FINANCIAL & ECONOMIC REVIEW

After ending Q3 impressively, the broader equity markets capitulated to a bevy of headwinds in the fourth quarter of 2018 and corrected approximately 20% off recent highs. Normally, this would be a well-received opportunity to enter the markets broadly for client cash, but in this environment we're continuing to recommend caution with additional downside to the broader markets possible. We're viewing several key themes likely to play out in 2019. As interest rates remained low, we observed borrowing at higher rates, driving up corporate and government debt to unhealthy levels. Balance sheet risk is becoming more and more a top concern for individual companies. The Chinese trade conflict continues to weigh on markets, as it remains unresolved and political paralysis has unfolded in the United States.

The Federal Reserve remains in the forefront of investors' minds, as they continued on their path of monetary tightening, raising rates again in Q4. With the Fed Funds rate now at 2.25-2.50%, this increase represents the fourth in 2018 and eighth raise in two years. The Fed is also engaged in another market tightening measure, allowing matured bonds to "roll-off" their balance sheet, shrinking the money supply. Both measures have added volatility to markets, while applying brakes to the macro economy. In the last Fed meeting of the year, Chairman Powell tempered expectations for additional rate hikes in 2019, but still expects two by year-end. As a result of this softened posture, the yield curve has begun to steepen, leading some to believe that the Fed anticipates a recession is in the near future. The last three recessions have been preceded by a Federal Reserve rate cut. All eyes will be on the Fed in 2019 to illustrate market expectation. OPEC ceded more world supply of crude oil in Q4, announcing a 1.2MM barrel/day cut in production. This statement came after US shale oil supply surged, driving prices down yet again. With higher than expected output from Iran, oil prices were down over 38% for the quarter, ending at $45.15/barrel.

The only equity sector in Q4 that ended positively was Precious Metals, gaining 4.9%. Utilities and Real Estate were next best, losing -1.5% and -7.2%. Energy, Industrials and Technology stocks were the worst sectors for the quarter, returning -31.1%, -18.3% and -17.6% respectively. In fixed income, the U.S. Aggregate Bond index rose 1.6%, while the 10-year Treasury yield ended the quarter down 11.8% to 2.69%. The S&P 500, Dow Jones Industrial Average and NASDAQ Composite Index lost -13.5%, -11.3% and -17.3% in the fourth quarter respectively. After the pullback, all equity sectors were trading at a 7 to 25% discount to fair value of Morningstar's coverage universe[1]. For full year 2018, the S&P 500, Dow Jones Industrial Average and NASDAQ lost -4.4%, -3.5% and -2.8% respectively. We are anxiously, but cautiously searching for new investment opportunities during, fully understanding we may have further downside before beginning to stabilize and rise again.

We're optimistic for 2019 and wish to thank you for allowing us to continue to manage your investments. We look forward to continually earning your business, your referrals and your trust as we navigate the markets in the New Year.

Jack A. Kennedy
Chief Investment Officer

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[1] Results referenced from Morningstar.com

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