Investment Watch

4th Quarter, 2018

NO GOOD NEWS?

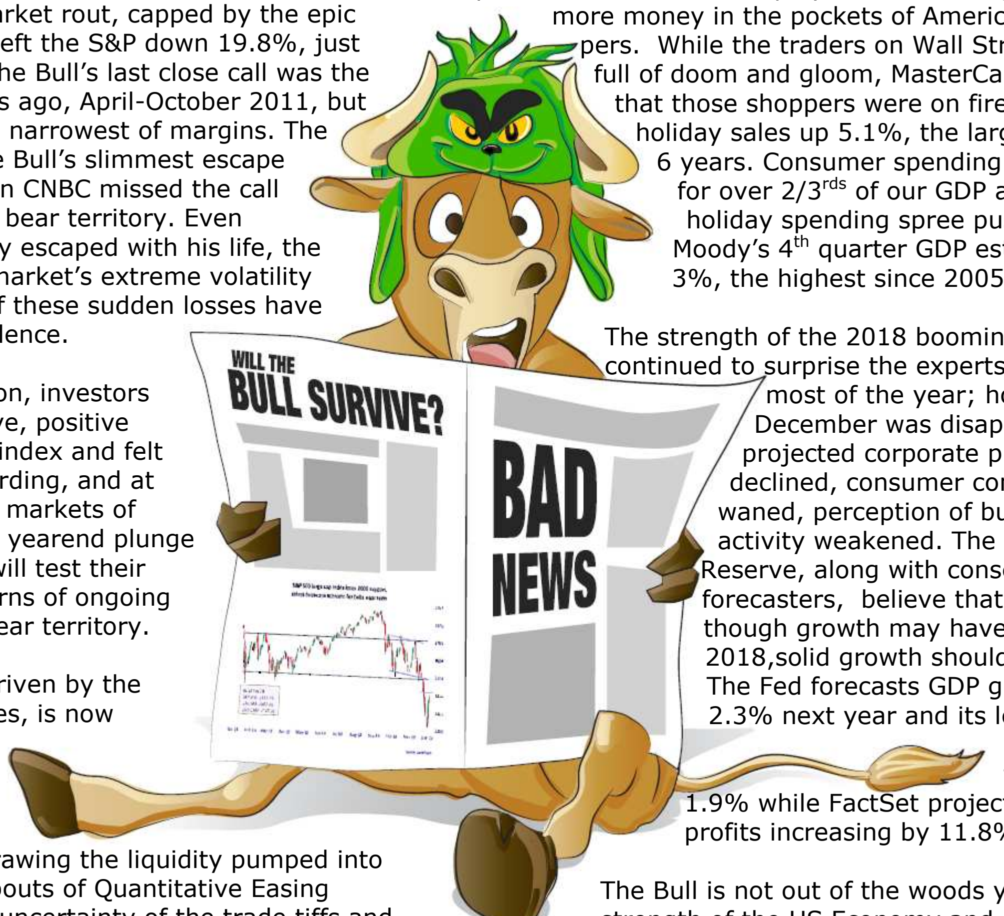
The only news in the stock market this holiday season was **BAD NEWS**! The stock market was in a tizzy during the 4th quarter. The S&P 500 notched its worst December since the Great Depression and its worst Christmas Eve trading day in history, ending within a gnat's eyelash of a bear market which is defined as a 20% decline from a recent high. It was just about three months ago when this newly dubbed longest Bull run hit the all-time high of 2930.75, measured by the S&P. The benchmark index was up 9%, but then tumbled 14.5%, ending the year in negative territory for the first time since the Great Recession.

This quarter's brutal market rout, capped by the epic Christmas Eve plunge, left the S&P down 19.8%, just shy of a Bear Market. The Bull's last close call was the 19.4% drop seven years ago, April-October 2011, but this Eve's nadir was the narrowest of margins. The 19.8% drop marked the Bull's slimmest escape yet! It was so close even CNBC missed the call saying the S&P entered bear territory. Even though the Bull narrowly escaped with his life, the anxiety caused by the market's extreme volatility and the financial pain of these sudden losses have shaken investors' confidence.

After the Great Recession, investors cheered nine consecutive, positive calendar returns in the index and felt confident with the rewarding, and at the same time, tranquil markets of 2017. 2018's surprising yearend plunge into negative territory will test their resolve and raise concerns of ongoing declines possibly into Bear territory.

This epic Bull Market, driven by the Fed's easy money polices, is now fighting strong headwinds caused by the Fed tightening monetary policy by raising rates and withdrawing the liquidity pumped into the economy by three bouts of Quantitative Easing (QE). Coupled with the uncertainty of the trade tiffs and tariffs and slowdown in the European and Chinese economies, the pundits are pondering the Bull's demise. Some see signs of recession—the drop in longer-term interest rates resulting in a flat or inverted yield curve (short term rates higher than longer-term rates) and the precipitous drop in oil prices. Others see lower inflation keeping the longer-term rates stubbornly low and excess supply for the drop in oil prices.

The markets may be drowning in a sea of Bad News, but there was much Good News in 2018's soaring economy.



Looking back, the current economic expansion began in June of 2009, established by the National Bureau of Economic Research (NBER). For several years the expansion was fragile and slow. Employment growth was historically low and unemployment wouldn't return to pre-recession levels until 2016. US GDP growth had been much slower than prior recoveries averaging just 2.0%. 2018 was a banner year for the job market with an estimated 2.4 million jobs added while the unemployment rate fell to 3.7% in October, a 49 year low.

Consumer confidence soared in 2018 to levels not seen since the turn of the century, while S&P companies had a 20.3% profit boom juiced by the tax cut, as reported by FactSet. The low unemployment and rising wages put more money in the pockets of American shoppers. While the traders on Wall Street were full of doom and gloom, MasterCard reported that those shoppers were on fire, pushing holiday sales up 5.1%, the largest gain in 6 years. Consumer spending accounts for over 2/3rds of our GDP and this holiday spending spree pushed Moody's 4th quarter GDP estimate to 3%, the highest since 2005.

The strength of the 2018 booming economy continued to surprise the experts through most of the year; however, December was disappointing: projected corporate profits declined, consumer confidence waned, perception of business activity weakened. The Federal Reserve, along with consensus forecasters, believe that even though growth may have peaked in 2018,solid growth should continue. The Fed forecasts GDP growth at 2.3% next year and its long-term growth ticked up to 1.9% while FactSet projects corporate profits increasing by 11.8% this year.

The Bull is not out of the woods yet. The strength of the US Economy and Corporate America will eventually determine the value of the US stock market, likewise for foreign economies. The fears and uncertainty of Fed increases, governmental gridlock, trade standoffs, and concerns of slowing growth will drive market volatility into the New Year. Fed Chairman Jerome Powell said the US economy is "performing very well overall." Hopefully, investors can take that to the bank in 2019.

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