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- Stocks rallied back in the first quarter
- The US economy has slowed a bit in recent weeks but continues to outperform the rest of the world.
- Manufacturing PMIs have been falling with the Eurozone dropping into contraction
- We are quite constructive on the markets and expect to see new highs in the next few months

Large Cap Core Growth Commentary

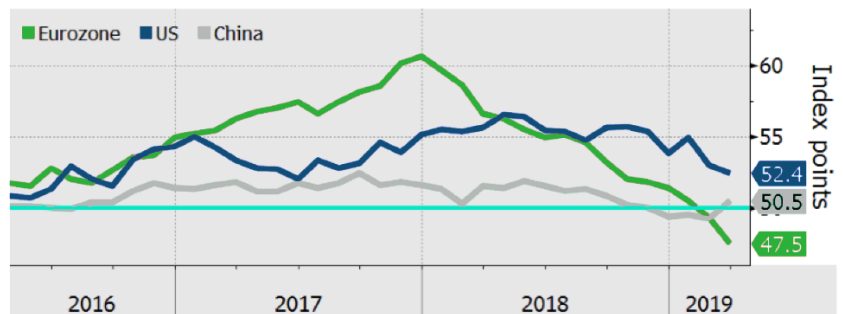
In the first quarter the stock market came roaring back from a disastrous fourth quarter of 2018. The S&P 500 declined 13.97% over the period and December alone fell 9.18%, for its worst showing since 1931. We believe the results were somewhat tied to tax selling where investors take losses just before year end to lock in a tax loss for the year. This action can push stocks down to attractive valuations that can drive a wave of buying at the start of the new year. This appears to be at least part of the story as stocks rallied back in the first quarter. In what is virtually a mirror image, the market has rebounded 13.65% for the first

three months of 2019 (although the S&P 500 stopped 3.29% from hitting a new high). The other force driving the markets was a new, softer tone coming from the Federal Reserve. In March, the Fed Chair Powell announced that they would be unlikely to raise rates again in 2019, leaving the policy rate unchanged at 2.25%-2.50%. Ten year rates responded by falling from 2.76% at the beginning of the month down to 2.31% near month's end. Stock markets had already been rallying in anticipation of such a move.

The markets did climb a "wall of worry" during the rally, including concerns of a trade war, slowing earnings as last year's tax cuts made their anniversary, and more fears of Brexit's impact and China's slowdown. The US economy has slowed a bit in recent weeks but continues to outperform the rest of the world.

As the chart illustrates, manufacturing PMIs have been falling with the Eurozone dropping into contraction (a reading below 50 indicates a contracting economy) and China, after a period on contraction, is peaking its head just above 50. The US number, at 52.4, is indicating slow but steady growth domestically. Other statistics indicate that the US is still in good shape. The unemployment rate came in at 3.8%, spot on with February's number and the initial jobless claims for the end of March posted the lowest number since November 1969 at 202,000. These claims generally start to move up before a recession starts. Auto sales look pretty solid too. Sales increased 5.3% in March for a 17.5 million annual rate.

Global Manufacturing PMIs Sending Mixed Signals



Source: JP Morgan, Caixin, Markit
Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2019 Bloomberg Finance L.P.
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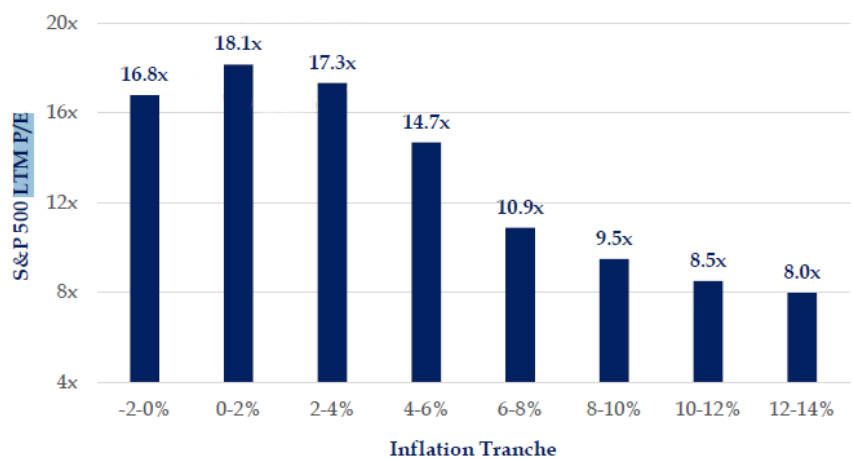
Source: JP Morgan, Caixin, Markit

“The markets have covered a lot of ground over the last six months but at the end of March the S&P 500 has not changed much from a price perspective.”

Balanced Core Commentary

With the reversal of the fourth quarter market action, much of it driven by tax considerations, the Large Cap Core Growth Model struggled in the first quarter, at least versus our Russell 1000 Growth benchmark which was on steroids during the period. It closed the quarter over 300 basis points higher than LCCG as tech stocks soared. The core portion of our portfolio model held us back a bit. The top performing sector for our model was Energy, which benefited from a significant rally in crude oil as well as Permian-fueled output gains. Brent crude jumped about 35% over the period. This was followed by Materials which was driven by a strong performance by Ecolab. On the other side of the equation, Financials and Consumer Staples brought up the rear while game maker Activision and Amdocs stumbled. We made several adjustments to the model over the quarter including: (1) we sold Constellation Brands after weak guidance (2) Bought Facebook and VMware to increase technology exposure (3) Sold Activision Blizzard due to poor price action, weak numbers and extreme weakness in the video gaming industry (4) Purchased both Estee Lauder and McDonald's.

Average S&P 500 LTM P/E by CPI Y/Y Tranche (1950 - Current)



Source: Strategas

Corporate profits growth will face a tough test in 2019 due to the anniversary of last year's corporate tax cuts. Last year's first quarter growth rate was artificially boosted through the tax cut compared to 2017's first quarter. The tax cut has now hit its anniversary, so 1Q19 growth will pale by comparison. First quarter earnings results for the S&P 500 are expected to be down 3.9% on revenue growth of 4.8%. The Utilities Sector is expected to be the strongest in terms of EPS growth at 4.6%. Healthcare is expected to take second place out of the eleven sectors at 4.0% growth. Bringing up the rear is the Energy Sector due to a decline in energy price compared with last year's 1st quarter and Materials, which is also expected to show a decline. The tough tax comparison has been expected and is hopefully already baked into the cake. For the full year 2019, earnings are expected to increase 3.7% on sales growth of 4.9%. While not terrific, at least we are moving in the right direction.

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Top 10 Model Holdings ¹

Microsoft Corp.
Apple, Inc.
Alphabet Class C
Cisco Systems, Inc.
CDW Corp.
Home Depot, Inc.
O'Reilly Automotive, Inc.
JP Morgan Chase & Co.
UnitedHealth Group, Inc.
Honeywell Intl, Inc.

% of Total Portfolio: 39%

The markets have covered a lot of ground over the last six months but at the end of March the S&P 500 has not changed much from a price perspective. The Price/Earnings ratio currently stands at 16.3x on a forward twelve month basis. That is about three P/E points below its peak in December of 2017. We think there is upside to the markets now that the Federal Reserve has changed its tune and decided against raising rates anytime soon. Some have speculated that the next move will be a rate cut and the administration is certainly in the rate cut camp. Studies show that with interest rates low and inflation also low, the S&P 500 could trade at an 18x multiple or higher. Our philosophy has always been "don't fight the fed" so we are quite constructive on the markets and expect to see new highs in the next few months. Our S&P 500 target based on EPS of \$172 and an 18x multiple is 3100.

¹ Model Portfolios are based on a hypothetical account managed during the current quarter. Actual characteristics and income may differ materially from model. As of 3/31/2019.

- Central banks, US/China trade, Brexit and slowing global growth have once again driven the markets in the first quarter of the year.
- The move lower in yields of roughly 40 basis points for the quarter on the US 10yr treasury was a positive for the market values of fixed income securities.
- We have been working to extend duration in our products as we anticipate that we are approaching the end of the rate hike cycle from the Federal Reserve and look to reposition slightly further out the yield curve.

Taxable Fixed Income Commentary

You already heard it last quarter, but the story remains the same – central banks, US/China trade, Brexit and slowing global growth. These factors once again have driven the markets in the first quarter of the year, although with a different result than what we saw previously. At the end of 2018, investors were concerned over the possibility of higher rates and a recession, pushing equity markets to one of the worst Decembers ever. Flip the calendar and the story began to shift. With a pivot from the Federal Reserve, a pull back from the ECB, optimism towards a deal with US and China and some Chinese data that may represent a bottom forming for that EM economy, we had the best 1st quarter for the equity markets in years.

The anticipation that the Federal Reserve will remain on hold for the rest of 2019 led to a shift lower in yields across the treasury curve both in the US and globally. We actually saw the 10yr German Bund move into negative territory as risk-off sentiment in the fixed income markets made a strong showing. We did see an inversion in the 3month-10yr part of the yield curve, although that has since reversed and we currently sit with that spread at around 9 basis points and the 2-10yr part of the yield curve exhibiting steepness of around 18 basis points. The move lower in yields of roughly 40 basis points for the quarter on the US 10yr treasury was a positive for the market values of fixed income securities although we have moved off the lows posted at the end of March of around 2.36%.

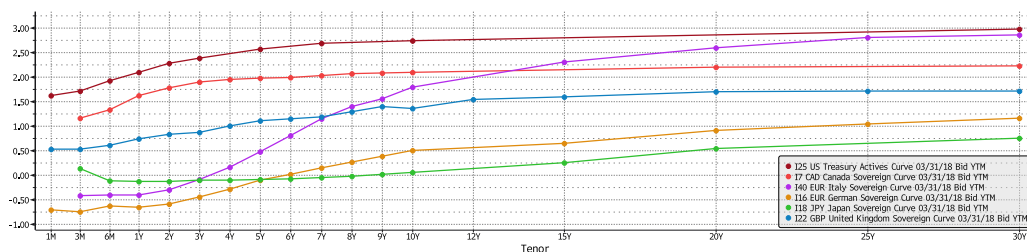
“With a pivot from the Federal Reserve, a pull back from the ECB, optimism towards a deal with US and China and some Chinese data that may represent a bottom forming for that EM economy, we had the best 1st quarter for the equity markets in years.”

At Crossmark, we utilize a four-step process to determine our investment strategy, which has led us to a more conservative approach in our holdings. This has been accomplished by purchasing higher quality securities with strong levels of income while reducing our exposure to interest rate risk. This worked well for us last year with all of the volatility in yield movements. This past quarter, with yields dropping by about 40 bps, we had positive performance across all taxable fixed income products, although underperforming the comparable benchmarks due to our shorter duration positioning and underweight in treasury notes. For the Current Income Product and Income Opportunities models, however, the allocation to fixed rate preferred securities and the corresponding income

from that sector allowed us to outperform the comparable benchmarks for the quarter.

We have been working to extend duration in our products as we anticipate that we are approaching the end of the rate hike cycle from the Federal Reserve and look to reposition slightly further out the yield curve.

Global 10yr Sovereign Yields - March 31, 2019



Source: Bloomberg

Balanced Core Commentary

If economic reports hold steady in the US and improve on a global basis in the second half of this year, we are not ruling out one more rate hike by the FOMC although we don't see rates moving up to previous year highs of 3.25%. As always, we are here to help guide you through the volatility of the markets and are happy to discuss our models, our outlook and the markets in general with you.

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Contact a member of our Advisor Solutions Team

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