Baird Market and Investment Strategy

Breaking News: Stock Market Update

May 31, 2019

Please refer to Appendix – Important Disclosures.

Economy, Stock Market and Asset Allocation

Economy

The first four months of the year stocks enjoyed a strong tailwind as the overwhelming consensus had the U.S. and China trade agreement settled before summer. This was an expected break in the downward spiral that the global economy has been experiencing the past 18 months. Additionally, a solid trade deal would spark a strong second half business recovery in the U.S. and allow corporate earnings to grow at double digits by the fourth quarter. The breakdown in the trade discussions has significantly altered the economic prospects for the U.S. and the rest of the world. As a result, the stock market has moved from a consolidation phase to a correction that could have more room on the downside. How long the trade impasse lasts is anyone's guess but we suspect that when the pain becomes so acute for both economies that a deal will eventually materialize. At such time when the economic pain becomes too great for China and the U.S. that consumer confidence shows significant deterioration the parties will come back to the table. But even if a deal is consummated, trade tensions with China are long from over.

Stock Market

Prior to the breakdown in the trade negotiations the underbelly of the stock market was suggesting the economy was not as strong as the first-quarter GDP numbers would indicate. This is seen by the fact that the utilities sector, that is an indicator of future bond yields, was making new highs while the transportation sector that is closely tied to the economy failed to confirm the new highs by the S&P 500 and NASDAQ. Additionally, the bond market was signaling most of the year that growth expectations were too robust. Investors have obviously been agreeing with the bond market as bond inflows are the strongest in nine years. Our largest concern was the action in the broad market that was sending a different message than the rally in the S&P or large-cap NASDAQ stocks. We should not lose sight of the fact that the strongest market moves are those that are broadly based. With less than 50% of the S&P 500 industry groups in uptrends the present situation does not meet those requirements. Eventually, the skies will clear and the trend will turn up. To be in front of this, we expect that investor sentiment will turn excessively pessimistic and that the broad market will stiffen as the averages hit new cycle lows.

Asset Allocation

Warren Buffett has indicated that his fund is sitting on $100 billion of cash waiting for valuations to meet his long-term investment goals. Cash can be a very important asset class as it offers investors to act when valuations become super attractive from time to time. Asset allocation models are obviously different and depend on risk tolerance levels, age, and jeopardy one sees in the current environment. In the present situation, the global economy is decelerating, tariffs are being expanded and business optimism has faded significantly from last year's peak as the influence of the tax cuts fades. The largest concern is given the current environment the level of complacency is too high. Given the S&P 500, NASDAQ and Dow Industrials are sitting on good gains despite the recent pullback, this is an opportunity to revisit asset allocation modes in terms of risk and goals.

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Appendix – Important Disclosures and Analyst Certification

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