Strength across risk-assets has fueled investor optimism, despite ongoing U.S.–China trade negotiations, low inflation, BREXIT, geopolitical tensions and slowing global growth. Realized 30-day equity volatility collapsed 9.0 percent and ranked among the lowest quartile of historical observations. Investors can take some solace in stronger than expected real gross domestic product growth in the U.S. (3.2 percent versus 2.0 percent expected) and low unemployment rates. But signals from the U.S. bond market convey a less sanguine outlook.

How should investors reconcile these mixed signals?

In our view, the market rebound in risk-assets is linked to confidence in the ability of central banks to contain downside risks of slowing global growth. Therefore, the most significant risk to this rebound and low volatility is central banks losing control of this narrative.

Global equity markets proved resilient again in April as the S&P 500 Index rallied 4.0 percent and recorded a new all-time high of 2945.8. The strong month propelled the year-to-date index return to 18.2 percent. U.S. equities continued to outpace both international developed (+2.9 percent) and emerging markets (+2.1 percent) on the heels of mixed economic results in the Euro Area, geopolitical tensions and slowing global trade. In contrast, U.S. corporations are beating (lowered) analyst estimates for revenue and earnings. Finally, continued U.S. dollar strength remained a headwind for international assets.

Real estate investment trusts fell just 0.2 percent while master limited partnerships fell 1.4 percent in April. However, both real asset categories produced the second and third-highest returns year-to-date behind U.S. equities.

Fixed income markets benefited from slower growth expectations and monetary policy accommodation from global central banks; however, the dichotomy between Treasury yields and credit spreads offer divergent outlooks in terms of the ability for monetary policy to deliver financial asset returns. Cautious investors can point to the inverted Treasury curve signaling monetary policy conditions are too restrictive. Federal funds futures corroborated this view and priced in a greater than 50 percent probability of a rate cut by year-end.

Bullish investors can point to further declines in credit spreads as evidence that economic growth remains solid, albeit at a slower pace. While these conflicting signals can persist in the short-run, market internals should eventually converge, and investors should expect elevated volatility when they do.

Market outlook

Despite the recent run-up in equities, we remain constructive on underlying fundamentals. The 12-month forward price-to-earnings multiple on the S&P 500 Index stood at 17.7 and ranked among the highest 71 percent of monthly historical observations since 1990. That means nearly 30 percent of the time equity valuations have exceeded current levels.

Along with low volatility, low correlations and moderate-to-high dispersion imply strong diversification potential and favorable conditions for actively managed strategies. Certainly, a welcome respite for active managers.

Although we acknowledge headwinds in international and emerging market economies in the short-term, valuations remain attractive on a relative basis and warrant thoughtful consideration for long-term investors. Real assets should continue to benefit from favorable interest rates and steady economic growth. In light of divergent signals from fixed income, we continue to caution investors from adding credit exposure. A precipitous slowdown in global economic growth, unexpected geopolitical tensions, or tighter financial conditions would trigger a review of this outlook.
RSM U.S. Wealth Management continues to believe that investors should be patient and adhere to a well-constructed, diversified investment portfolio anchored to your goals and time horizon. Despite elevated uncertainty, we do not find compelling reasons at this time that would justify overriding our asset allocation methodology.

For more information and assistance, please contact any professional at RSM U.S. Wealth Management.

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