The Stonebridge Market Commentary

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Equity Market Commentary

Everybody ready for February? After a horrible end of December that saw the S&P 500 fall 9.18%, along comes January with a blistering rebound. While we didn't recover all our December losses, adding 7.87% seemed like a bit of vindication for not deciding to panic and sell out.

Over the last quarter of the year, we saw huge losses in our old friends the FAANG stocks. They had run up so fast that when the selling took hold, it seemed like there would be more than a correction in the former darlings, so down they went, taking the broader market with them. The gloom that hung over the market was pervasive.

Cut to 2019. Buying pressure has resumed in a few of the FAANGs, most notably in Facebook (up 27.16%), Netflix (up 26.84%) and Amazon (up 14.43%) in January. Apple and Google are more muted but still are up mid-single digits, so far. Beyond the FAANGs, we have seen strength in some of last year's worst performers like banks and energy. In January: Citigroup was up 23.82%, Goldman was up 18.53%, XOM was up 8.95%, Schlumberger was up 19.79% and Boeing was up 19.57%. You get the idea.

Meanwhile, most of the "fear factors" that spooked the market are still out there. China and global growth worries, tariffs, possible earnings slowdowns, energy prices, government dysfunction and the pace of Fed policy moves. On the latter, it appears that Fed Chair Powell has signaled that for now, we will probably have a pause in rate increases and the moves will be more data driven.

Last but not least, we have had about half of companies report earnings for the fourth quarter:

- Earnings Scorecard: For Q4 2018 (with 46% of the companies in the S&P 500 reporting actual results for the quarter), 70% of S&P 500 companies have reported a positive EPS surprise and 62% have reported a positive revenue surprise.

- Earnings Growth: For Q4 2018, the blended earnings growth rate for the S&P 500 is 12.4%. If 12.4% is the actual growth rate for the quarter, it will mark the fifth straight quarter of double-digit earnings growth for the index.

- Earnings Revisions: On December 31, the estimated earnings growth rate for Q4 2018 was 12.2%. Six sectors have higher growth rates today (compared to December 31) due to upward revisions to EPS estimates and positive EPS surprises.

- Earnings Guidance: For Q1 2019, 33 S&P 500 companies have issued negative EPS guidance and 9 S&P 500 companies have issued positive EPS guidance.

- Valuation: The forward 12-month P/E ratio for the S&P 500 is 15.7. This P/E ratio is below the 5-year average (16.4) but above the 10-year average (14.6).

The message is that things are pretty good with risks of course. No recession in sight at this point.

Fixed Income Market Commentary

January was a good month for bondholders. The so-called January Effect in the municipal market refers to the sudden drop off in supply entering a new year. It typically bodes well for bond prices. Demand for new tax-exempt bonds outpaced supply for the month, boosting prices and pushing yields lower in the short and intermediate part of the curve. Yields were little changed much beyond 10 years, while the 30-year held firm at 3.02% the whole month.

2-year Treasuries bounced around during the month, but largely closed unchanged from year-end at around 2.45%. The 10-year followed a similar course, ending the month down just a couple basis points at 2.63%. Credit spreads on investment grade corporate bonds have widened in the last three months, while municipal yields as a percentage of Treasuries have contracted. That has made tax-exempts more expensive, but on a taxable equivalent basis still attractive compared to Government bonds for higher tax bracket investors. Whether you are looking for tax-exempts or taxable bonds, most of the yield curve's return can be found in short to intermediate durations, though we are now finding more opportunities to add maturities on the further end of that range. For tax-exempts we see a near-term continuation of tight credit spreads on rated bonds and largely favor higher rated investment grade credits for high quality allocations over lower rated issues that offer very little incremental yield. Some lower rated and non-rated borrowers do still offer a decent yield pick up for investors willing do their own credit analysis. On the taxable side, with wider credit spreads, it is possible to still pick up some additional yield moving a bit further down the rating spectrum within the investment grade space. So, whether we are buying taxables or tax-exempts right now, we are focused largely in the same duration range, it's just slightly different quality targets that make up the sweet spots for us.

Sources

Data sourced through Bloomberg and Factset.com