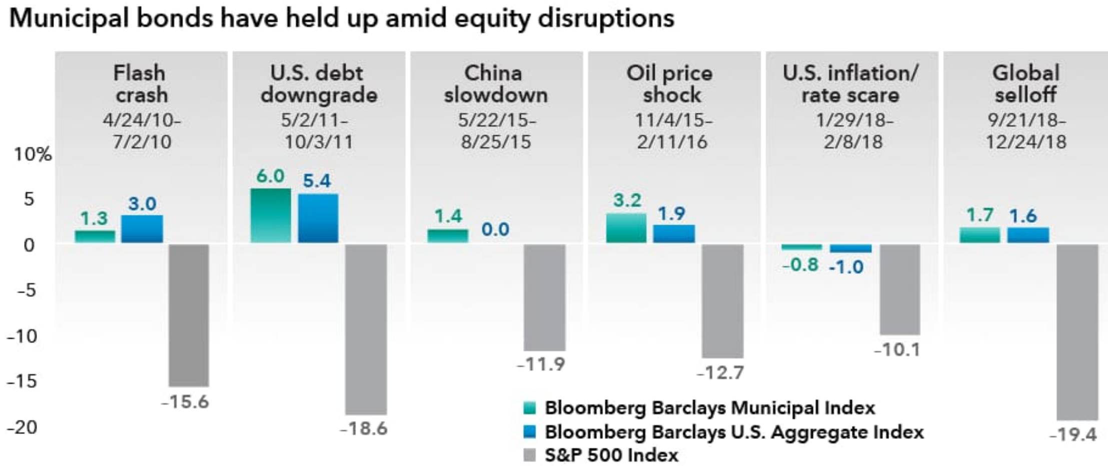
All stock sectors advanced in Q1, with only financials, communication services, and utilities posting single-digit advances. Technology, real estate, energy and materials were the top performing sectors.

Figure 11: Ex-USA Sector Returns – 1st Qtr 2019



Back Page Perspectives

During the ten years since equity markets bottomed during the Great Financial Recession, we've had six major market corrections (using the S&P 500 as our proxy for the market), as set forth below. The worst was the most recent, in 4Q18, and actually ended the bull market run for US small caps (which declined 27% from their August peak). Assuming we want to focus on the larger stock market, the bull market remains intact and counting at 10.1 years.



Sources: Capital Group, Bloomberg Index Services, Ltd., Morningstar. Dates shown for market corrections are based on price declines of 10% or more (without dividends reinvested) in the unmanaged S&P 500 with at least 50% recovery between declines for the earlier five periods shown. The returns are based on total returns.

The point we wish to make is not how great high quality bonds are, except as a store of value when equity markets crack. Rather, we want you to look back to Figure 1, and observe how great the past ten years have been for equity investors compared to bond investors, despite these six bouts of "downside volatility." The S&P has returned 15% per annum. The Barclays Aggregate Bond Index has returned 3.8%, p.a., and the Muni Bond index 4.7%, p.a.

If we look past 2009's strong recovery, and drill down just on the 4/1/10 – 3/31/19 period, which would have been a "not good" time to initially invest, the S&P has returned 12.7%,p.a., the B/Agg has returned 3.3%, and the B/Muni 4.2%. We could do that for every trailing period 1-20 years and the result would be the same – stocks have done better than bonds if you are a long-term investor who can/will ride out the inevitable periods of sharp downside volatility. It's been a great recovery for stock investors.

But you need staying power, because neither corrections nor bear markets announce themselves - nobody rings a bell. Which is where cash and bonds come in. Their expected annual returns are projected in the 2-4% range over the medium term. Terrible, really. Taking quite a bit of credit risk *might* get you to 5-6%. Yet, investors that will be drawing down their portfolios annually (DB plans, endowments, foundations, family offices) simply can't absorb the risk of having to fund any of the next 5-7 years from equity. Too much drawdown risk. Which means that cash and bond portfolios need to cover at least 5-7 years of forecasted net distributions. A 5% annual distribution rate gets you to 35% cash+bonds and 65% risk assets, as a base case.

Everyone is waiting for the equity markets to finally tire out, with the 1st quarter being the latest example of Mr. Market saying, "not just yet." However, investors continue to hedge their bets, plowing much more money into the relative safety of bond funds rather than into stock funds. They sent a net $110 billion into bond-focused mutual and exchange-traded funds in the first quarter, according to Investment Company Institute estimates. In contrast, US-stock funds had a net outflow of $16.5 billion, and international-stock funds took in a modest $3.2 billion. It's a bull market which has been unloved by investors.

We're a long way from a tight money policy. There were five major Fed rate hiking cycles since early 1984, not counting the one which ended in March. Here is how they compared to this cycle –

	Average of past five cycles	March 2019
Nominal fed funds rate	7.55%	2.40%
Core CPI	3.58%	2.08%
Real fed funds rate	3.97%	0.32%
Real 10-yr Treasury yield	4.73%	0.49%

Sell high, buy low. See you next quarter!

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