FIRST QUARTER – SPRING 2019

INVESTMENT SPOTLIGHT

"Courage is what it takes to stand up and speak; courage is also what it takes to sit down and listen."
– Winston Churchill

"Risk on" found its way back into equity markets in 2019 as quickly as it had come off in the fourth quarter of 2018. The S&P 500 started the year with the strongest January monthly return on record in 30 years. The return in the first quarter of calendar year 2019 was the strongest for the index going back to September 2009.

What changed in such a short period of time to account for the dramatic reversal? Certainly, company fundamentals didn't have such a tectonic shift. Negative headlines relating to the longest government shutdown in U.S. history persisted during the period. The political turmoil in the United Kingdom with the Prime Minister receiving three strikes by the British Parliament on her Brexit plan went from bad to worse. China reported the slowest annual pace of economic growth since 1990 amid trade talks with the U.S. grinding along at a tepid pace. Talks of a denuclearization-sanction reduction deal with North Korea broke down. The list of geopolitical worries many cited during the dramatic U.S. stock market sell off in the previous quarter remained quite intact, but then again long-term investors know better than to expect an "all clear" message on global risks. The premium earned over time by investing in stocks dictates that the list of risks and worries will change over time, but not disappear. Long-term investors keep focused on fundamentals rather than near-term distractions that drive speculators in and out of risk assets.

The most significant fundamental difference in the first quarter was the watershed change in monetary policy stance taken by the Fed. What was initially described as a pivot to a more dovish stance early in the year developed into a complete U-turn in March. As recently as November the message from the Fed to market participants had been to expect three rate hikes in 2019. By March the message changed 180 degrees to no hikes planned for the remainder of the year, a path the futures market and yield curve had already been plotting out. It appears the FOMC had the courage to sit down and listen to the market, displaying a willingness to change course late in an economic cycle that others before have lacked. ■

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Economic Review & Outlook

Real Gross Domestic Product (GDP) in the U.S. grew by 2.2% in the fourth quarter led by personal consumption of 2.5%. Business fixed investment was a positive contributor in the latest report despite being inconsistent in recent quarters. The total amount of goods and services produced in the U.S. grew by an average of 3% in calendar year 2018, the strongest in the current economic cycle. While this may very well prove to be a peak, there is ample support for ongoing economic expansion in line with the cycle average of 2%. The consensus view holds that recessionary risks are not apparent until perhaps later 2020 or into 2021. Retail Sales and Durable Goods Orders have pulled back thus far into 2019, a first quarter slower consumption trend that has been pervasive throughout the expansion.

Employment remains robust with the unemployment rate in the U.S. holding at 3.8%. The number of individuals filing for unemployment claims has decreased and there continues to be available positions for all active job seekers. The skills mismatch between candidates and available jobs is an ongoing challenge. Wage growth is happening slowly but surely with a 3.2% increase on a year-on-year basis through March. With further growth in worker salaries, we will be looking for a commensurate rise in productivity (yet to materialize) to offset costs.

	Q1-2019
Communication Services	14.0%
Consumer Discretionary	15.7%
Consumer Staples	12.0%
Energy	16.4%
Financials	8.6%
Healthcare	6.6%
Industrials	17.2%
Information Technology	19.9%
Materials	10.3%
Utilities	10.8%

Inflation pressures are in a word, "absent." Personal Consumption Expenditures (PCE) expanded by a modest 1.4% on a year-on-year basis. The Core PCE reading excluding the volatile food and energy segments was 1.8%. This is the Fed's preferred measure of inflation and remains below their 2.0% target. The Consumer Price Index (CPI) for March was 1.9%. The Core CPI reading excluding food and energy was 2.0%. Producer Prices (PPI) were marginally higher at 2.2% and the Core PPI was 2.4%, showing an ongoing lack of pricing power for producers to pass through incremental costs to consumers.

Weakness in the housing market subsided. Existing and New Home Sales showed signs of life, while Housing Starts and New Permits remained below average. Inventory supply remains tight as homes hitting the market get bought up quickly. A retreat in the level of 30-Year fixed mortgage rates should be a tailwind to the housing market. ■

Bond Market Review & Outlook

The Federal Open Market Committee (FOMC) pivot from tight monetary policy early in the year turned into a full-blown U-turn by quarter end. Despite all the statements made regarding higher rates by the Fed Chairman and governing members to the market in the months prior to the March meeting, the Committee held the Fed Funds Rate target steady at 2.25-2.50%. The updated "dot plot" of forward rate projections of the Committee members now shows no hikes anticipated in 2019, one in 2020, and none in 2021.

In addition to standing pat on rates, the FOMC surprised traders by modifying plans to taper balance sheet run off sooner than anticipated and ending it all together in October. The level of U.S. Treasuries rolling off on a monthly basis will be cut in half from $30 to $15 billion from May through September and then eliminated in October. Beginning in October, the first $20 billion per month of maturing mortgage-backed securities (MBS) holdings will be reinvested into Treasuries rather than rolling off completely. The announcement drove the price of U.S. Treasuries higher, pulling down yields.

Reaction to the new Fed stance was mixed. While the pause on tighter policy should be a positive for the economy, market participants found reason to worry about the slower global growth forecast cited as a key factor in the shift. The combination of positive flows into Treasuries, combined with renewed concerns

	Q1-2019
Cash:	
FTSE 3 Mo. T-Bill Index	0.6%
Taxable Fixed Income:	
Barclays US Agg. Bond	2.9%
Barclays Govt./Credit Int.	2.3%
Barclays Govt./Credit Long	6.5%
BofAML High Yield Index	7.4%
Tax Exempt Fixed Income:	
Barclays Muni. 5 Yr.	2.1%
Barclays Muni. 7 Yr.	2.7%
Barclays Muni. TR	2.9%

about slowing growth, pulled yields down in a meaningful way in the intermediate part of the yield curve. The 10-Year U.S. Treasury hit a low of 2.37% not seen since 2017. The pullback led to an "inversion" in which 3-Month T-Bills had a higher yield than the 10-Year bellwether bonds for a matter of days. Such inversions have a tendency to be viewed as an ominous sign for the economy. While an inverted yield curve has preceded the last seven recessions, there have also been two instances during the same time period in which a brief inversion reversed, the curve steepened, and economic expansion rolled on.

Returns on fixed income investments were positive in the quarter, but paled significantly in comparison to stellar stock market returns. The Barclays Aggregate Index provided a 2.9% total return to investors. High Yield bonds were stronger, up 7.4%. More interest rate sensitive investments such as preferred stocks and REITs did particularly well in the falling rate environment. ■

Stock Market Review & Outlook

A pronounced sell off across risk assets in the final quarter of 2018 solidified a negative calendar year return for U.S. equities. The -19.8% draw down of the S&P 500 came dangerously close to ending the longest bull market in history. Then just as quickly as it started, equities rebounded and replotted the course back to near record highs. The S&P 500 returned a stellar 13.7% return in the first quarter. The NASDAQ Composite increased by 16.8%. Exposure to small and mid-cap stocks was additive in the risk on environment as the Russell 2000 Index advanced by 14.6%. Growth stocks continued to outperform value. The dominance of growth over value stocks has now reached a level not seen since before the financial crisis. Investors with a mindset toward "reversion to the mean" (like us) continue to look opportunistically in the value equity space. Equities outside of the U.S. provided impressive returns as well, but did not keep pace with the booming U.S. market. The MSCI EAFE Index of developed countries increased by 10.0% and the MSCI Emerging Markets Index advanced 9.9%.

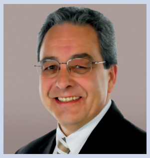
Despite surveys of small business optimism and consumer confidence reporting a pullback, investors fearful of missing out on the gains would not be deterred. All sectors of the S&P 500 Index produced a positive total return in the quarter. Information Technology stocks (heavily sold off in the 2018 draw down) provided the strongest returns, up nearly 20% in the quarter. Eight of the 10 index sectors provided impressive double digit returns during the period. While still well into positive territory, Healthcare was a laggard due to uncertainty over regulatory issues and Financials returns were weighed down by the flat yield curve. Banks were particularly impacted by earning lower rates from lending tied to intermediate term rates, while continuing to pay elevated interest to depositors tied to short-term rates.

Valuations of U.S. equities extended into 2019 driven by P/E (price/earnings) multiple expansion. On a trailing one-year basis the S&P 500 is trading at 20x earnings, roughly in line with the average over the past three to five years. On a forward basis, the index trades at 17.5x, showing a decent level of implied earnings growth.

Corporate earnings for the fourth quarter (reported in Q1 2019) were pulled down by declining margins, but share buybacks made up some of the slack, keeping earnings growth moving in the right direction. Companies continued to plow free cash flow back into their own stock at a record pace, reducing the share count and boosting earnings per share. Consequently, business fixed investment on capital expenditures was not as robust as it otherwise may have been. This is a factor weighing into our "bend but not break" outlook for 2019 GDP returning to cycle trend level growth of approximately 2%. ■

	Q1-2019
DJIA Index	11.8%
S&P 500 Index	13.7%
Russell 2000 Index	14.6%
MSCI EAFE Index	10.0%

Meet the Plimoth Investment Advisors Executive Leadership Team



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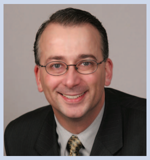

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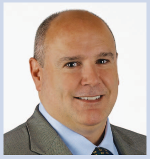

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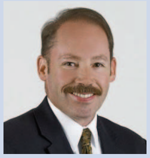

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Closing Thoughts

There is no better time period in recent memory which epitomizes the fact that stock market volatility works in two directions. Patient investors were rewarded by waiting out the pullback in December rather than overreacting. The desire to react quickly to a change in market sentiment could easily have led to exiting the market at the wrong time, and equally important, missing one of the strongest rallies on record while on the sidelines. The occurrence exemplifies why market timing is an unsustainable strategy.

While investor sentiment turned decidedly positive through the run up, some have raised the question of whether the rebound has come too far too quickly with record market highs back in sight. The term "market melt up," defined as a period of dramatic gains led by a stampede of investors fearful of missing out on a rising market, is making a quiet comeback. We continue to remind investors that while the short-term actions of speculators make headlines, we as long-term investors continue to dig into the fundamental details that will matter over time.

From our view, the record for the longest economic expansion in U.S. history will be broken in 2019. Despite its length however, we do not see signs of recession on the horizon anytime soon. We continue to maintain our "bend but not break" forward view of the economy and "good but not great" outlook for corporate earnings. We anticipate both will be sufficient to propel us into 2020 on solid economic ground.

If we can be of assistance to you along the way, please do not hesitate to call us at the numbers provided. ■