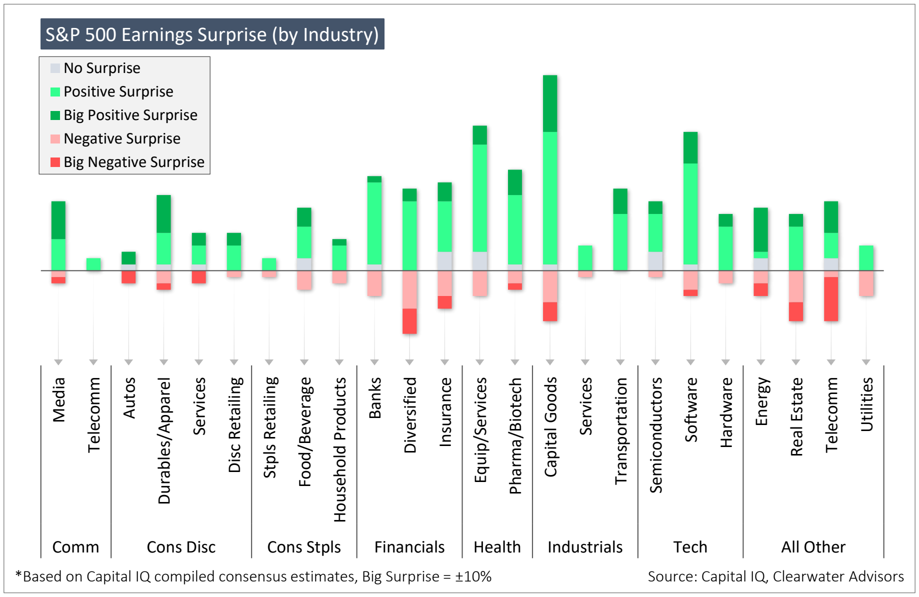
Rosy Markets

During the month of January, the ICE BofAML Investment Grade Corporate Index returned 2.09% compared to -2.25% for all of 2018. Performance of 4.59% in the high yield sector was even more impressive compared to -2.27% for 2018. Sentiment for risks assets has vastly improved as fear of a recession induced by monetary policy missteps eased considerably with the Fed explicitly stating during its January meeting that it will remain patient not only in interest rate hikes but also in balance sheet reduction if needed.

Earnings results further strengthen the case for the rally in risk assets. Based on data from S&P Capital IQ, almost two-thirds of S&P 500 constituents have reported 4Q18 earnings with about 70% of these companies beating consensus earnings estimates. Year-over-year revenue and earnings growth of 10% and 23%, respectively, suggest that credit profiles for US corporates have benefited from solid fundamentals over the last year.



While fed funds hikes are seemingly off the table, at least, through the first half of this year, the concerns over global growth and escalation of trade tensions that precipitated the sell-off at the end of the last year are still present. Just last week, the European Commission revised down its GDP growth estimates for the Euro area highlighting challenges in maintaining economic momentum. Survey data out of China also portends to slower growth as the government generates less incremental return on its stimulative actions. These factors provide a technical tailwind for US assets as domestic and foreign investor demand drives down yields and raises prices.

From a relative value perspective, we continue to favor US banks over Yankee banks. While increased regulatory scrutiny and improved capital structures have reduced overall risk in the global banking sector, we think economic fundamentals will allow US banks to outperform their international peers in terms of asset quality and revenue growth. Despite the disparities in economic outlook, spread differentials are more attractive for US banks in our opinion. Nonetheless, M&A risk for regional US banks is increasing, but the credit impact will depend on how deals are structured. For example, we view the proposed all-stock merger of BB&T and SunTrust as a credit positive. The consolidation of these entities will enable them to better leverage investments in technology lowering their combined efficiency ratio and improving profit generation all while maintaining appropriate capital buffers.