CURBSTONE FINANCIAL MANAGEMENT CORPORATION

From the Curb

Letter to Clients

Quarter Ending March 31, 2019

It was a good start to the year. Stocks rebounded strongly in the first quarter thanks to a combination of improving U.S.-China trade relations, the Federal Reserve halting interest rate increases, and a better outlook for corporate earnings. The S&P 500 finished the first quarter of 2019 with the best quarterly return since 2009.

Starting with U.S.-China trade negotiations, significant progress was made towards a new deal over the past three months, highlighted by the removal of the March 1st trade deal deadline imposed by the administration back in late November. Most of that progress occurred in January and that was one of the initial catalysts for the first quarter rally in stocks.

Perhaps the most impactful event of the first quarter was the Fed meeting that took place on January 29 and 30 when the Federal Open Market Committee (FOMC) opted to hold interest rates steady, but also stated that it would be "patient" regarding further rate increases. This shift, which according to the Fed was in response to global economic uncertainty, helped extend the markets' gains from early January. The expected "pause" in rate hikes was later confirmed by the Fed at the March meeting as official projections for interest rates (known as the "dot plot") showed no more rate hikes are expected in 2019. The Fed keeping interest rates steady should relieve pressure on the economy, which has already shown some positive effects via a decline in mortgage rates and a rebound in housing sales in the first quarter.

Adding to the first quarter's strength, earnings results for the final quarter of 2018 were better than expected. More than 70% of S&P 500 companies reported earnings that beat estimates, while over 60% of companies reported stronger than expected revenues. Investors reaction to earnings disappointments also reflected a resilience to bad news. We can see that most clearly in the market reactions to companies that posted disappointing results. According to the research firm FactSet, S&P 500 companies saw the best stock price reaction to negative earnings per share surprises in nine years. Companies that missed analysts' expectations, fell, on average, just 0.40% during the most recent reporting period, compared to an average 2.6% decline over the past five years. Put plainly, an elevated number of bad earnings results were expected by the markets, but based on investor reactions, the results were not as bad as feared.

In sum, the market's performance during the first quarter was welcomed following the volatility and un-nerving declines in the fourth quarter of 2018. And, while the outlook

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for markets has improved, notable risks remain. We continue to expect and, are prepared for, more volatility. The issues that contributed to uncertainty in the fourth quarter of 2018 were three-fold: disappointing economic growth, underwhelming earnings results and confusion regarding the outlook for future Fed policy. While there has been improvement on two of those three fronts, none have been fully resolved.

And, there are still legitimate concerns about the pace of economic growth globally following the disappointing economic readings of the last three months. Additionally, while it is largely expected that the U.S. and China will sign a new trade deal that will result in tariff reductions, as of this writing, that has not occurred. And, as the past two years have taught us, this administration's approach is an unorthodox one and anything can happen.

Looking forward to the second quarter, we will be searching for signs that global economic growth has stabilized. The upcoming earnings season, which begins mid-month, will also be important as corporate earnings' results and commentary need to reinforce and confirm the optimistic economic and corporate views currently reflected in the stock market. Finally, regarding trade, we do not expect a new treaty, but we believe we could see some initial agreement on terms that will lead to an improved relationship with China.

So, we start this second quarter of 2019 thankful for the strong start to the year, but also mindful that now is not a time to become complacent – because risks to investors' portfolios remain. As advisors, we remain vigilant in respect to your chosen risk profile. We've worked with you to establish a personal allocation target based on your financial goals, risk tolerance, and investment timeline. We aim to take a diversified and disciplined approach with a clear focus on your longer-term goals.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review. If you would like a copy of our Privacy Notice, please let us know and we will send you a copy. We appreciate the opportunity to serve as your investment advisor.