BROADWAY BANK
WEALTH MANAGEMENT

Newsletter
FIRST QUARTER **2019**

Investment Management Group

REVIEW & OUTLOOK *written by Broadway Bank's Portfolio Managers*

First Quarter Madness

As college basketball "March Madness" ends, the markets themselves had their own bout of madness during the first quarter. Following the equity market's fourth quarter waterfall loss, a V-shaped recovery ensued during the first quarter. In fact, with a 13.7% gain, the S&P 500 recorded its best quarter since the third quarter of 2009 and its best first quarter since 1998.

Madness existed not only in the equity markets, but also in the fixed income markets. Toward the end of the quarter, the yield curve inverted. This means that the 3-month Treasury Bill had a higher yield than the 10-year Treasury Bond, which happens when the bond market prices in less future economic growth and lower inflation. Historically, an inverted yield curve is typically followed by a recession one to two years later.

These major effects had many drivers, but the Federal Reserve was the predominant one. In January, Federal Reserve members began to speak about taking a softer approach to monetary policy and stressed that they would now become data-dependent. This change marked the beginning of the Fed's "dovish" pivot. To cement this idea after the Fed's January meeting, Chairman Jerome Powell stated, "Today the FOMC decided that the cumulative effects of developments over the last several months warrant a patient, wait-and-see approach regarding future policy changes." The referenced developments included slower growth in China and Europe, as well as uncertainty around government policies including Brexit, ongoing trade negotiations and the effects of the partial government shutdown in the United States. Powell further revealed that the Fed's balance sheet normalization was in its final stages. As the case for raising interest rates weakened and interest rate increases for 2019 began to come off the table, the equity markets rallied vigorously.

If January's events seemed exciting, March's would be even more so. Powell reiterated his message that the Fed should be "patient in assessing the need for any change in the stance of policy" after evidence of slower than expected growth and financial conditions which tightened considerably over the fourth quarter. Economic data received for 2019 were mixed. This observation caused members to reduce their estimates of two rate hikes during the year to zero. In fact, markets are currently pricing in a higher probability of a cut occurring before a hike. Fed members that contribute to quarterly interest rate projections seemed less dovish as six of 17 members indicated a rate hike this year is still warranted. Furthermore, none of the members indicated a cut was necessary through 2021.

Even more important to the markets was the announcement of the revised Balance Sheet Normalization Principles and Plans. After the Great Recession, the Fed unleashed multiple rounds of quantitative easing (QE) to stabilize the economy. This began a rapid increase in the size of the Fed's balance sheet through the purchase of billions in U.S. Treasury and other government agency securities and was a subtle way for the Fed to loosen monetary policy. To begin normalizing monetary policy, the third and continuous round of purchases (nicknamed QE Infinity) was stopped, but maturities and prepayments were reinvested. This effectively kept the Fed's balance sheet at a constant level. A further step was taken in October 2017, when the Fed allowed their asset holdings to decline by reinvesting only a portion of maturities and prepayments, allowing for a runoff that caused the balance sheet to contract slowly. At their meeting on March 20th, the Fed announced they would slow the runoff starting in May and cease the runoff in September. Thus, the Fed's balance sheet would once again be at a more constant level after shrinking for over a year and a half. To be clear, this decision was not taken lightly and had been formulated over four Fed meetings.

The equity markets' reaction to this development was mixed as even two weeks out, it had not moved more than 1.5% in either direction; however, the bond market was a different story. Yields on the 10-year Treasury Bond fell dramatically after the Fed's announcement coincided with the release of negative economic data from Europe. Yields dropped from 2.60% the day before the meeting to 2.40% a week later. Two days after the announcement the yield curve inverted. The inversion was short-lived, lasting for only five days and flattened out by the end of the month. Significant changes in monetary policy like those witnessed during the first quarter can have a dramatic effect on asset prices.

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Economics

The U.S. economy grew 2.2% during the fourth quarter of 2018 led again by personal consumption, which grew at a 2.5% rate. Although the economy grew 2.9% for the year in 2018, economists currently expect the economy to grow at a slower 2.4% pace during 2019 with a further slow down to less than 2.0% in 2020 and 2021. Most other measures of the economy showed slower, yet positive growth. The Leading Economic Indicators also show future growth to be at a moderate pace. Housing tumbled in the fourth quarter, but recent numbers have shown a rebound due to activity spurred by lower mortgage rates. March employment data came in with the 102nd straight month of added jobs, the longest stretch ever, and the lowest initial unemployment claims since 1969.

Inflation data remained tame as both the Consumer and Producer Price Indices remained below the Fed's target of 2.0%. The Fed's preferred gauge of inflation (Core-PCE) was also below 2.0%, giving them the flexibility to cease interest rate increases. Economists expect both CPI and Core-CPE to be 1.9% in 2019 showing that inflation expectations remain appropriately anchored.

Equity Markets Review

The S&P 500's 13.7% return during the quarter led all major indices except for mid cap stocks which rose 14.5%. Small cap stocks rose a healthy 11.6% during the quarter as they built on sharp gains during the final days of December. Within the international sphere, small cap international stocks gained 10.8% followed by developed international stocks and emerging market stocks gaining 10.2% and 9.9%, respectively. With the ongoing saga of Brexit, we continue to be focused on our manager exposure to the United Kingdom. In fact, the main funds Broadway uses have an underweight allocation to the United Kingdom and in our discussions with these managers, they emphasize their exposure is to companies that generate a large amount of their revenue outside the United Kingdom.

All eleven economic sectors were positive during the quarter as Information Technology, Real Estate and Industrials led while Health Care and Financials lagged. Companies contributing the most gain to Broadway Bank's portfolios included: Facebook, Cisco, Microchip, Accenture and Paychex. Detractors included: CVS Health, AbbVie, Coca-Cola, Pfizer, and Amgen. As can be inferred by the winners and losers, growth stocks outperformed value stocks during the quarter.

Fixed Income Market Review

Aside from the chaos in the latter part of the quarter, the fixed income markets were relatively stable. The 10-year Treasury Bond yield ended the quarter at 2.41% falling from where it started the year at 2.69%. The decrease in yields helped drive prices and therefore returns on bonds higher, allowing the Bloomberg Barclays US Aggregate Bond Index to gain 2.9%. Treasury Inflation Protected Securities (TIPS) gained 3.2%. The real winner during the quarter were high-yield bonds which gained 7.3% as markets were in a "risk-on" mode during the quarter.

Other Assets

Crude oil made up for most of its price decrease in the fourth quarter by rising 32.4%. This price increase helped to drive Master Limited Partnership (MLP) prices higher resulting in a return of 16.8%. As Real Estate was one of the top performing sectors this quarter, it is no surprise that REITs also had a great quarter, gaining 16.3%. Absolute return vehicles, which act as volatility reducers in the portfolio, performed as expected and earned a steady and consistent return of 2.6%.

Please contact your portfolio manager or email us at BWealthManagement@Broadway.Bank with any questions or comments.

Index	YTD	3 Year	5Years**
Dow Jones	11.2%	16.4%	12.2%
S&P 500 Index	13.7%	13.5%	10.9%
MSCI EAFE*	10.2%	7.9%	2.9%

*EAFE = Europe, Australasia, & Far East International Index

**Annualized Return

2 Year Treasury Bond Yield as of 3/31/19	2.26%
10 Treasury Bond Yield as of 3/31/19	2.41%
2 Year Muni Bond (AAA) as of 3/31/19	1.52%

Source: Bloomberg

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