IFAM Capital
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As widely expected, Fed policymakers left the target range for the federal funds rate unchanged (2.25 – 2.50 percent) citing low unemployment and below-target inflation trends. Household spending and business investment data were weaker than expected in the first quarter, but the Committee still expects both to rebound later this year. Furthermore, the Committee believes global financial conditions have eased since the start of the year aided by supportive monetary and fiscal policies abroad. While the Committee opted to leave its target rate unchanged, the Federal Reserve will move forward to cut back the pace of its balance sheet reduction program. From May through August, the Federal Reserve will reinvest just $15 billion U.S. Treasuries that mature each month – down from $30 billion per month. The Fed will continue to allow approximately $20 billion of Mortage-backed securities (MBS) holdings to roll off its balance sheet per month as those securities mature. Overall, the committee will continue to monitor the aggregate size of the Fed's balance sheet to determine the appropriate size to implement monetary policy effectively.

Key Points

- U.S. equities sold off sharply following the Federal Open Market Committee (FOMC) statement ending the day down 0.75 percent. Although investors widely anticipated the Fed decision, the pullback may signal investors are growing restless with the Fed's data-dependent approach. The unemployment rate remains anchored to historic lows, the S&P 500 Index recorded a new all-time high; yet core inflation continues to fall short of the Fed's target while household and business conditions remain weak. The confluence of mixed signals following a remarkable equity rally off December lows provided tactical investors a good opportunity to lock in short-term gains.

- U.S. Treasury yields were close to unchanged on the day. The 2-year/10-year spread fell below 20 basis points, and the front end of the yield curve remained inverted. In our view, the shape of the yield curve signals monetary conditions remains too tight. As of the close of trading on Wednesday, May 1 following the FOMC press conference, Fed Fund futures had priced in a greater than 80 percent chance of a rate cut in 2019. As we continue to monitor macroeconomic data influencing our view on the eventual path for short-term interest rates, we remain focused on the potential effects of the committee's balance sheet normalization policy. Although Fed policymakers did not change their interest rate policy, their ongoing balance sheet reduction program is modestly tightening financial conditions on balance.

Market Commentary

Strength across risk-assets fueled investor optimism despite ongoing to U.S.-China trade negotiations, low inflation, BREXIT, geopolitical tensions and slowing global growth. Realized 30-day equity volatility collapsed just 9.0 percent and ranked among the lowest quartile of historical observations. Investors can take some solace in stronger than expected Real GDP growth in the U.S. (3.2 percent versus 2.0 percent expected) and low unemployment rates, but signals from the U.S. bond market convey a less sanguine outlook.

How should investors reconcile these mixed signals? In our view, the market rebound in risk-assets is linked to confidence in the ability of central banks to contain downside risks of slowing global growth. Therefore, the most significant risk to this rebound and low volatility is central banks losing control of this narrative.

Global equity markets proved resilient again in April as the S&P 500 Index rallied 4.0 percent and recorded a new all-time high of 2945.8. The strong month propelled the year-to-date index return to 18.2 percent. U.S. equities continued to outpace both international developed (+2.9 percent) and emerging markets (+2.1 percent) on the heels of mixed economic results in the Euro Area, geopolitical tensions and slowing global trade.

In contrast, U.S. corporations are beating (lowered) analyst estimates for revenue and earnings. Finally, continued U.S. dollar strength remained a headwind for international assets. Real Estate Investment Trusts fell just 0.2 percent while Master Limited Partnerships fell 1.4 percent in April. However, both real asset categories produced the second and third-highest returns year-to-date behind U.S. equities.

Fixed income markets benefited from slower growth expectations and monetary policy accommodation from global central banks; however, the dichotomy between Treasury yields and credit spreads offer divergent outlooks in terms of the ability for monetary policy to deliver financial asset returns. Cautious investors can point to the inverted Treasury curve signaling monetary policy conditions are too restrictive. Federal Funds futures corroborated this view and priced in a greater than 50 percent probability of a rate cut by year-end.

In contrast, bullish investors can point to further declines in credit spreads as evidence that economic growth remains solid, albeit at a slower pace. While these conflicting signals can persist in the short-run, market internals should eventually converge, and investors should expect elevated volatility when they do.

Market Outlook

Despite the recent run-up in equities, we remain constructive on underlying fundamentals. Despite recent strength, the 12-month forward price-to-earnings multiple on the S&P 500 Index stood at 17.7 and ranked among the highest 71 percent of monthly historical observations since 1990. That means nearly 30 percent of the time equity valuations have exceeded current levels.

Along with low volatility, low correlations and moderate-to-high dispersion imply strong diversification potential and favorable conditions for actively managed strategies. Certainly, a welcome respite for active managers.

Although we acknowledge headwinds in international and emerging market economies in the short-term, valuations remain attractive on a relative basis and warrant thoughtful consideration for long-term investors. Real assets should continue to benefit from favorable interest rates and steady economic growth. In light of divergent signals from fixed income, we continue to caution investors from adding credit exposure. A precipitous slowdown in global economic growth, unexpected geopolitical tensions, or tighter financial conditions would trigger a review of this outlook.