**What Caught Our Eye This Week**

On Thursday evening, Kraft Heinz (KHC) announced disappointing results in a drama-filled fourth quarter earnings report. In addition to missing its earnings per share estimate by approximately 11%, the company slashed its dividend by 36%, took a goodwill impairment charge of $15.4 billion on its signature Kraft and Oscar Mayer brands, and announced a $25 million charge associated with an investigation by the Securities and Exchange Commission (SEC) into the accounting practices of Kraft’s procurement division. While Kraft’s difficulties seem somewhat unique unto themselves at present, the news is noteworthy not only in that it involves significant sophisticated institutional investors (Warren Buffett and 3G Capital) but also that it highlights ongoing challenges facing investors in the mature consumer packaged goods industry – changing consumer preferences, acquisitions which create high levels of debt, and weak organic sales growth.

**Economy**

The most anticipated report this week was the durable goods report, which was released on Thursday. Overall orders for durable goods increased by 1.2%, but when excluding the volatile transportation component, orders advanced by 0.1%. Core capital goods orders (excluding air and defense) decreased by 0.1% in December, and this is the fourth decline since August of 2018. This metric grew 2.5% year-over-year, but this is significantly slower than the growth we witnessed back in September 2017 (+13%). Core capital goods shipments increased by 0.5% in December after displaying negative growth figures in November and September of 2018. Overall capital equipment spending growth was nonexistent in Q4 and is off to a slow start in 2019. In other news this week, existing home sales posted a decline of 1.2% in January to a seasonally adjusted annual rate of 4.94 million. Year-over-year, these figures are down 8.5%, and the January decline represents the third consecutive month of declining sales. Finally we were pleased to see weekly jobless claims drop by 23,000 to 216,000 during the week ending February 16th.

**Fixed Income/Credit Market**

Year-to-date, diminishing global growth expectations, a more dovish Fed, and a decrease in volatility have contributed to investors’ increased appetite for corporate debt which has put downward pressure on both investment grade (IG) and high yield (HY) credit spreads. Since the beginning of the year, IG 5-year AA, A and BBB-rated composites are down 26 basis points (bps), 22.3 bps, and 23.4 bps, respectively. The compression in corporate credit spreads is even more pronounced in the HY sector where BB and B-rated composites are respectively lower by 99.5 bps and 141.7 bps. According to Bloomberg, U.S. ETF data shows that corporate bonds have added net fund flows of approximately $12.98 thus far in 2019, equating to a 7.7% increase to the asset class’ market cap. Meanwhile, the VIX is trading at 13.51, slightly more than 3 percentage points below its 1-year average.

**Equities**

U.S. equities continued to rally during the holiday-shortened week resulting in nine consecutive weeks of gains. Trade negotiations between the U.S. and China restarted and most of the updates have been optimistic. President Trump stated that the March 1st deadline is not a “magical date,” implying that the deal deadline could be pushed back if negotiations continue to progress. The minutes for the January FOMC meeting were released on Wednesday, and the commentary indicated thoughts of ending the balance sheet runoff sometime this year and a continued patient approach regarding interest rate decisions. Thursday was the only down day of the week after disappointing economic releases added to concerns of a global economic slowdown. Thursday’s decline broke the Nasdaq’s 8-day winning streak and marked just the 4th down day for the S&P 500 in February. Equities ended the week strong helping the S&P 500 close in the green with a gain of 0.61%. The utilities sector was the best performer increasing by 2.36%, while healthcare and energy were the only sectors to decline on the week.

**Our View**

Almost a full five years ago, the European Central Bank lowered its deposit facility rate to a -0.1% embarking on a negative interest rate policy (NIRP). Negative interest rates are an unconventional policy tool that essentially charges European banks to hold reserves at the ECB which encourages banks to lend more. Negative rates, in theory, dissuade businesses and consumers from keeping cash and encourages both consumption and investment. The ultimate intention is to stimulate economic activity and raise economic growth. The Bank of Japan announced a negative interest rate approach as well in January of 2016. Over $11 trillion worth of bonds in Japan and Europe currently carry a negative rate of interest. The transmission mechanism between interest rate changes, the level of interest rates and economic effects in the real world is complicated. Investor and consumer behavior are affected by numerous factors and not just interest rates. Additionally, when rates are negative, the market participants’ behaviors change depending on the length of time rates stay below zero. As negative rates persist, the market will ultimately interpret NIRP as a drastic measure that indicates the central bank is afraid that the economy is at risk of falling into a deflationary spiral. Due to low returns in an aberrant rate environment, investors become concerned that savings will not grow enough for future needs and they increase savings. So NIRP eventually has the opposite effect that the policy intended. It can also weaken the banking sector over time. Banks generally are liability sensitive and they feel constrained by the zero-bound rates. Thus, bank lending actually decreases as margins are squeezed. With NIRP and the astounding expansion of the ECB’s balance sheet, it is concerning how anemic economic growth has been in Europe and inflation expectations are well anchored below 2%. Some countries such as France and Italy, that have experienced GDP growth averaging 0.8% and 0.5%, respectively, since the end of the Great Recession, are hurting and seeing rising political unrest. It is perhaps unfair to say that the negative interest rate experiment has been a failure, but NIRP has not worked as Europeans had hoped. The ECB has also effectively lost its primary tool to combat the next recession.