2019 Economic & Stock Market Outlook:

Conditions In Place For Return Of Cyclical Bull In 2019

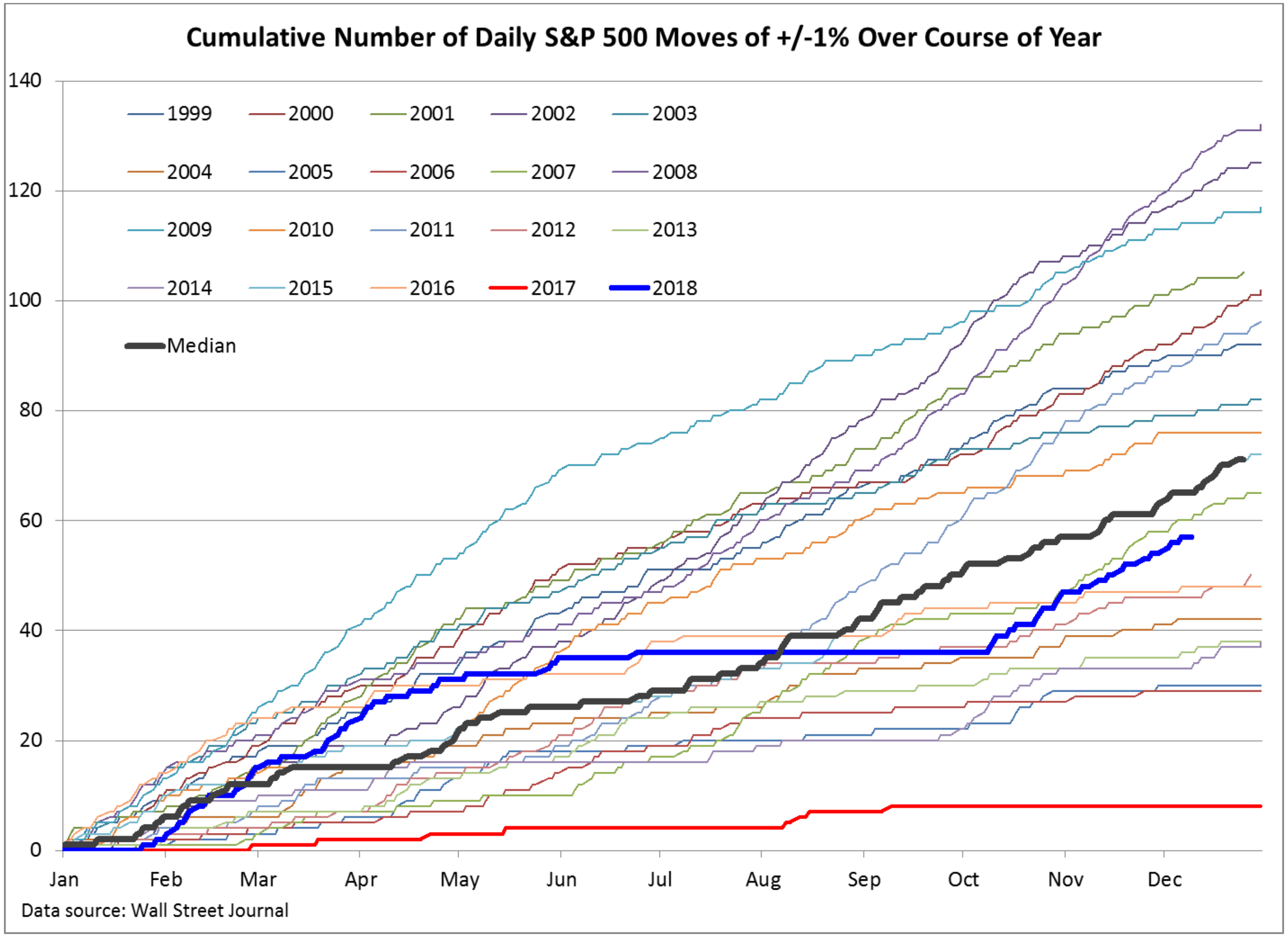
Supplemental Chart Pack

December 13, 2018

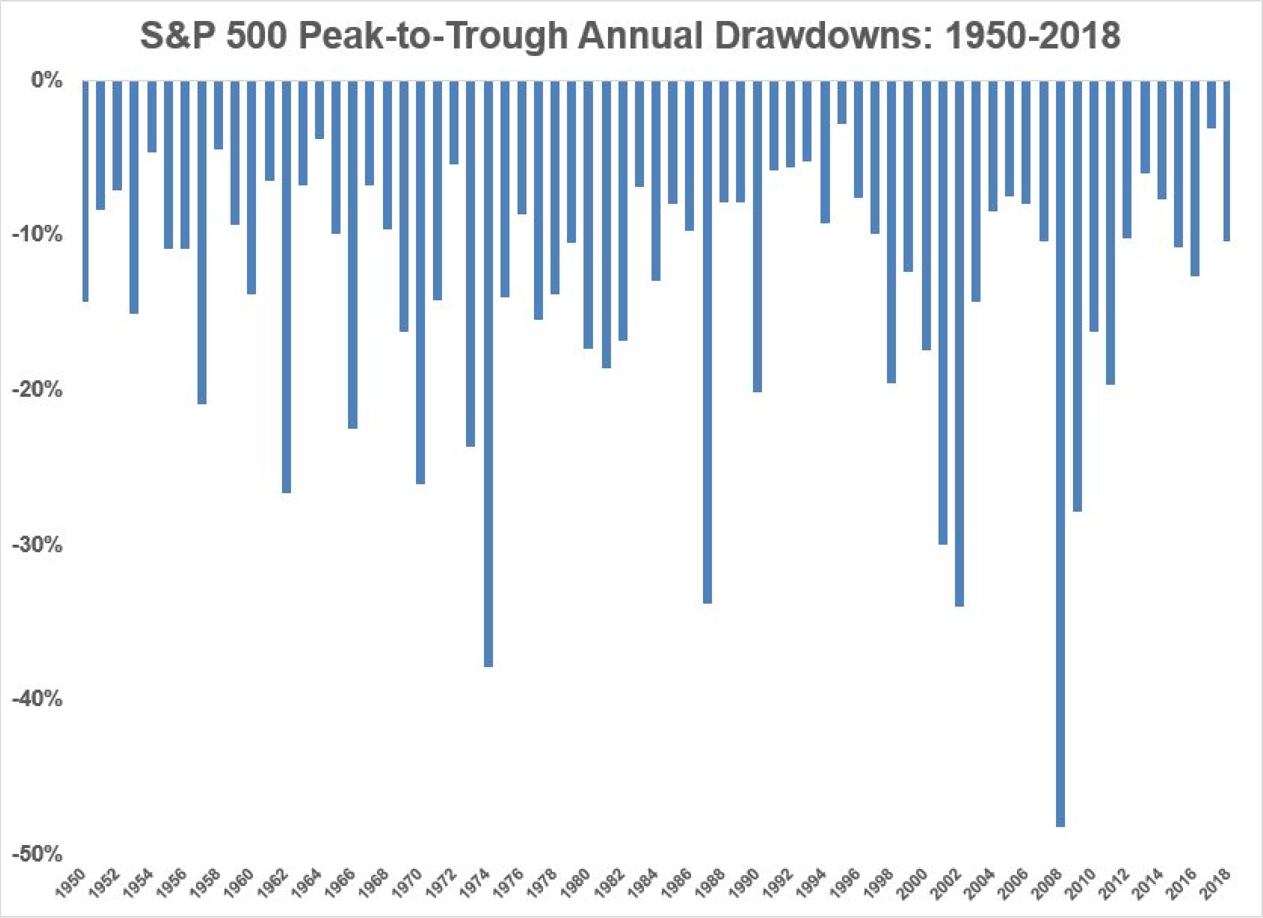
Bruce Bittles
Chief Investment Strategist
(941) 906-2830
bbittles@rwbaird.com

William Delwiche, CMT, CFA
Investment Strategist
(414) 298-7802
wdelwiche@rwbaird.com
Twitter: @WillieDelwiche

Volatility returned in 2018. The lack of +/-1% moves seen in 2017 is proving to be a clear historical outlier.

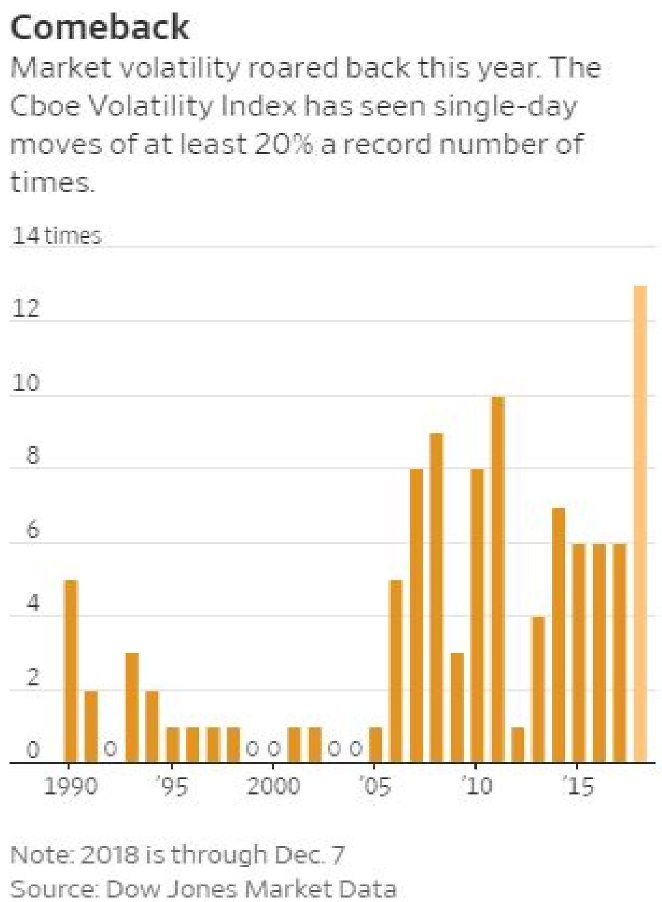


The price swings in 2018 occurred within a broad trading range and the peak-to-trough drawdown for the year was actually below average.

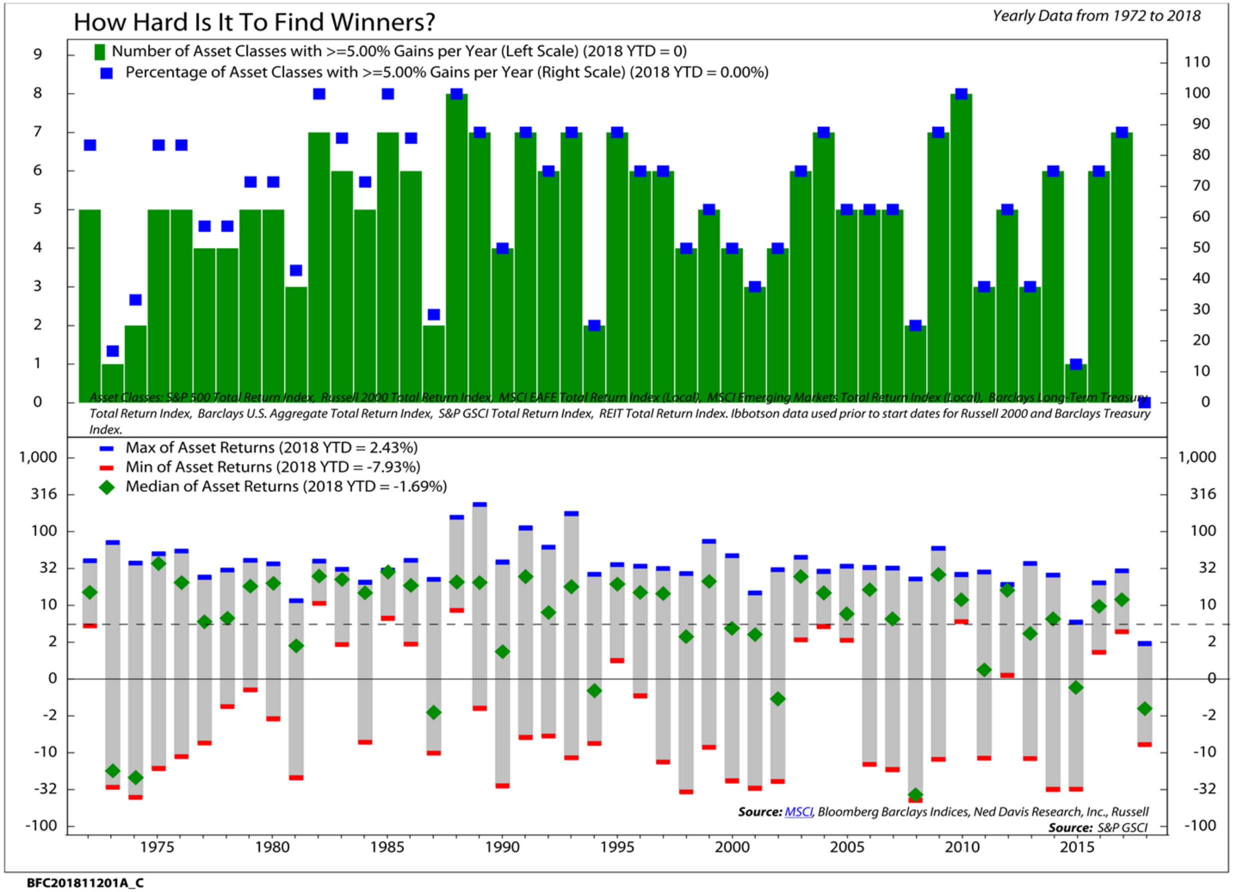


Source: Ben Carlson (awealthofcommonsense.com)

An uptick in large price swings within a broad trading range has meant that volatility (as measured by the VIX) is seeing a record level of volatility.



2018 has defied the adage that "there is a bull market somewhere" -- it is poised to be the first year since at least 1972 where no asset class had at least a 5% gain.



Source: Ned Davis Research

The weight of the evidence turned cautious in mid-2018 and the message persists heading into 2019.

MACRO FACTORS (WHAT COULD HAPPEN):

FED POLICY

After a likely four rate hikes in 2018, the Fed could slow the pace of tightening in 2019.

ECONOMIC FUNDAMENTALS

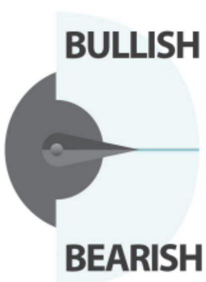
Economic growth could moderate in the year ahead, but improving productivity growth trends are a longer-term tailwind.

VALUATIONS

Valuations have moved in an encouraging direction, but stocks are not historically cheap and earnings growth may have already peaked.

MARKET FACTORS (WHAT IS HAPPENING):

SENTIMENT



Bullish investors have been slow to throw in the towel on stocks and that has delayed the bottoming process.

SEASONAL PATTERNS AND TRENDS

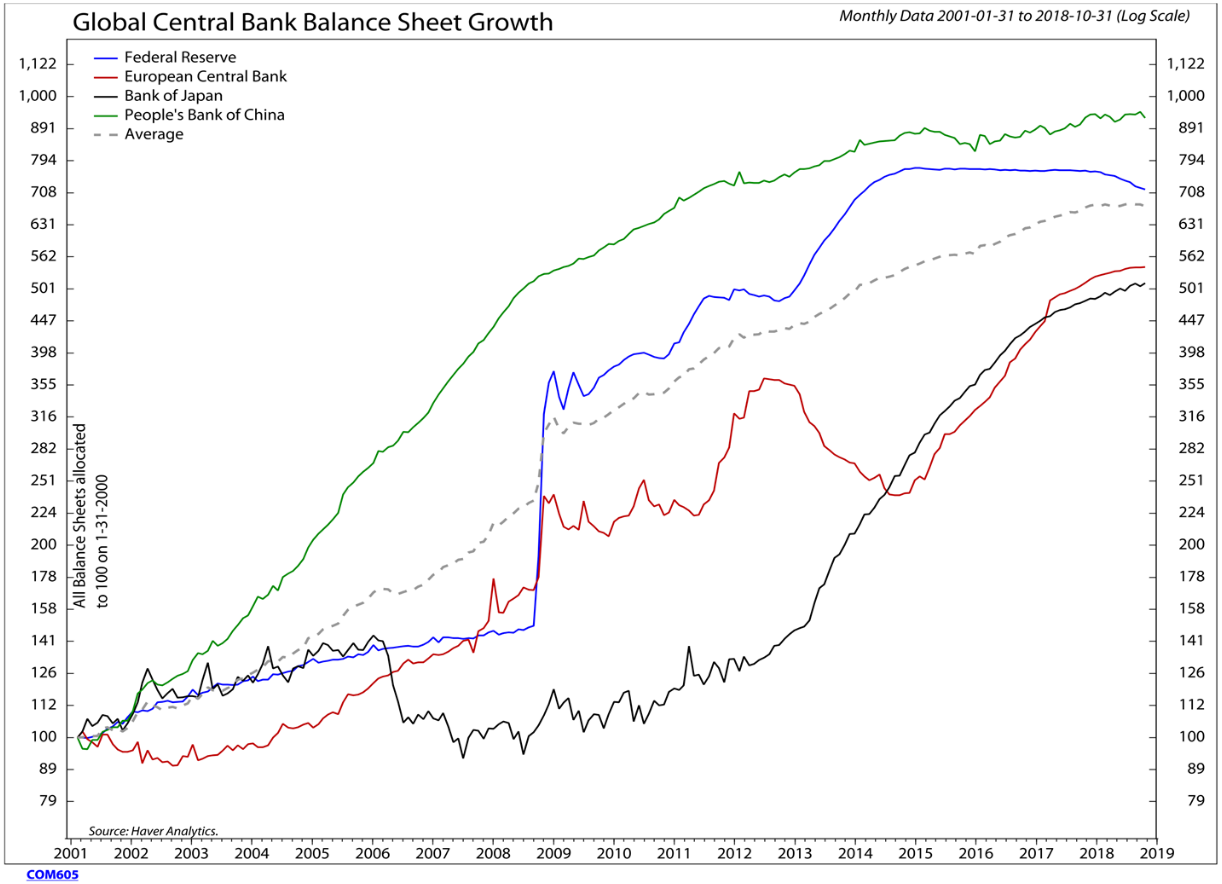
Seasonal leadership trends have been slow to develop, despite favorable calendar considerations.

BREADTH

The new low list remains elevated and industry group trends show fewer areas of the market in up-trends.

Source: Baird Investment Strategy team

One source of market volatility has been central banks shifting from quantitative easing to tightening – this could intensify in 2019.

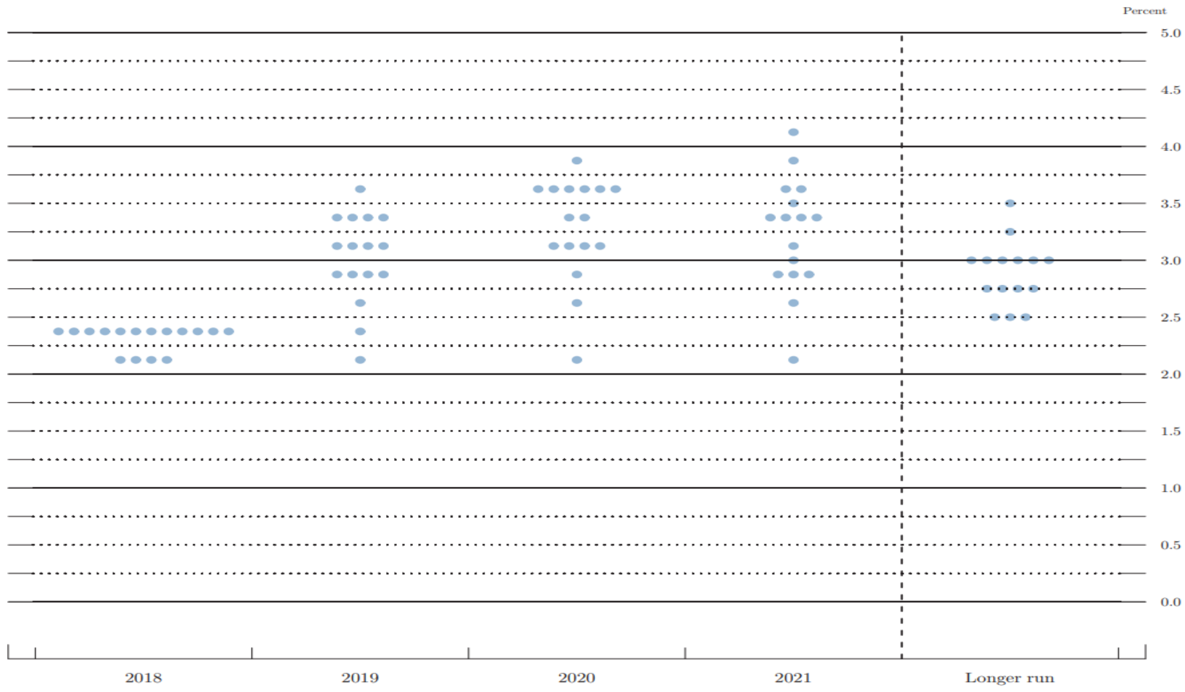


Source: Ned Davis Research

As of September, the consensus view on the Fed was that after a December rate hike (the 4th move of 2018), three more hikes would be in store for 2019.

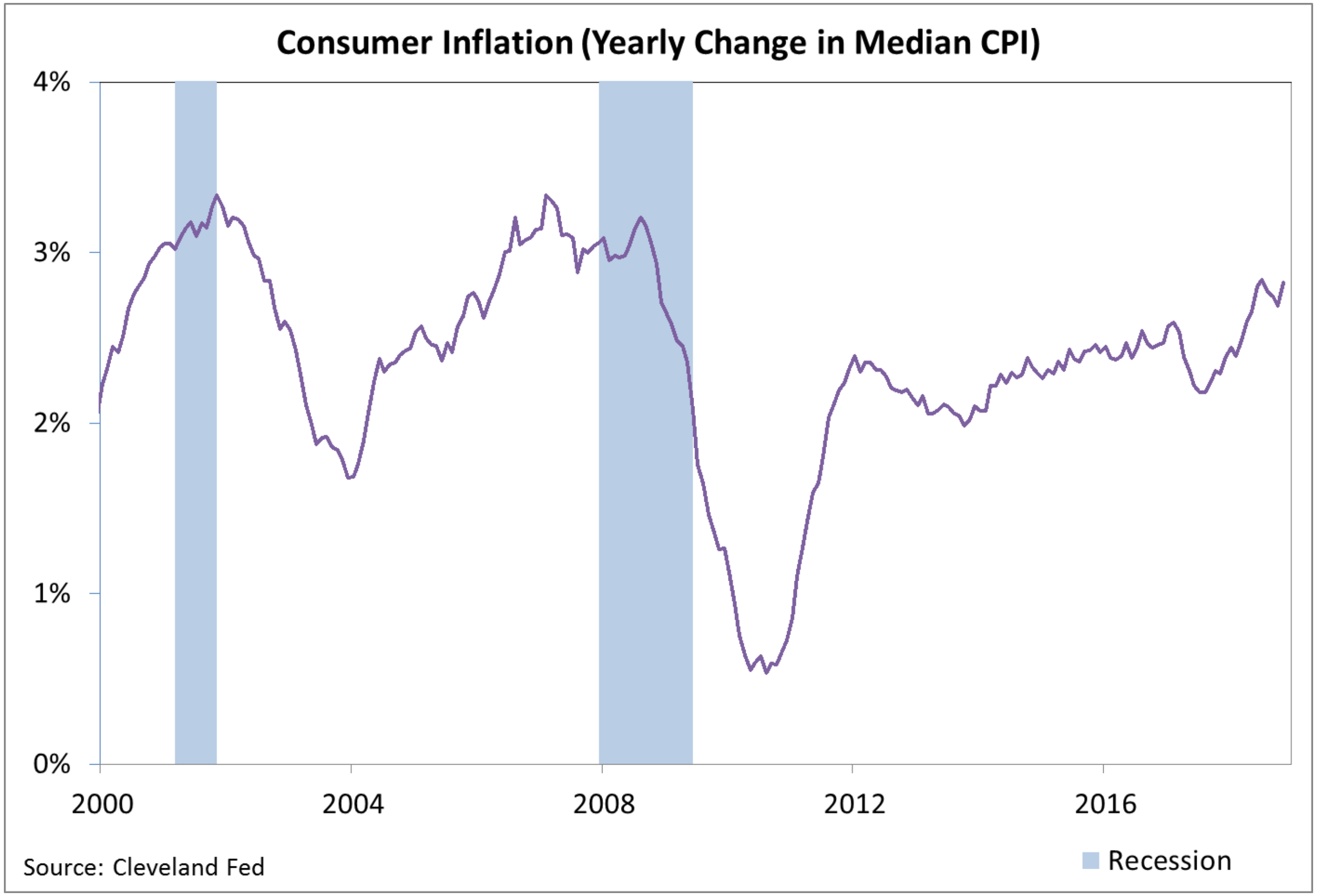
BAIRD

FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate

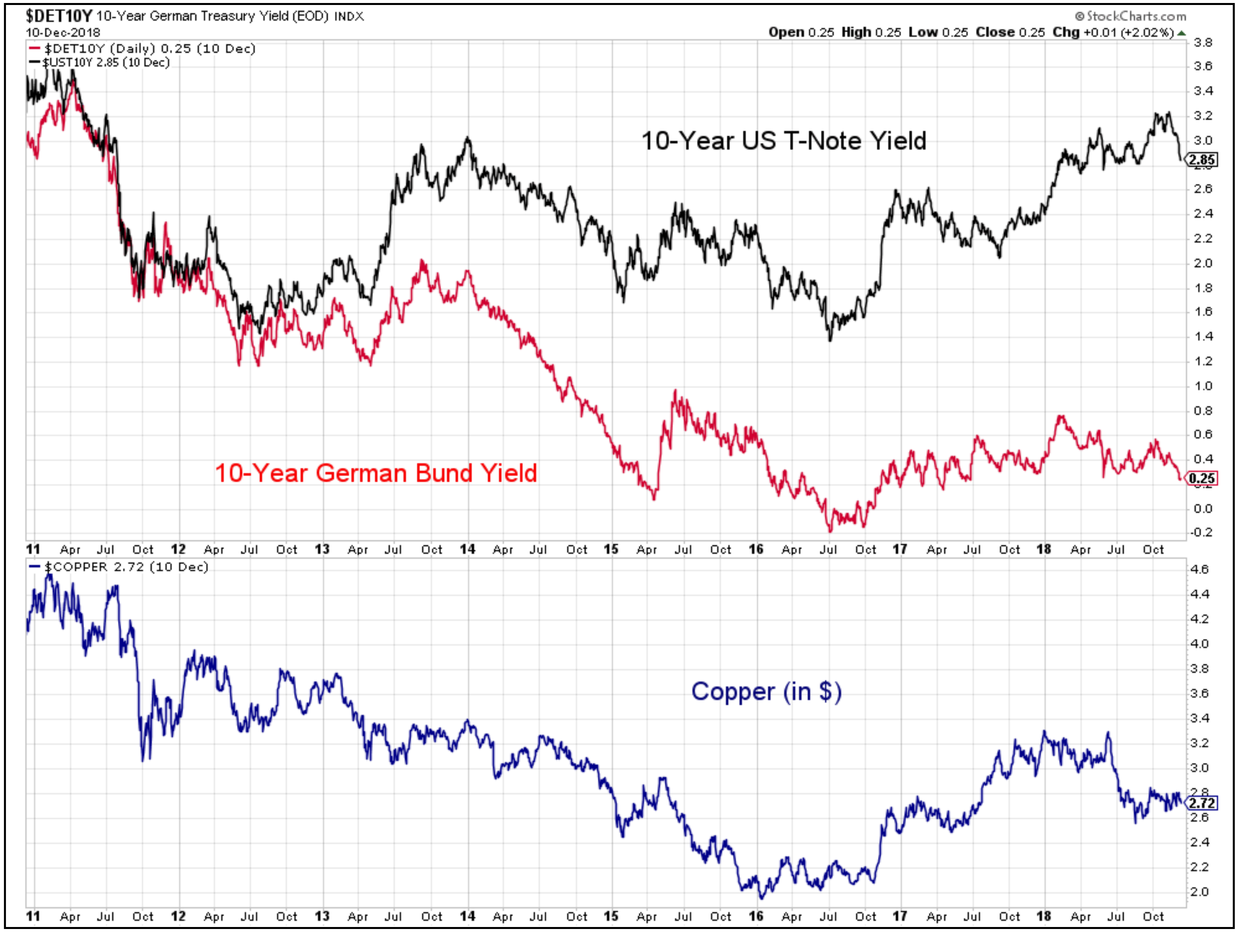


Source: Federal Reserve, Chairman's FOMC Press Conference Projections Materials, September 26, 2018

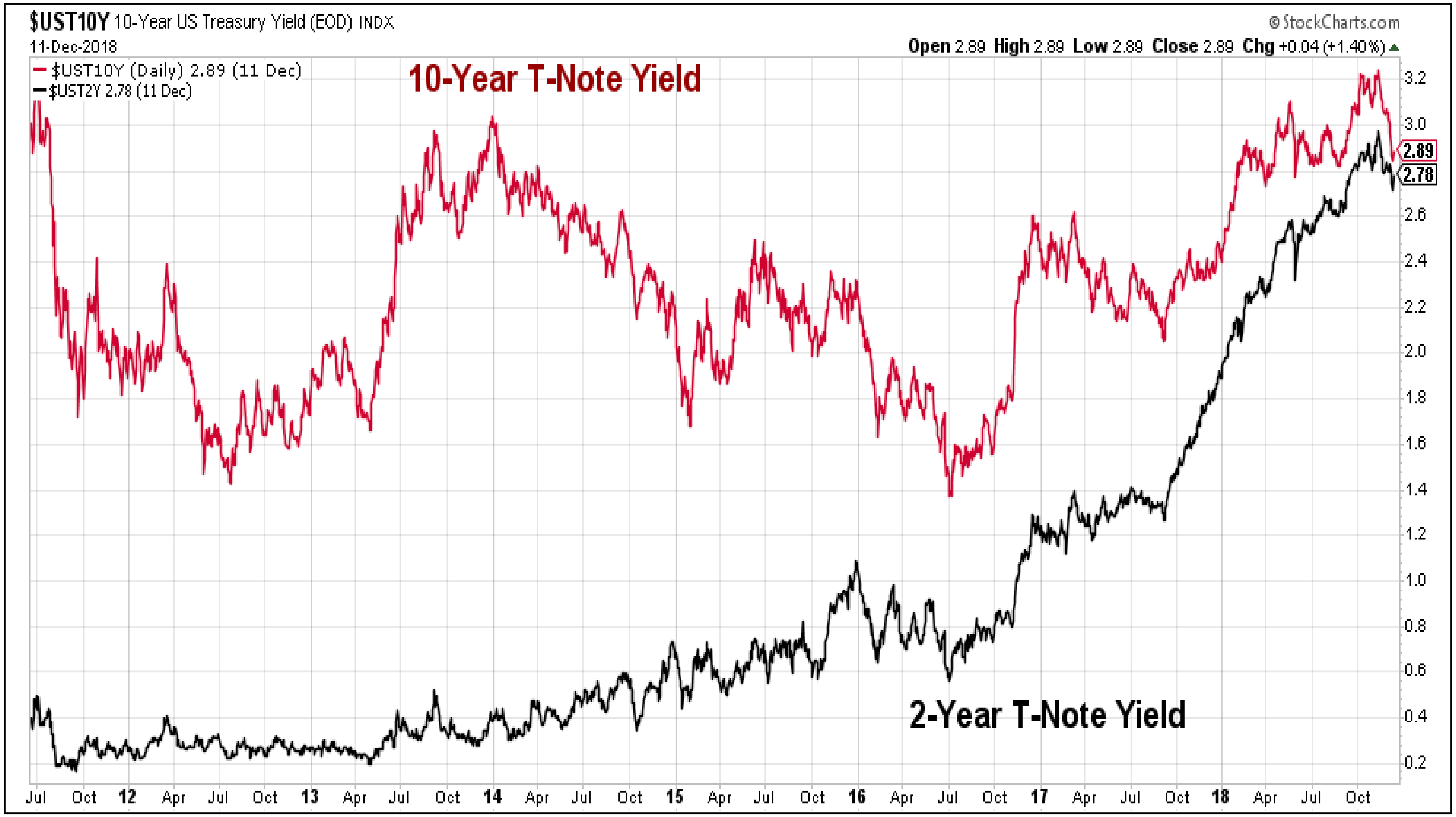
Moderating inflation pressures would give the Fed flexibility to adopt a more dovish stance. The data are not consistent in suggesting inflation is moderating.



Bond yields are on the Fed's radar: The move higher in 2018 by the 10-Year T-Note was not confirmed by German yields or Copper prices.

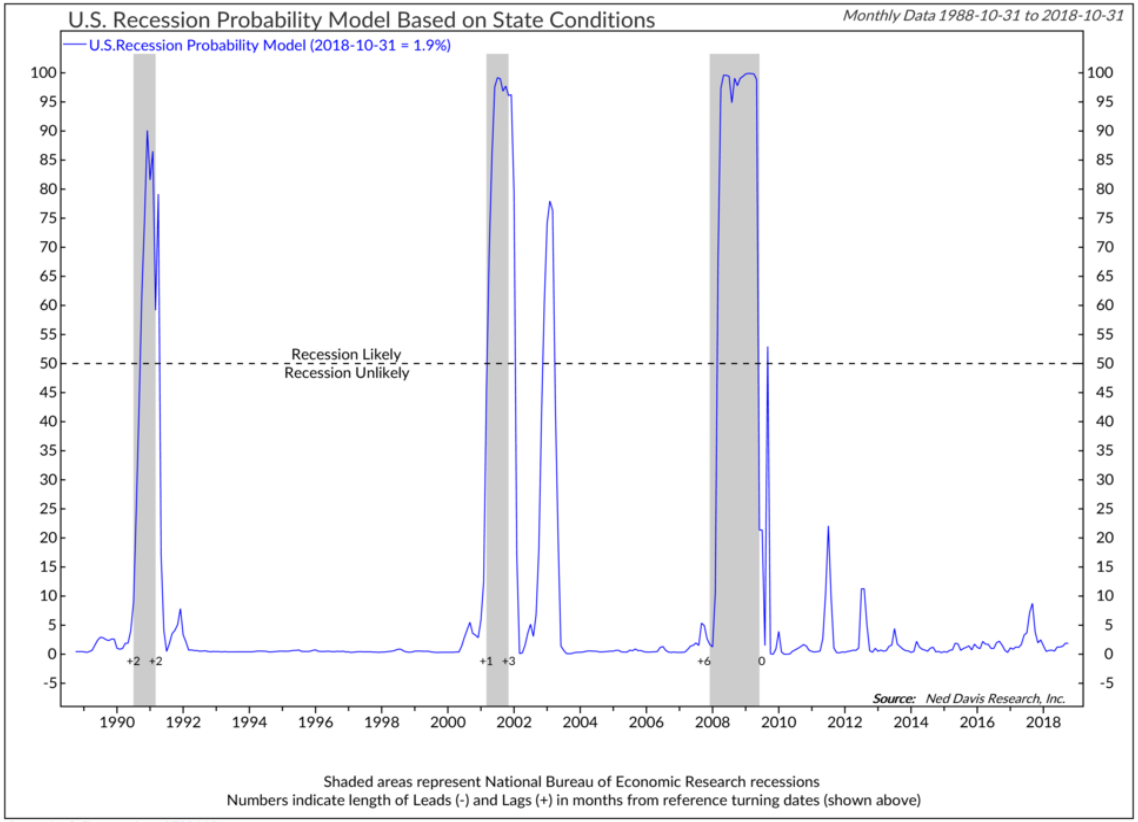


The yield on the 2-Year T-Note has risen even faster than the yield on the 10-Year T-Note, producing a flattening and near inversion of the yield curve.



Source: StockCharts

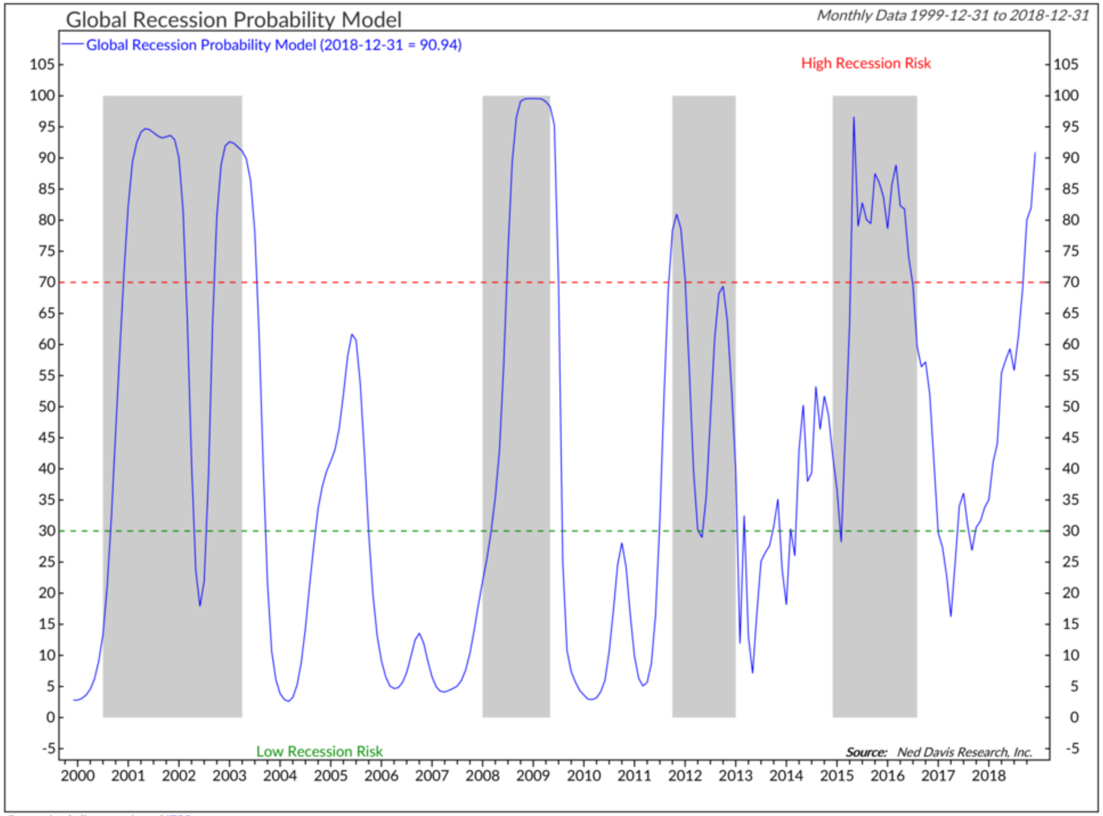
An inverted yield curve is typically associated with an increased risk of recession. Heading into 2019, recession risk in the U.S. remains quite low.



Customized client version of E0046C

Source: Ned Davis Research

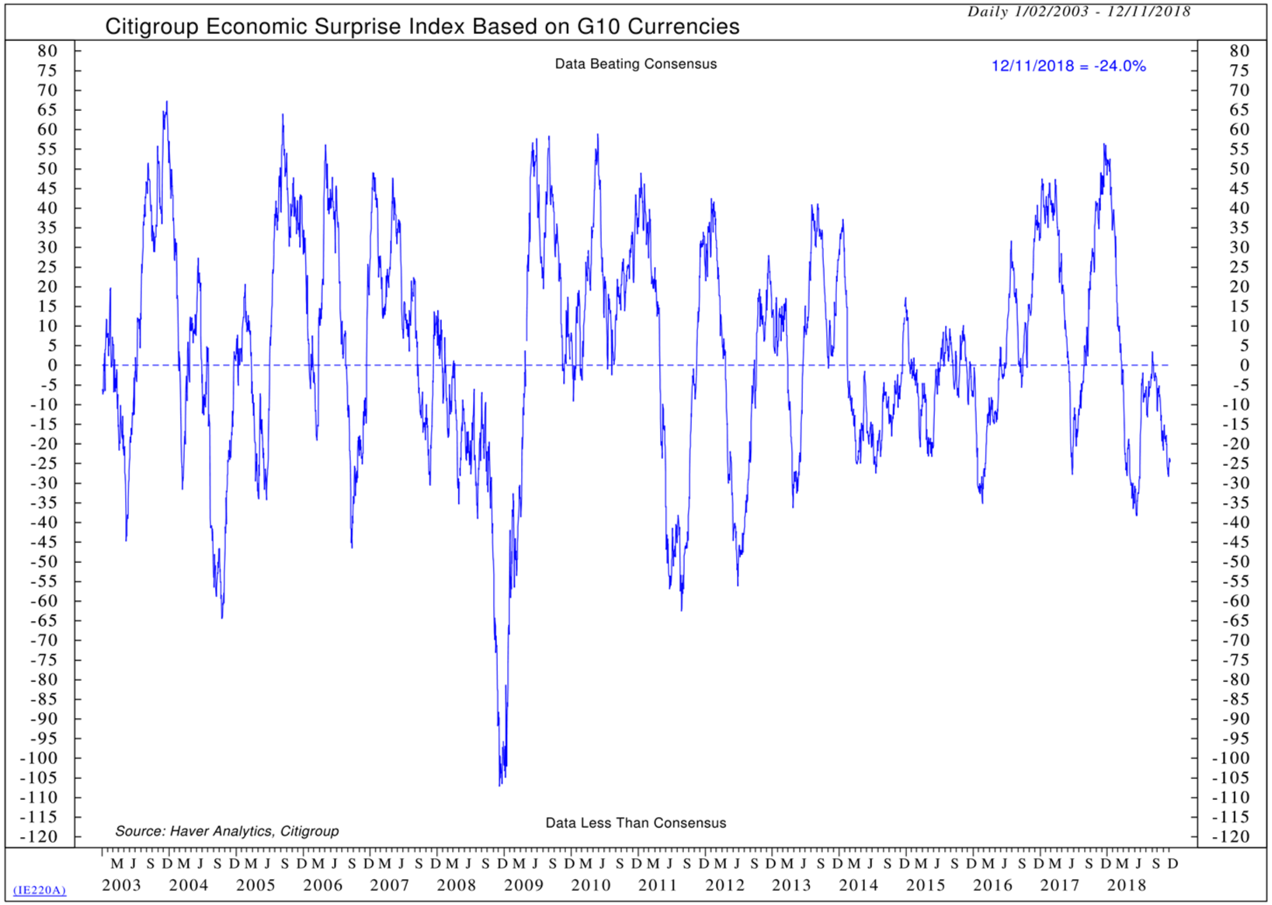
Globally synchronized growth proved fleeting. The likelihood that the global economy had entered a recession rose over the course of 2018.



Customized client version of IE90

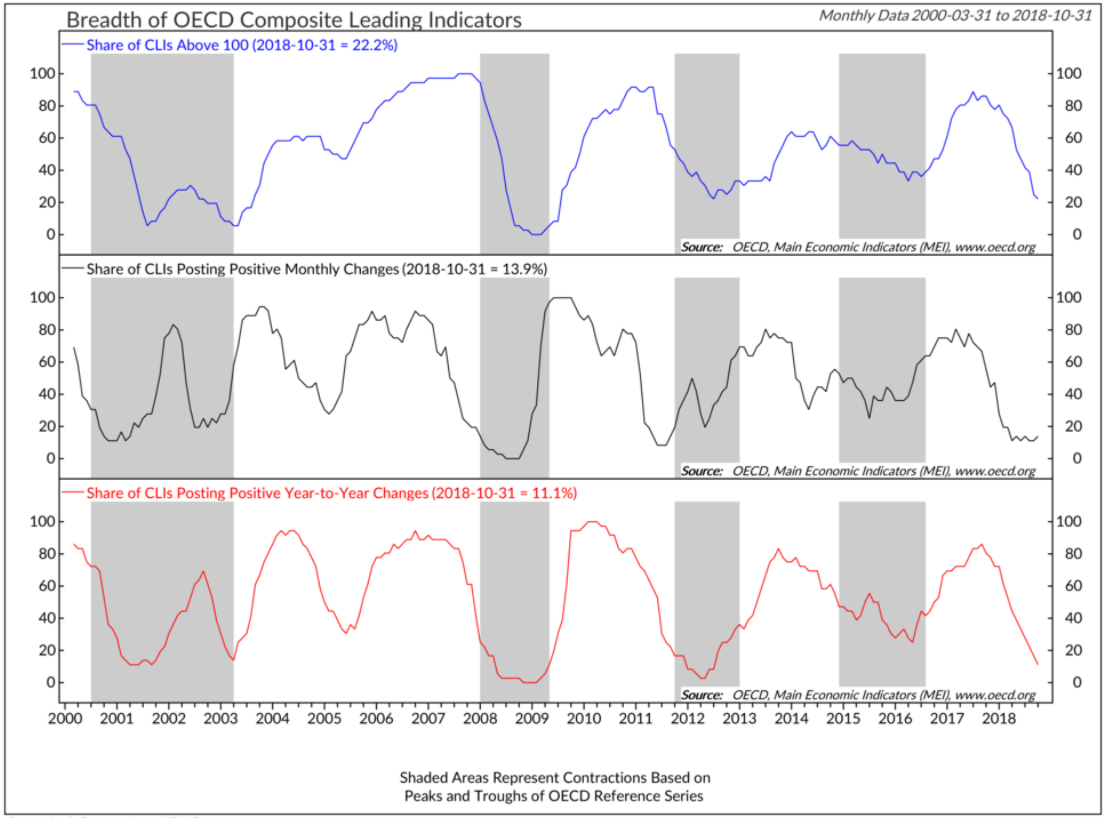
Source: Ned Davis Research

Disappointing global growth has been evident in the Economic Surprise Indexes. We want to see if these can move back into positive territory in 2019.



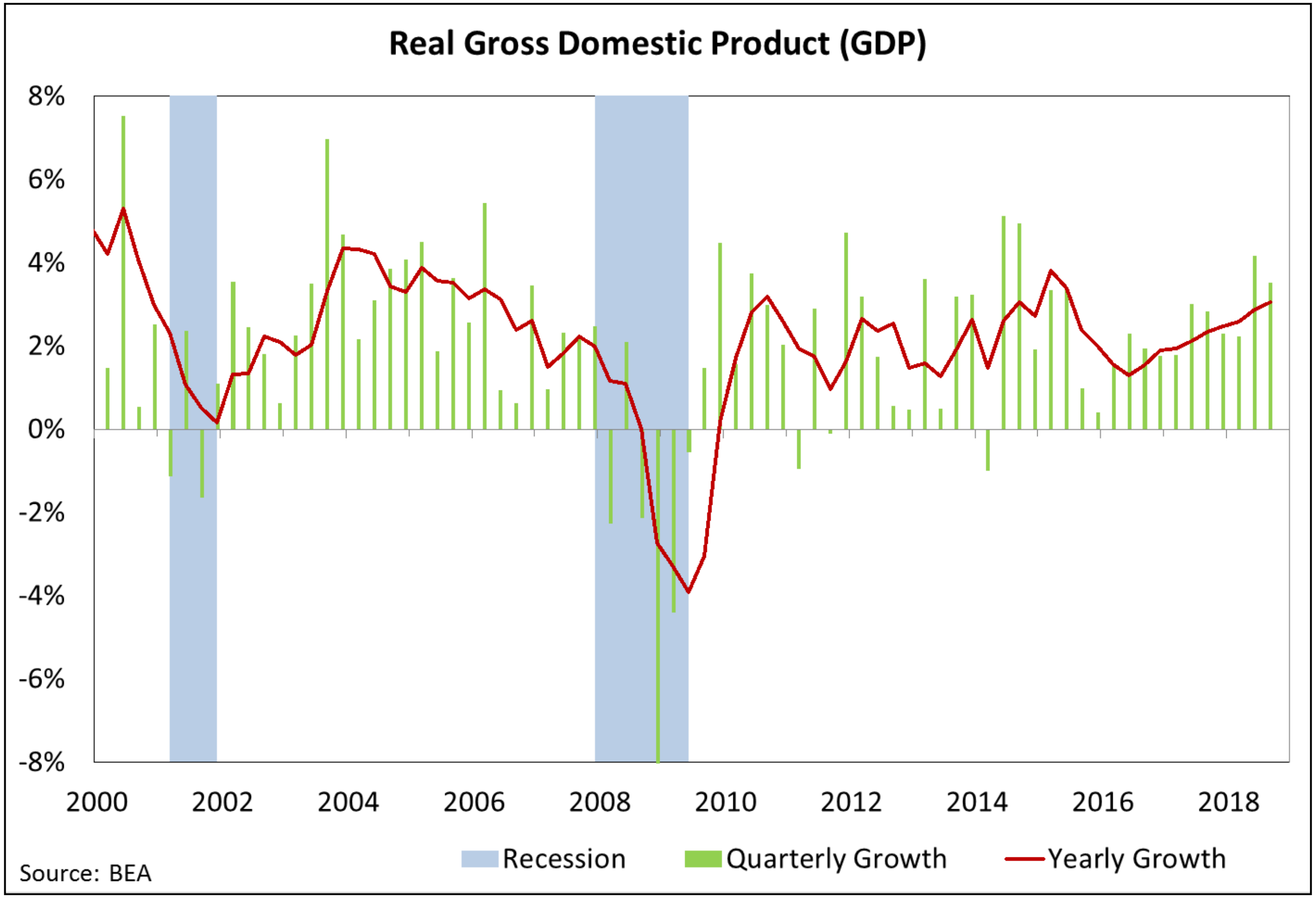
Source: Ned Davis Research

Additional evidence that growth is becoming re-synchronized would be an upturn and more positive tone from the country-level leading indicators.

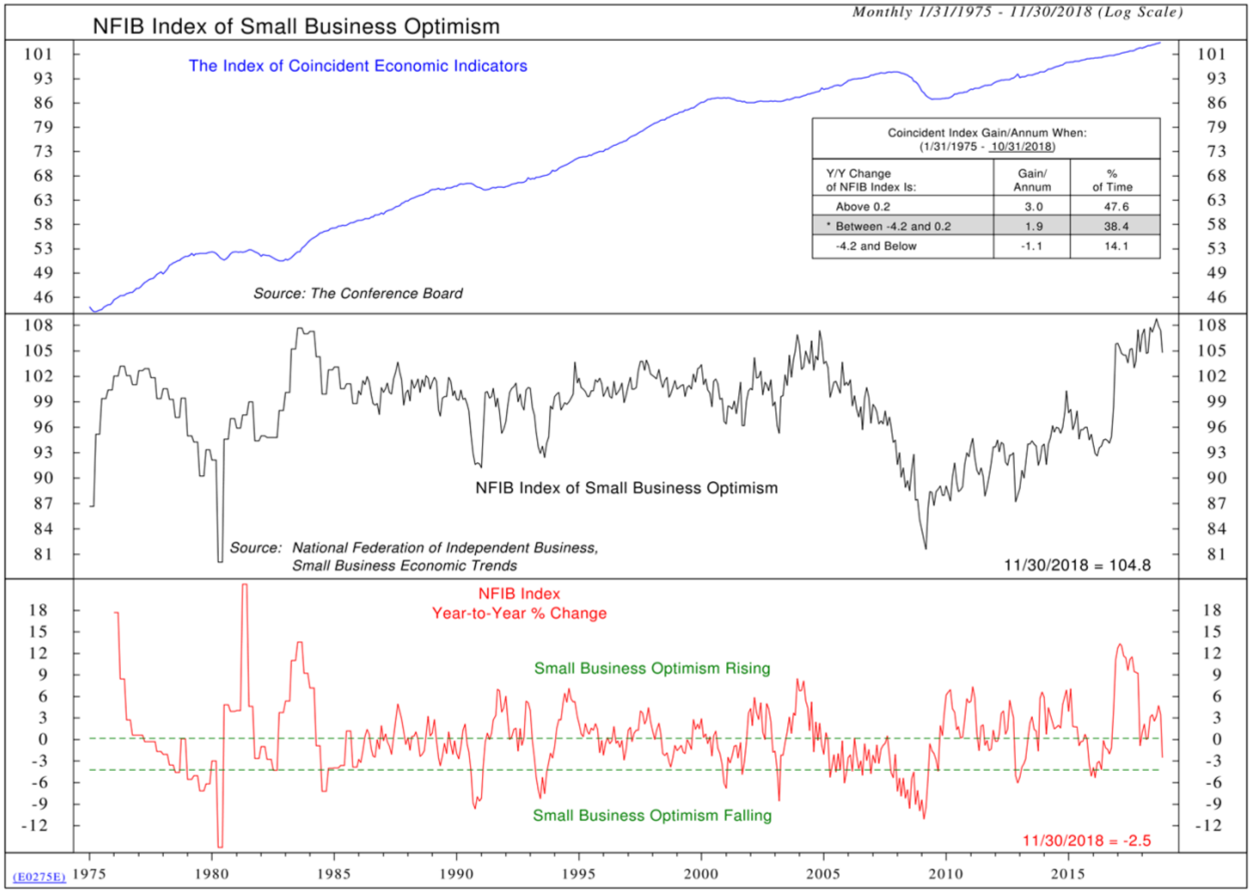


Customized client version of IE11B

Global growth has faltered, but U.S. growth has kept accelerating. Yearly growth in GDP has moved higher in eight consecutive quarters.

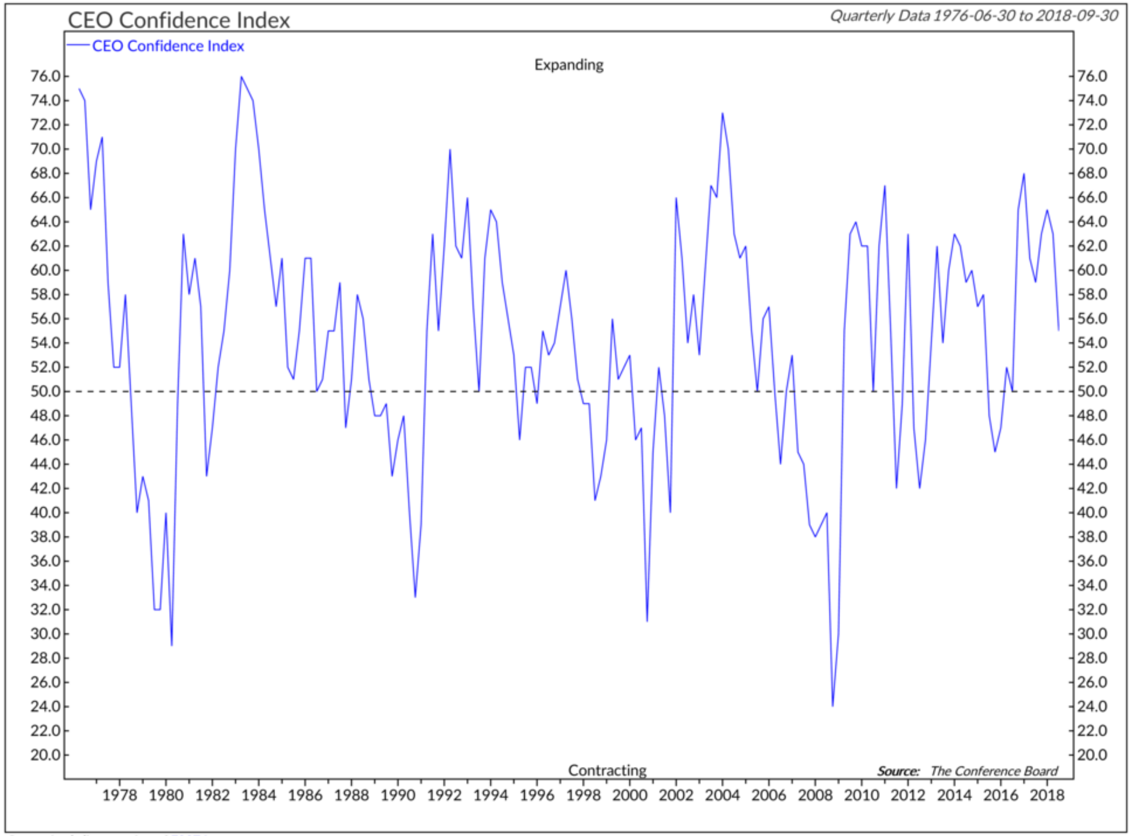


Weighing on growth in 2019 is the lack of additional tax cut stimulus and evidence that business optimism is moderating.



Source: Ned Davis Research

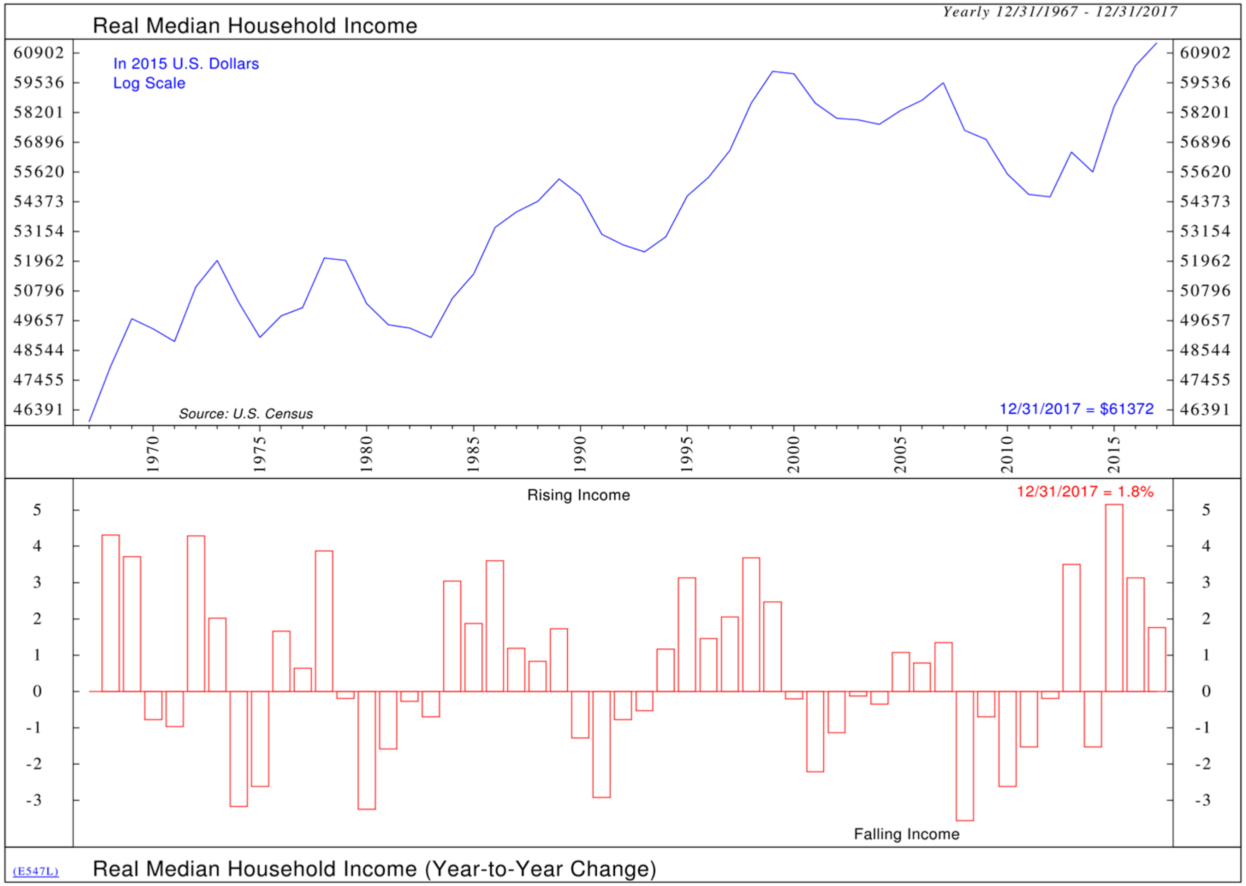
Echoing the pullback in small business optimism is the decline in CEO confidence. Animal spirits may not be the tailwind in 2019 that they were in 2018.



Customized client version of E0276

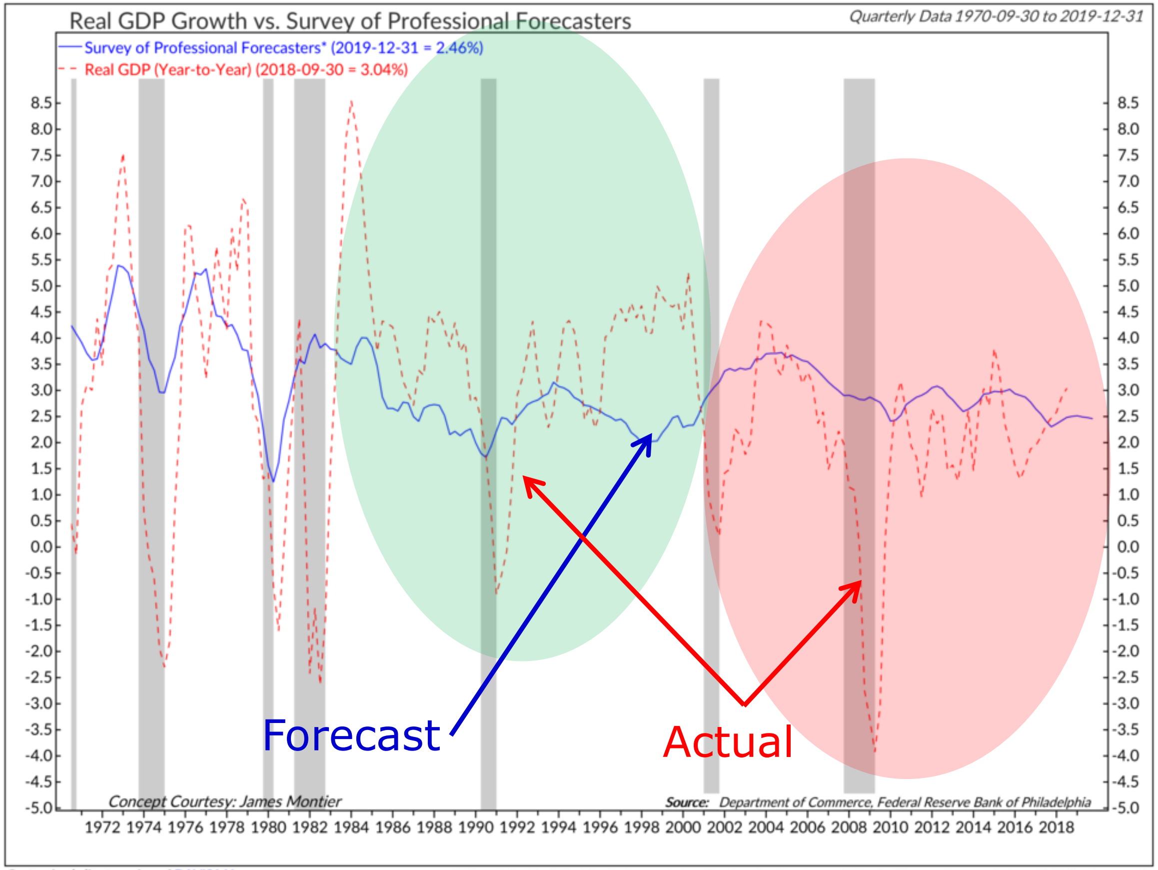
Source: Ned Davis Research

Real median household income moving to a new high in 2017 is further evidence that a bullish secular shift has occurred in the economy.



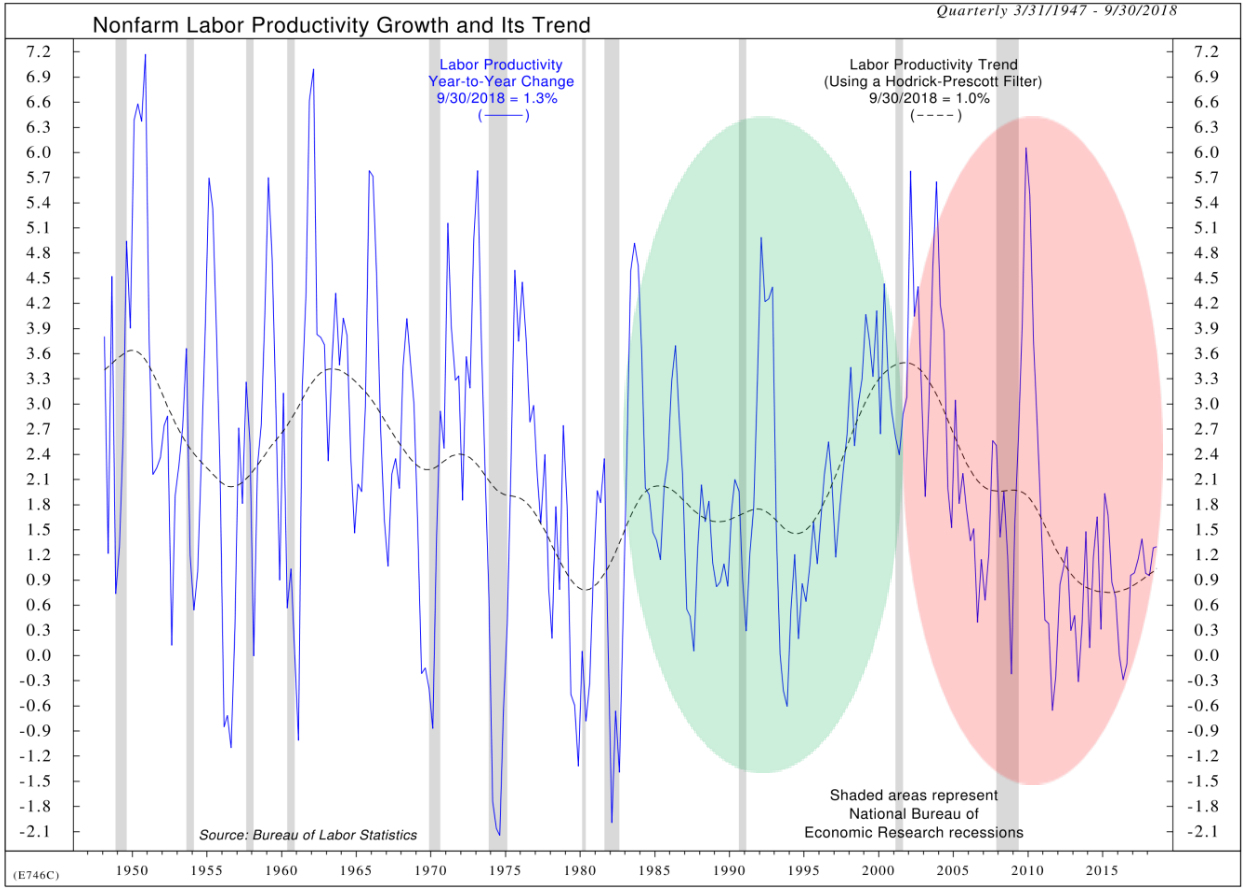
Source: Ned Davis Research

Actual growth has moved ahead of forecast growth even as forecasts call for slower growth. This supports a view that economic surprises may be to the upside.



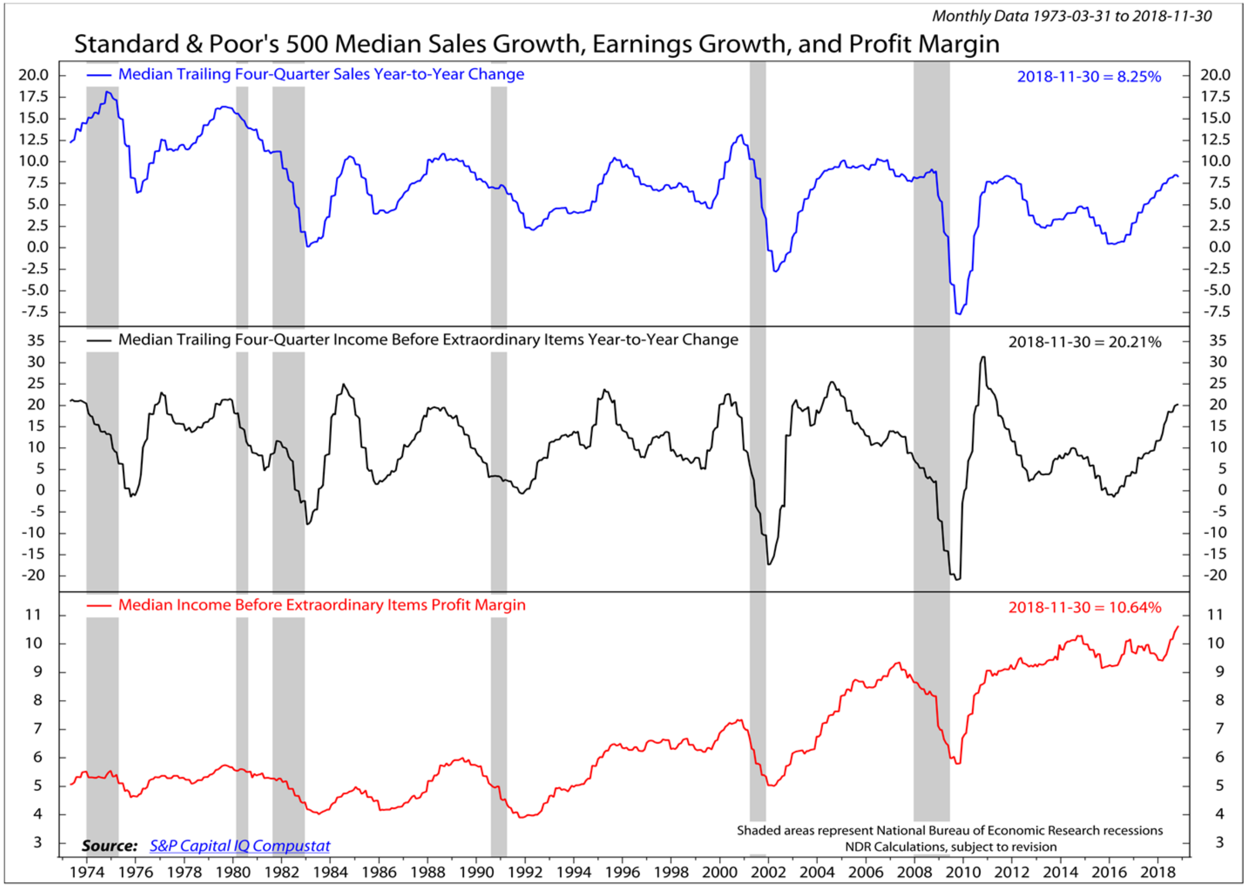
Source: Ned Davis Research

Fueling this secular upswing in the economy has been resurgent productivity growth, the trend of which has turned higher after a decade-plus of declining.

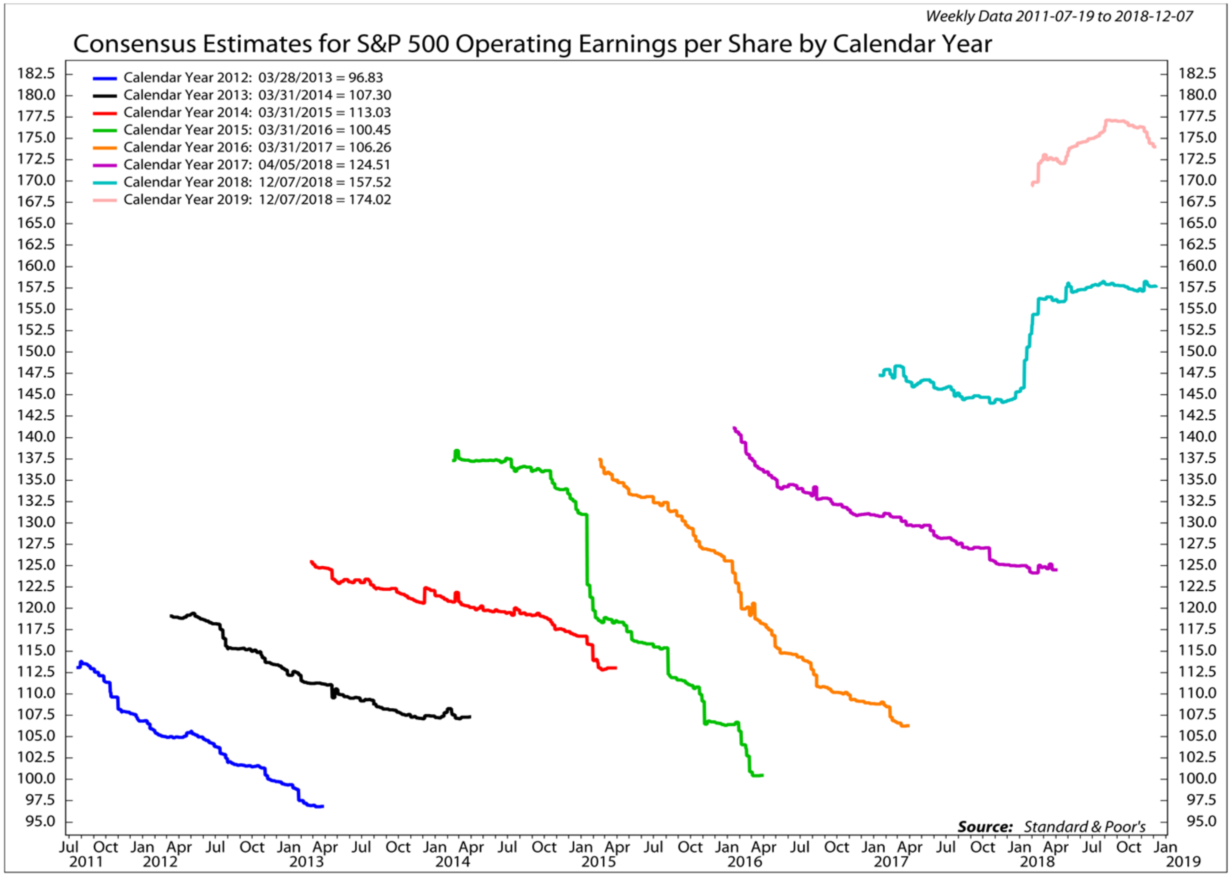


Source: Ned Davis Research

The improving trend in economic growth combined with the tax cuts to deliver strong corporate results in 2018, with both top- and bottom-line growth improving.

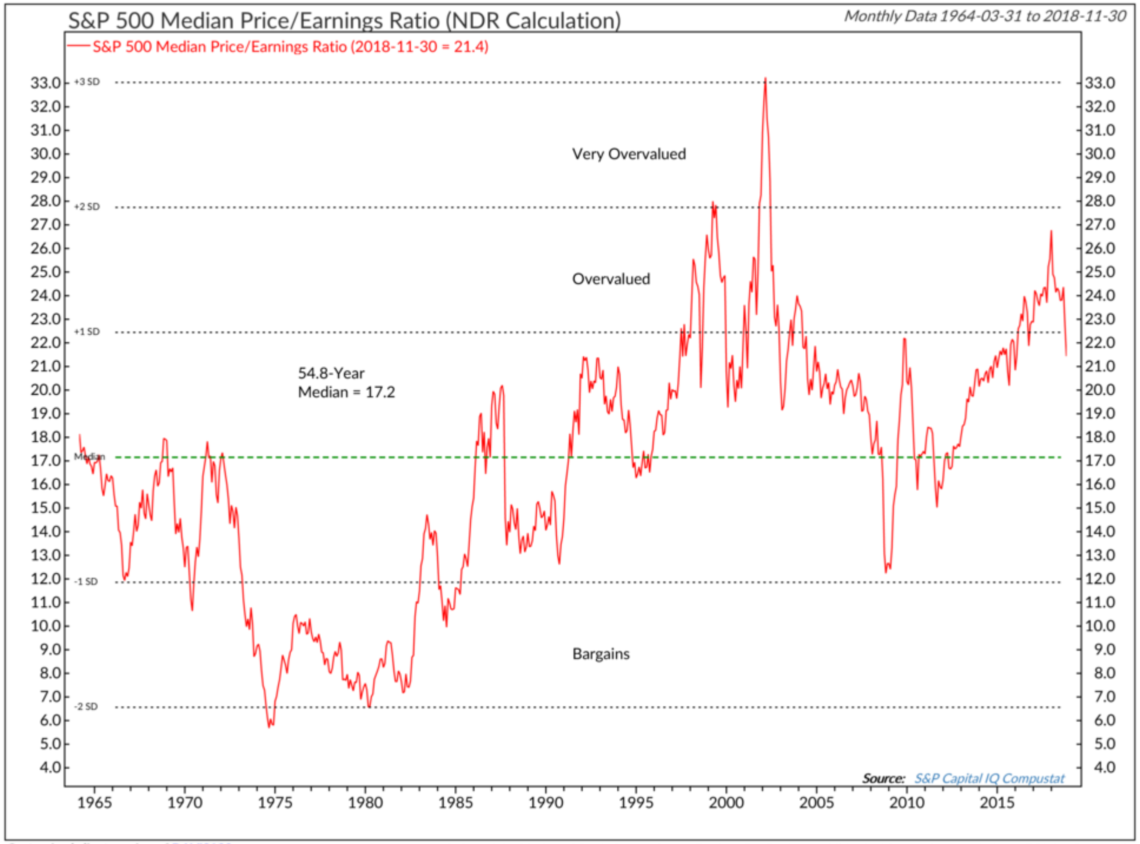


In a marked shift from previous years, earnings expectations for 2018 actually rose over the course of the year. Hoping for a repeat of this in 2019.



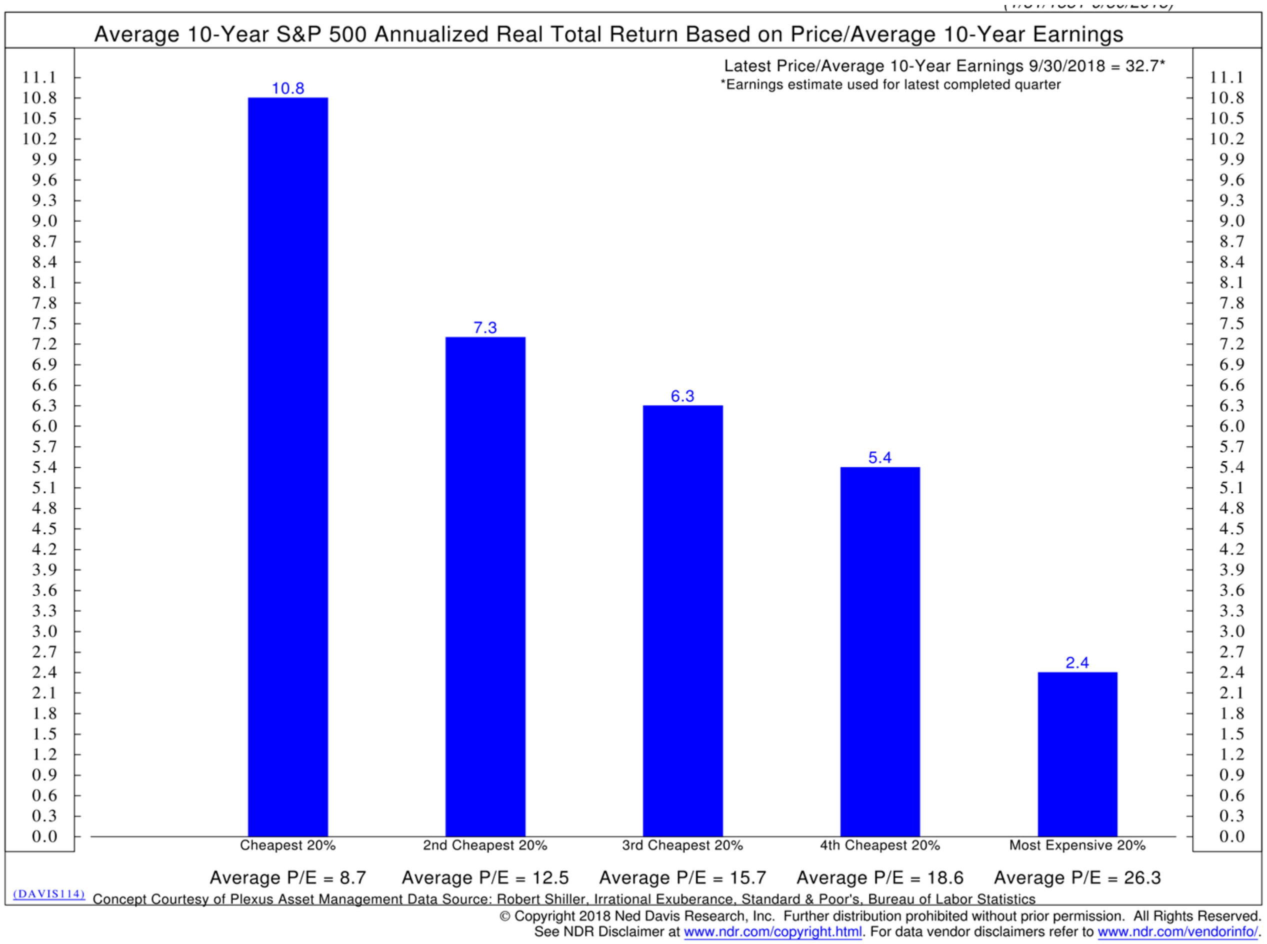
Source: Ned Davis Research

Stock market volatility and improving earnings growth helped bring down valuations. Stocks, however, are still not cheap from a historical perspective.

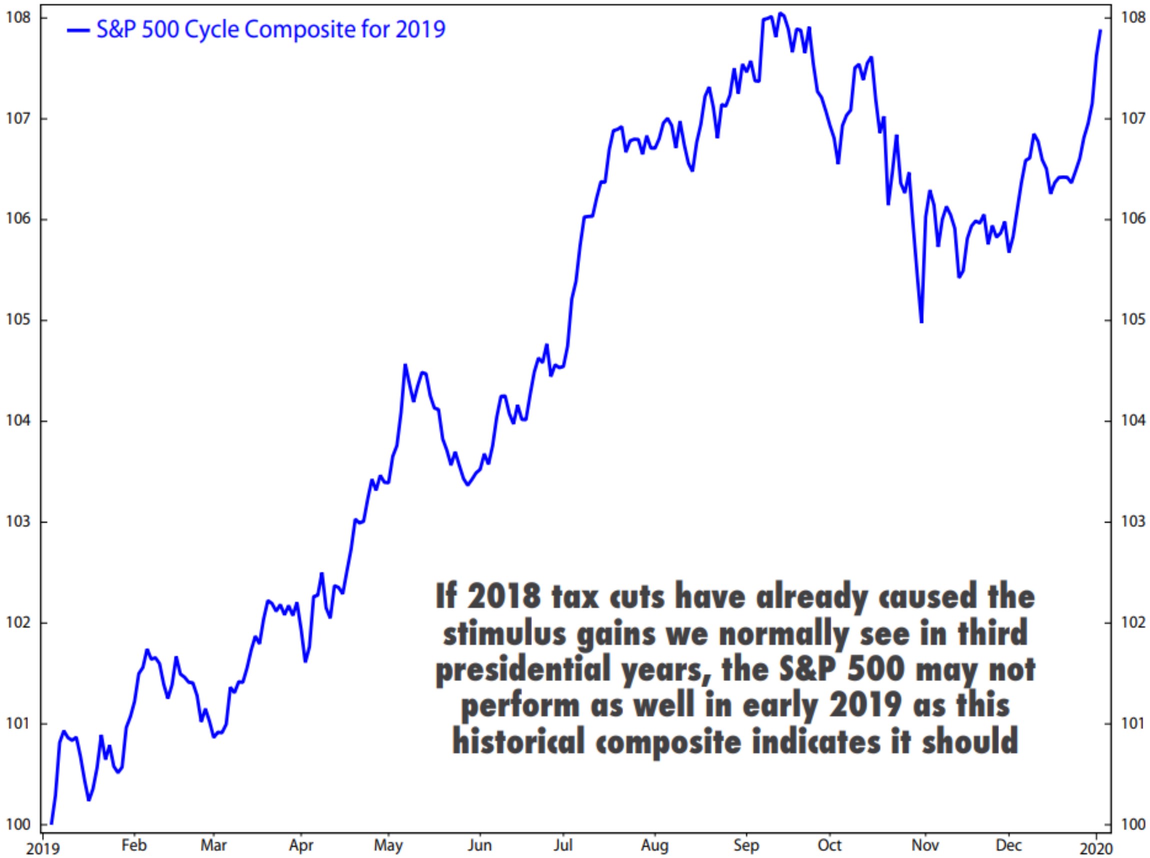


Customized client version of DAVIS100

Valuations are best viewed from the perspective of longer-term risk/reward. Current valuations are consistent with muted forward returns.



While the seasonal pattern argues for strength in early 2019, recent leadership and the ongoing cyclical bear market are not consistent with that trend.



2019 cycle composite puts equal weight on the one-year seasonal cycle, four-year presidential cycle, and 10-year decennial cycle. Trend is more important than level.

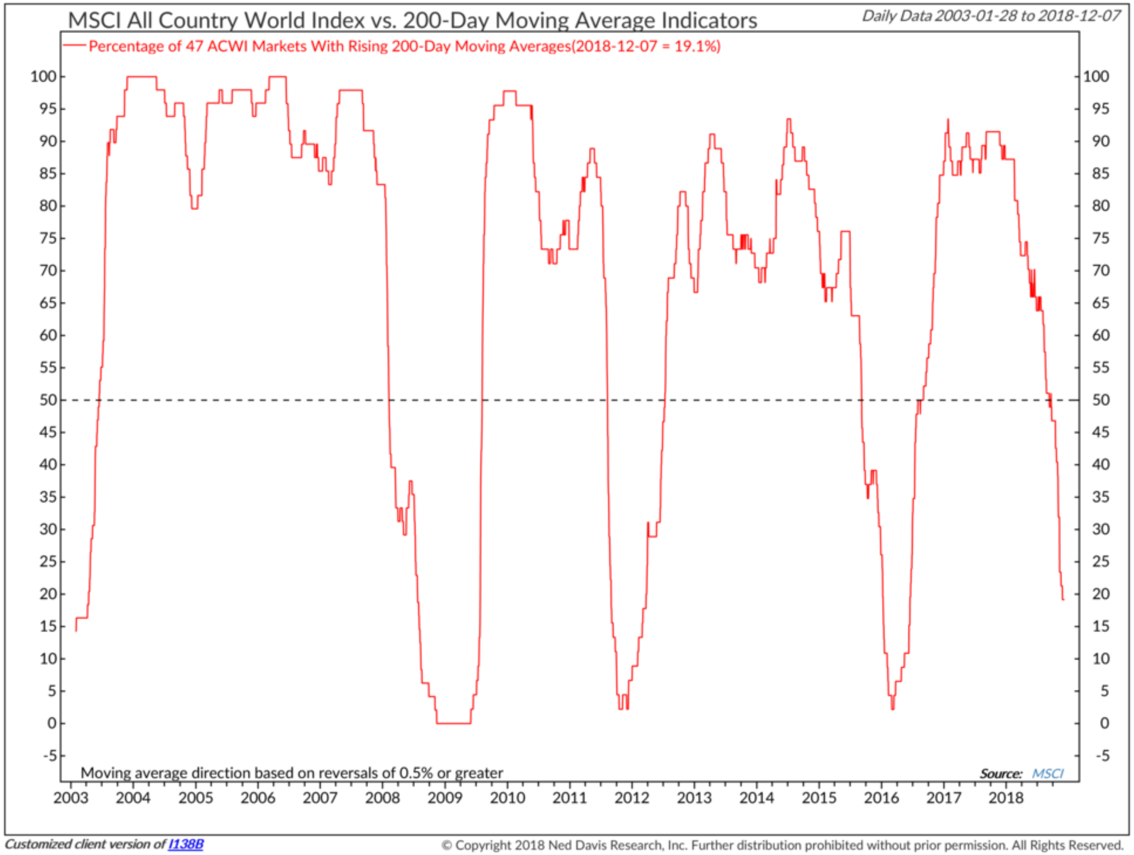
Source: *S&P Dow Jones Indices*

CYCLE_2019

The September peak in the S&P 500 came with a momentum divergence, and selling since then has broken the cyclical trend that emerged in 2016.

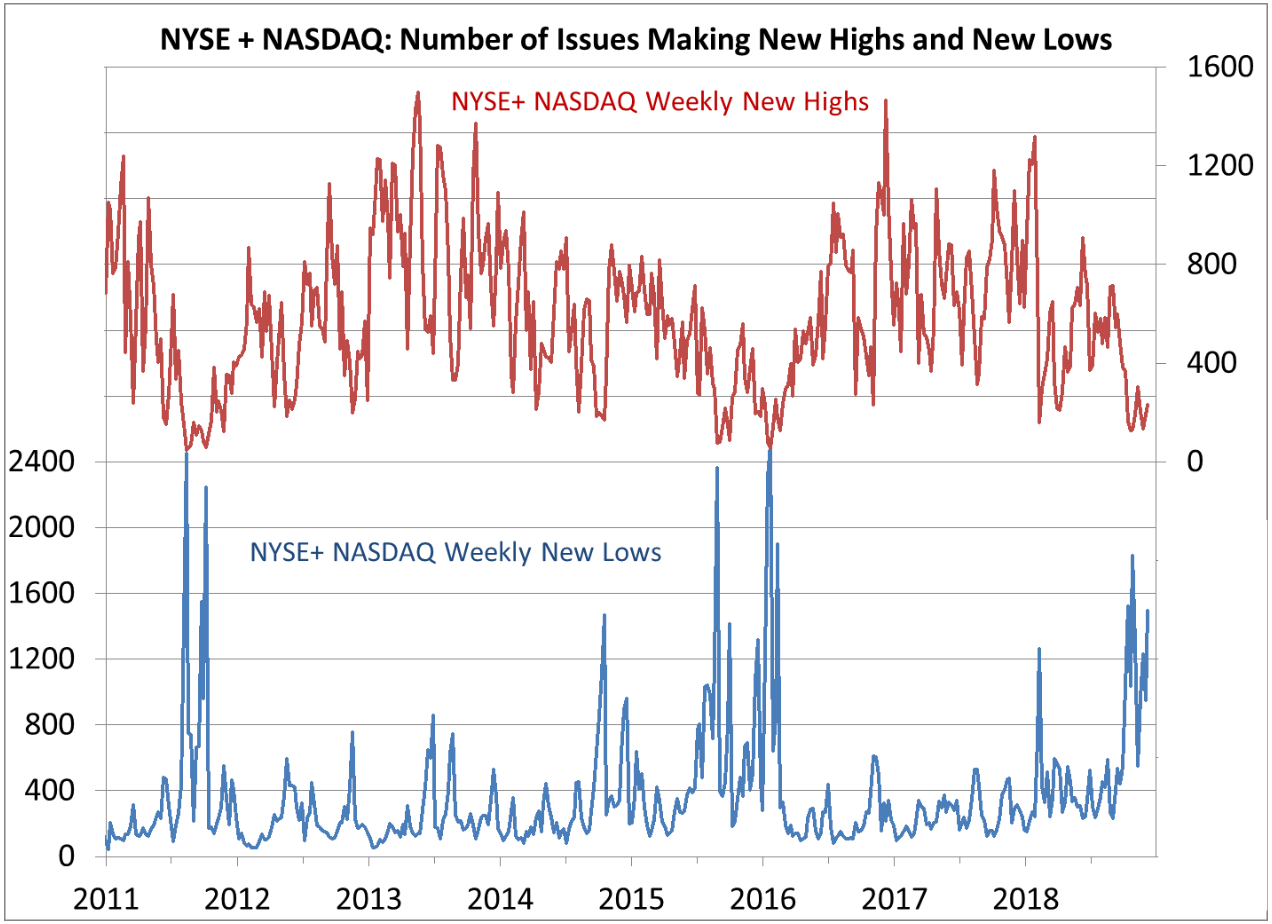
Source: StockCharts

As stocks in the U.S. were making new high mid-year, an increasing percentage of global markets were already rolling over and trending lower.



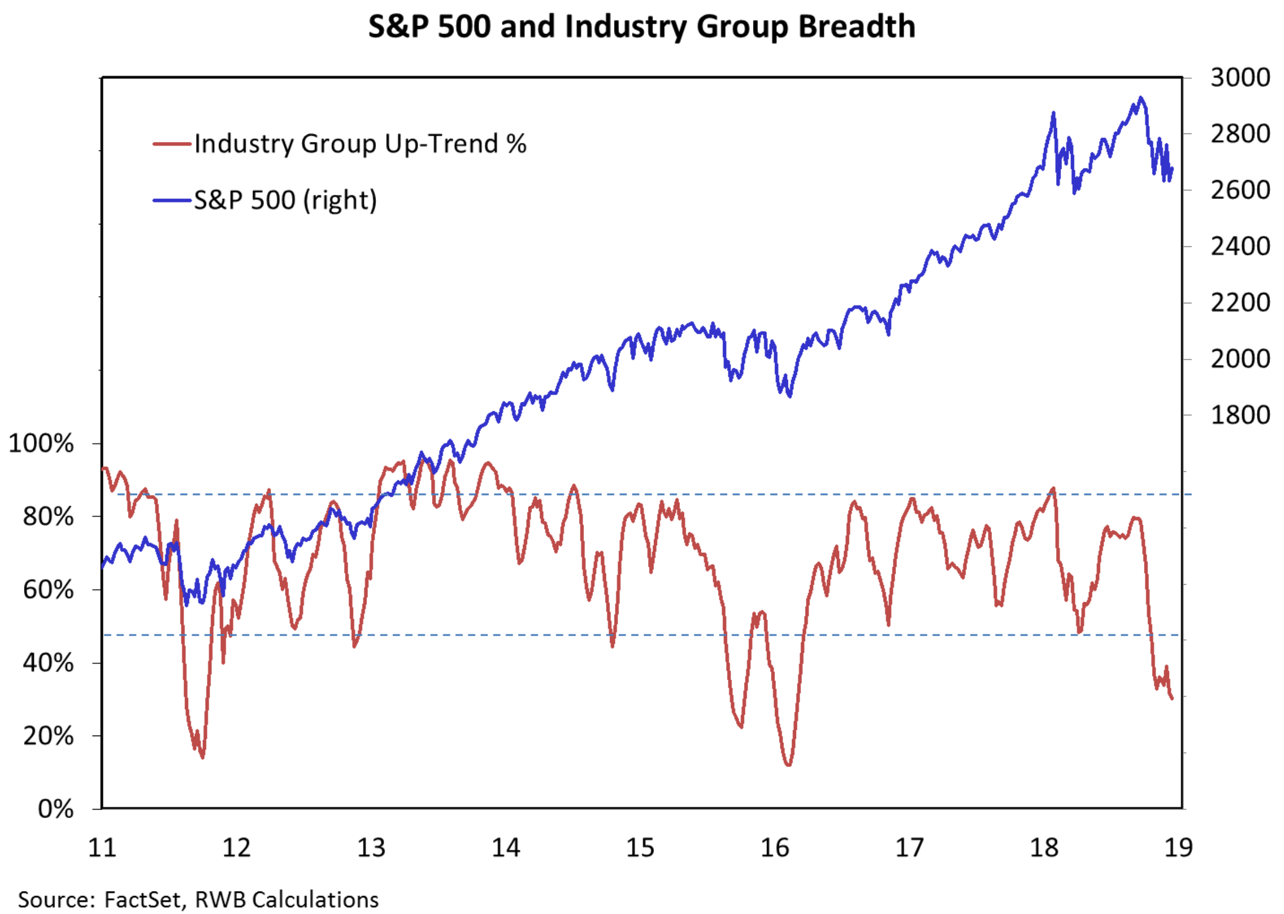
Source: Ned Davis Research

In the U.S., index-level highs were accompanied by a narrowing in the new high list, and selling since has produced a sharp expansion in the new low list.

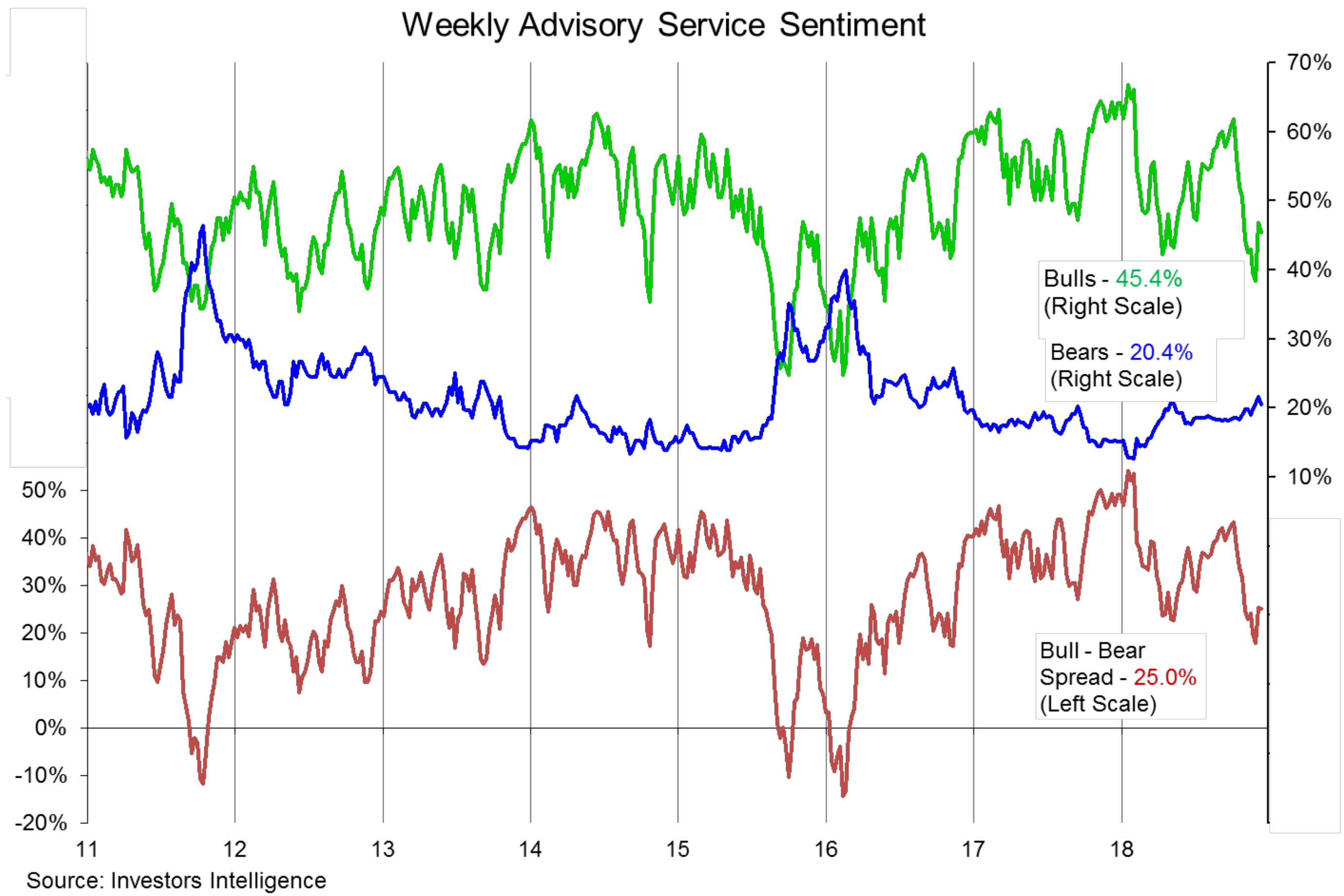


Source: Barron’s

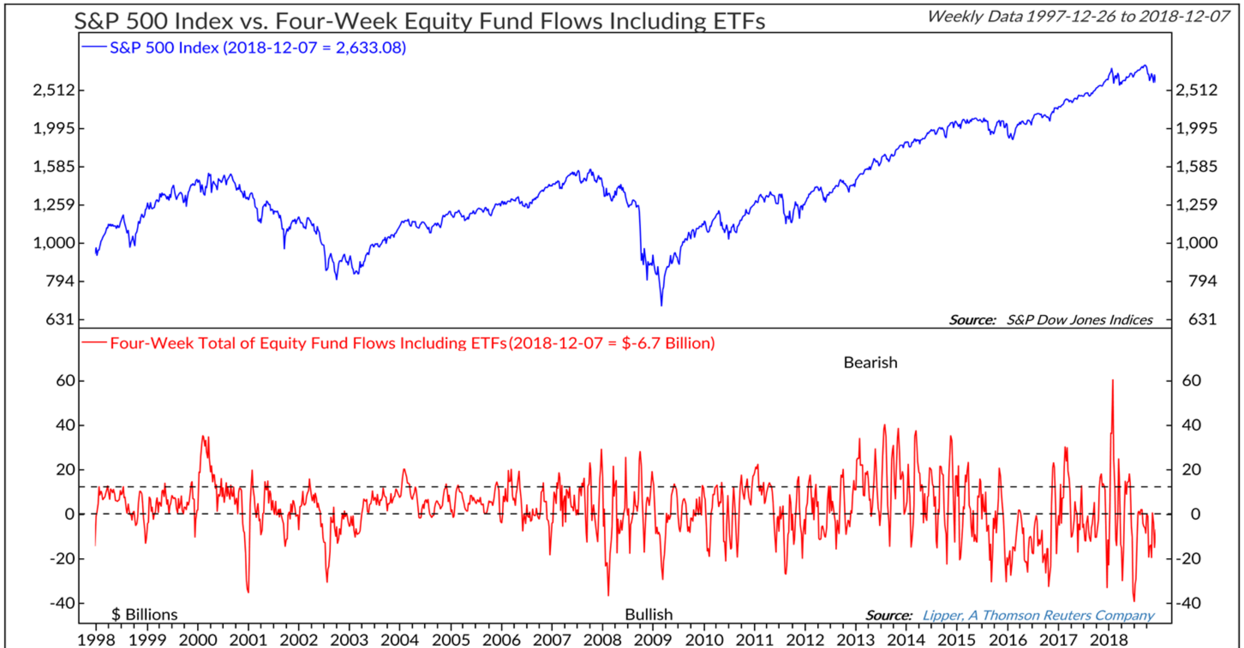
The percentage of industry groups in up-trends continues to decline. Seeing improvement here is key if cyclical conditions are going to improve in 2019.



By the time the past two cyclical bear markets (2011 & 2015/16) had run their course, the bull-bear spread had turned negative, indicating excessive pessimism.



After an initial surge in inflows, equity funds have seen outflows for much of 2018. This suggests some skepticism among investors.



S&P 500 Index Performance
Full History: 1997-12-26 to 2018-12-07

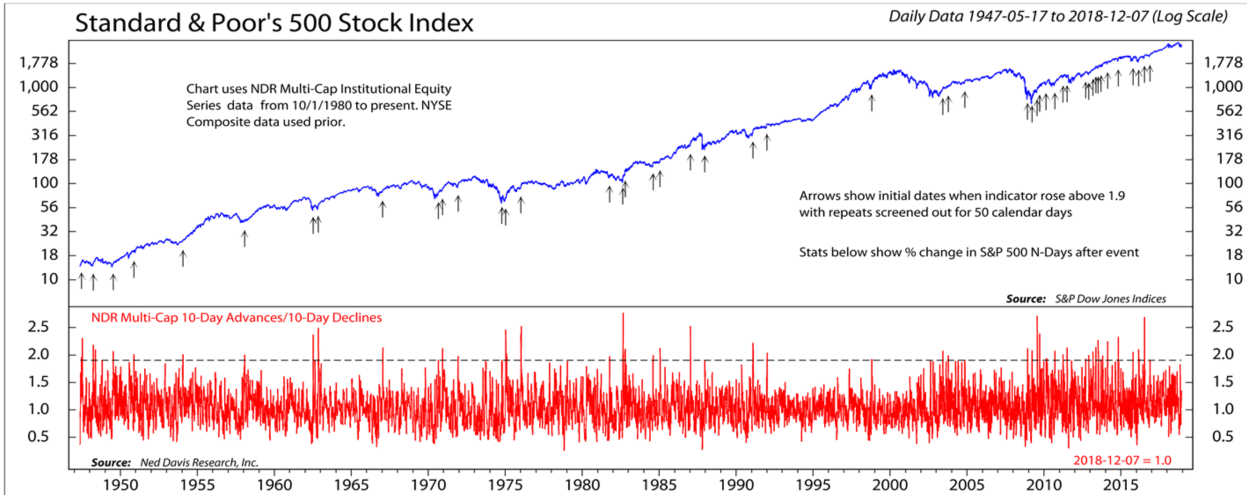
Four-Week Flows Are:	% Gain/ Annum	% of Time
Above 12.4	-16.12	18.74
0.4 - 12.4	-0.01	44.58
Below 0.4	25.16	36.67

Buy/Hold = 5.06% Gain/Annum

DAVIS207A

After seeing excessive pessimism followed by capitulation, an upside breadth thrust would signal that the ensuing rally could lead to a new cyclical bull.

Standard & Poor's 500 Stock Index



Event Date	10-Day A/D	5 Days	10 Days	22 Days	63 Days	126 Days	252 Days
1947-06-23	1.96	-0.2	2.8	5.8	-0.4	-2.6	4.2
1948-03-29	2.05	3.1	4.0	7.3	16.1	7.6	0.6
1949-07-13	2.06	1.3	1.9	3.7	7.3	12.7	26.7
1950-11-20	2.01	1.3	-2.0	-1.5	11.0	10.2	19.4
1954-01-25	2.00	0.2	1.2	-0.1	7.5	17.0	37.0
1958-01-24	2.00	-0.0	0.0	-2.6	3.4	11.8	33.7
1962-07-10	1.98	-0.7	-1.5	0.5	-0.2	12.9	22.2
1962-11-07	1.91	2.5	3.6	6.1	12.7	19.8	24.4
1967-01-13	1.94	1.8	1.9	4.3	7.0	9.7	14.1
1970-08-31	1.91	1.9	-0.2	3.4	7.0	19.0	22.1
1970-12-03	1.95	1.1	1.3	3.9	11.3	13.9	7.8
1971-12-08	1.98	1.7	4.4	6.6	12.4	11.1	21.8
1974-10-14	1.91	1.0	-3.6	0.8	-1.5	18.6	23.0
1975-01-08	1.98	3.0	2.4	12.3	18.3	35.4	34.1
1976-01-06	2.05	2.2	5.7	7.3	10.7	10.7	13.0
1981-10-09	1.97	-1.9	-2.3	1.0	-3.8	-4.5	7.9
1982-08-24	1.96	3.6	5.9	6.9	16.4	26.1	42.5
1982-10-18	2.11	-2.5	-0.9	0.9	7.3	16.8	24.2
1984-08-07	1.95	1.1	3.1	1.0	3.6	11.0	15.5

Event Date	10-Day A/D	5 Days	10 Days	22 Days	63 Days	126 Days	252 Days
1985-01-21	2.00	1.2	2.9	2.8	3.1	10.9	17.4
1987-01-13	2.02	3.5	5.3	6.0	9.9	19.5	-5.6
1987-12-18	1.90	-1.4	3.8	-2.4	7.9	7.9	10.9
1991-02-04	1.95	5.8	6.0	7.9	9.1	10.5	17.6
1992-01-03	1.92	-1.0	-0.1	-1.3	-4.5	-1.8	3.9
1998-10-22	1.93	0.7	5.1	10.2	14.4	26.1	20.7
2003-06-04	2.06	1.1	2.4	1.8	4.1	8.2	13.2
2003-10-14	1.99	-0.3	-0.3	0.9	7.7	7.6	5.1
2004-11-05	1.91	1.5	0.4	1.4	3.0	1.1	4.6
2008-12-05	2.12	0.4	1.3	3.8	-17.9	7.6	25.9
2009-03-23	2.08	-4.3	1.5	3.5	8.5	29.4	42.7
2009-07-21	1.91	2.6	5.3	5.5	15.0	19.2	12.0
2009-09-16	2.35	-0.7	-1.1	1.8	3.7	9.1	5.2
2010-02-19	1.92	-0.4	2.7	5.9	-3.4	-3.0	20.8
2010-09-14	1.97	1.7	2.4	4.7	10.6	14.3	4.6
2011-03-30	2.01	0.5	-1.0	2.5	-1.6	-13.3	5.6
2011-07-01	2.14	-1.5	-2.6	-5.9	-15.5	-6.1	1.9
2012-09-14	1.93	-0.4	-1.7	-0.7	-2.4	6.3	17.7
2012-11-30	2.00	0.1	-0.2	3.0	8.7	15.2	27.2

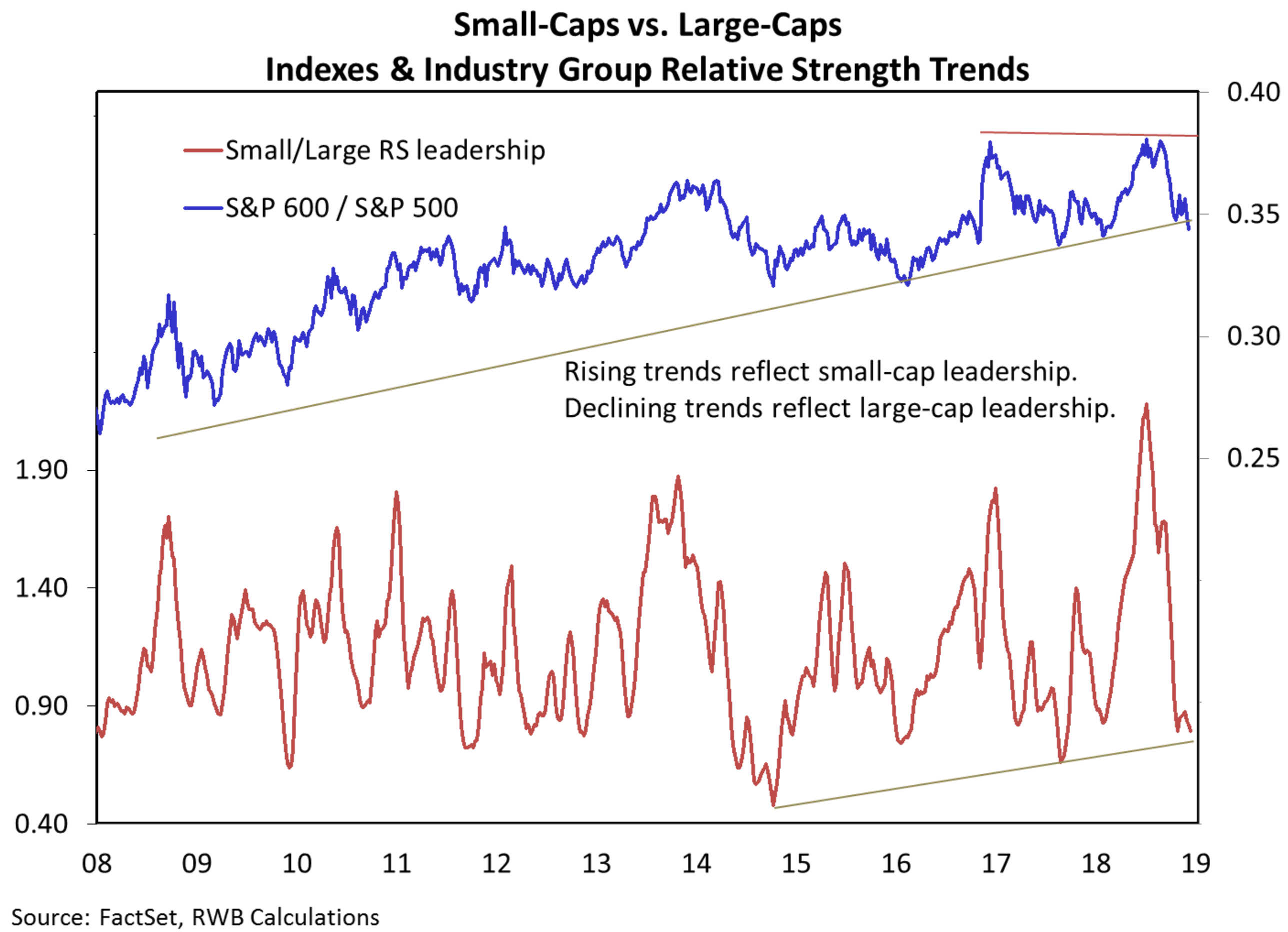
Event Date	10-Day A/D	5 Days	10 Days	22 Days	63 Days	126 Days	252 Days
2013-03-11	2.06	-0.3	-0.3	2.4	5.6	7.4	20.0
2013-05-15	2.14	-0.2	-0.3	-1.2	1.6	6.6	12.8
2013-07-09	2.27	1.4	2.4	2.7	1.4	11.2	19.4
2013-09-17	1.92	-0.4	-0.6	1.7	4.8	9.2	17.4
2014-02-18	2.25	0.2	1.8	1.7	2.4	7.1	14.1
2014-10-27	2.05	2.9	3.9	5.7	2.1	7.4	5.3
2015-10-12	2.05	0.8	2.7	2.9	-3.9	3.2	5.9
2016-02-26	2.11	2.7	3.8	5.9	7.3	11.5	21.6
2016-07-11	2.01	1.4	1.5	1.8	0.8	6.2	13.5
2016-11-17	1.91	1.2	0.2	3.8	8.2	9.5	17.9

Summary Item	5 Days	10 Days	22 Days	63 Days	126 Days	252 Days
Mean	0.82	1.57	3.05	4.93	10.53	16.54
Median	1.05	1.66	2.84	6.27	10.36	17.43
Number Up	32	32	40	37	42	47
Number Down	16	16	8	11	6	1
All Periods Mean	0.17	0.33	0.73	2.09	4.28	8.81

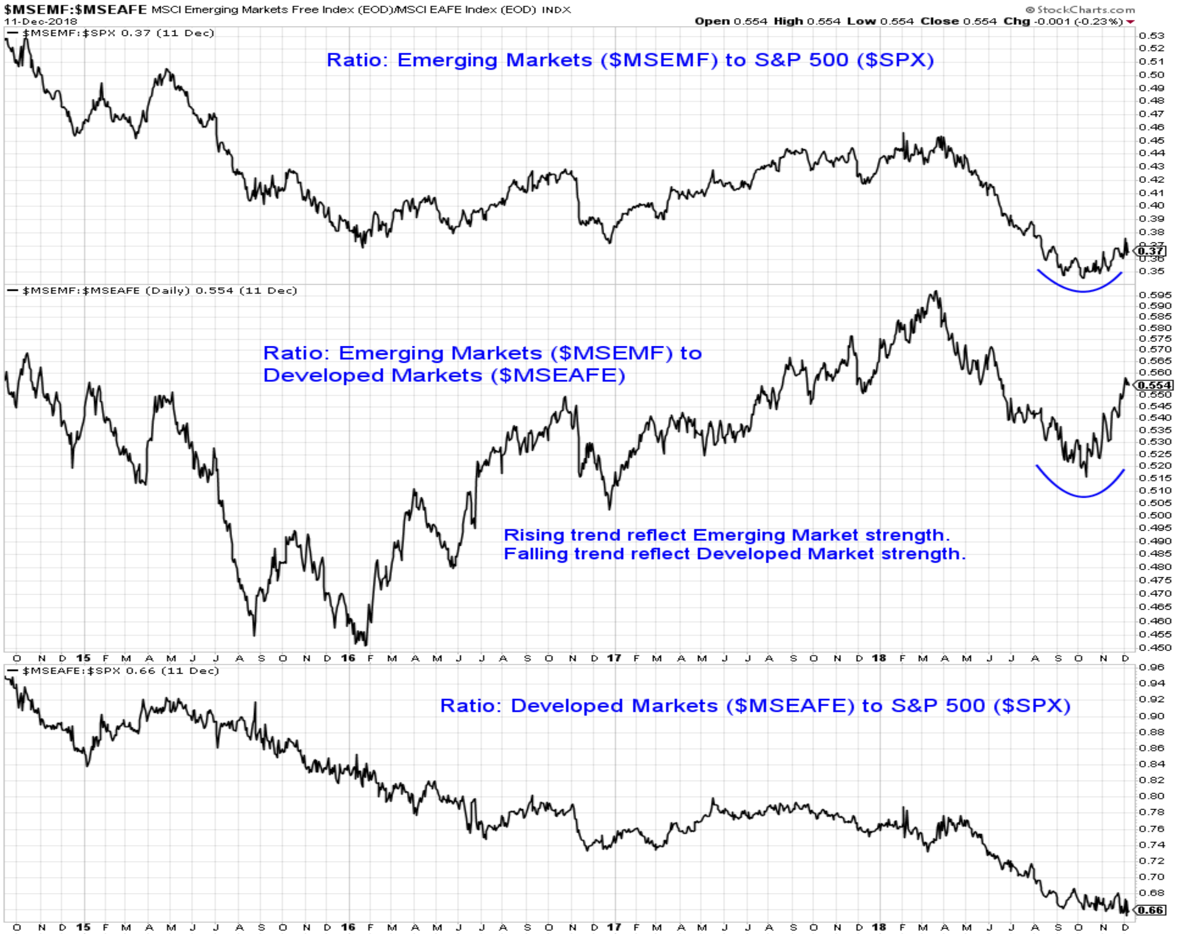
S48

Source: Marketplace

Small-caps gaining strength relative to large caps would suggest historically bullish seasonal tailwinds are emerging.



If the cyclical bear yields to a cyclical bull market in 2019, it could be signaled by more substantial leadership from Emerging Markets.



Appendix - Important Disclosures

Analyst Certification

The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

Disclaimers

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST

The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 and any other indices mentioned are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

United Kingdom ("UK") disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds a MiFID passport.

The contents of this report may contain an "investment recommendation", as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). This report does not contain a “personal recommendation” or “investment advice”, as defined by the Market in Financial Instruments Directive 2014/65/EU (“MiFID”). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. The views contained in this report: (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated; and (ii) may differ from the views of another individual of Robert W. Baird Limited.

This material is distributed in the UK and the European Economic Area (“EEA”) by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB and is authorized and regulated by the Financial Conduct Authority (“FCA”) in the UK.

For the purposes of the FCA requirements, this investment research report is classified as investment research and is objective. This material is only directed at and is only made available to persons in the EEA who would satisfy the criteria of being "Professional" investors under MiFID and to persons in the UK falling within Articles 19, 38, 47, and 49 of the Financial Services and Markets Act of 2000 (Financial Promotion) Order 2005 (all such persons being referred to as “relevant persons”). Accordingly, this document is intended only for persons regarded as investment professionals (or equivalent) and is not to be distributed to or passed onto any other person (such as persons who would be classified as Retail clients under MiFID).

All substantially material sources of the information contained in this report are disclosed. All sources of information in this report are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated. There is no intention to update this report in future. Where, for any reason, an update is made, this will be made clear in writing on the research report. Such instances will be occasional only.

Investment involves risk. The price of securities may fluctuate and past performance is not indicative of future results. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. You are advised to exercise caution in relation to the research report. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Robert W. Baird Limited and Robert W. Baird & Co. Incorporated have in place organisational and administrative arrangements for the prevention, avoidance, and disclosure of conflicts of interest with respect to research recommendations. Robert W. Baird Limited's Conflicts of Interest Policy, available here, outlines the approach Robert W. Baird Limited takes in relation to conflicts of interest and includes detail as to its procedures in place to identify, manage and control conflicts of interest. Robert W. Baird Limited and or one of its affiliates may be party to an agreement with the issuer that is the subject of this report relating to the provision of services of investment firms. Robert W. Baird & Co. Incorporated's policies and procedures are designed to identify and effectively manage conflicts of interest related to the preparation and content of research reports and to promote objective and reliable research that reflects the truly held opinions of research analysts. Robert W. Baird & Co. Incorporated's research analysts certify on a quarterly basis that such research reports accurately reflect their personal views. This material is strictly confidential to the recipient and not intended for persons in jurisdictions where the distribution or publication of this research report is not permitted under the applicable laws or regulations of such jurisdiction.

Robert W. Baird Limited is exempt from the requirement to hold an Australian financial services license and is regulated by the FCA under UK laws, which may differ from Australian laws. As such, this document has not been prepared in accordance with Australian laws.