MARKET OBSERVATIONS
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Vortex

The polar vortex hit the U.S. this winter with a vengeance. Chicago temperatures last month swung between a high of 55°F and a low of -21°F, and the latter was before adding a wind chill factor. Investors have been exposed recently to several turbulent vortexes as well. The most notable were the markets vortex, the economics vortex and the policies vortex. A perspective of the turbulence these vortexes unleashed can provide investment implications.

PERSPECTIVE

Turbulence of the markets vortex can be seen in Table I. Especially for stock markets, adverse turbulence of December was replaced by favorable turbulence of January. The diversification benefit of bonds versus stocks generally prevailed in December while bonds returned to their customary lower-risk/lower-return profile versus stocks in January. As has been the case historically, commodities displayed risk and return characteristics in the past two months somewhere between stocks and bonds but more closely aligned with stocks.

The economics vortex is reflected in Chart I. Favorable turbulence carried quarterly real U.S. economic growth in 2018 to some of the strongest rates since the Great Recession. Two quarters actually surpassed the long-term average quarterly growth rate. Less favorable turbulence is projected. At this time, the consensus forecast is for real growth to fall below the lower average growth rate of the current expansion. Importantly, no recession is anticipated even from the more pessimistic forecasters. Concern remains, however, that ongoing variables such as the U.S.-China trade dispute or the Brexit uncertainty could turn adverse economic turbulence into recession.

For some time, the Federal Reserve's pursuit of a higher interest rate regime evolved in a policies vortex with contained turbulence on market returns. Some of December's adverse market turbulence, however, was attributable directly to concerns that monetary policy was becoming too constraining relative to data feeding into the economics vortex. Chart II shows trends and expectations for the key federal funds policy rate. The consensus forecast for further rate increases was recorded before a major shift in Fed policy announced on January 30. While as many as four rate increases had been expected during 2019, the Fed now indicates it will be *"patient"* in determining *"what future adjustments . . . may be appropriate"*. The turbulence from the policies vortex still is being assessed by investors.

INVESTMENT IMPLICATIONS

Portfolios are managed amidst the turbulences of many vortexes – markets, economics, policies. As these turbulences are not controllable directly, the goal of portfolio management is to minimize their adverse impacts on achieving portfolio goals. Turbulence can and must be controlled around the goals vortex. Control is accomplished by establishing clear goals, time horizons and risk tolerance. Portfolios then can be structured to withstand turbulence over time.

TABLE I

COMPARATIVE RETURNS

	December 2018	January 2019
U.S. Stocks		
Large Cap	-9.0%	+8.0%
Small Cap	-11.9%	+11.3%
Foreign Stocks		
Developed Mkt.	-4.8%	+7.6%
Emerging Mkt.	-2.6%	+8.8%
Taxable U.S. Bonds		
High Quality	+1.8%	+1.1%
High Yield	-2.1%	+4.5%
Commodities	-6.9%	+5.5%
U.S. Dollar	-0.3%	-1.4%

CHART I

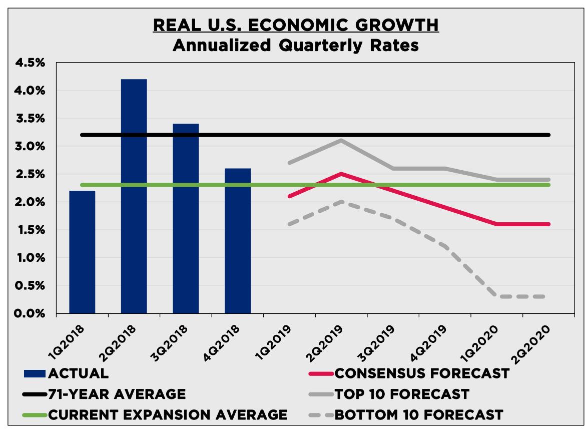
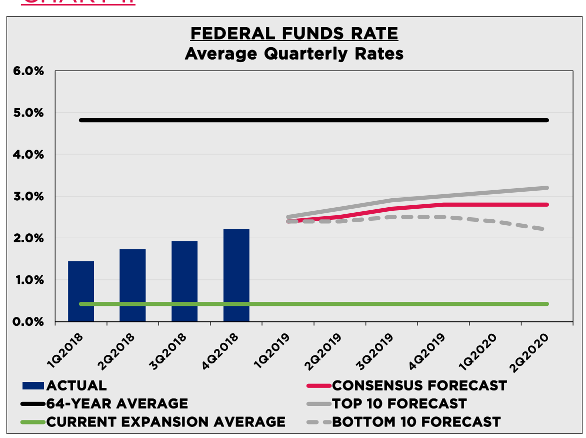


CHART II



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