# ECONOMIC & FINANCIAL MARKET UPDATE

## CURRENT STATE OF AFFAIRS – November 2018

**The Equity Markets**

As we approach the end of 2018, we wanted to share our thoughts with you on the current financial market environment.

After nine consecutive years of positive returns from the stock (S&P 500) market (only the second time in market history for that to occur[i]) which resulted in that index increasing at a compound annual rate of return of 13.1% (15.5% if all dividends were invested[ii]), 2018 may be a "softer" period in that positive string of years, but not necessarily the end of the bull market or a signal that the economy is headed for recession.

Following the "choppy" start to 2018, most major equity indexes reached record levels in mid-to-late summer, only to give back those gains during the down trend that began in early October. While the October and November "downdraft" is significant (-10.2%) from market highs, it still leaves the major indexes e.g., the S&P 500, and the Dow Jones Industrial Average and the NASDAQ Composite up +0.19%, +0.26% and +1.49%, on a total return basis, year-to-date through the week ending November 23, 2018. Certainly, a disappointing performance for stock returns, but not ruinous, particularly in light of the returns achieved by most investors during the last decade.

**What Has Changed?**

After the "challenging" and negative start to 2018 (both the S&P and Dow were in negative territory at the end of the first calendar quarter[iii]) it appeared that Goldilocks had taken control of the business/investment environment. Global economies appeared healthy, U.S. unemployment was, and remains, at a decades' low rate, consumer and business confidence surveys were reaching record highs, U.S. corporate earnings and dividends were growing rapidly and interest rates and inflation (while

increasing) were both under the Fed's radar. All of this good news and economic data was positive for the equity markets and was the propellant for higher equity prices.

As the year has progressed, strong U.S. economic growth has given rise to further Fed rate increases as the Fed attempts to keep the economy from over-heating and causing inflation to become a problem(?). Thus far in 2018 there have been three Fed rate increases and a fourth scheduled (?) for December. The current Fed funds rate range is 2.00%-2.25%[iv] and compares to a rate of 1.00%-1.25% at the end of 2017. On a percentage basis the increase from 1.00% to 2.00% seems large, but from a historic standpoint, a Fed Funds rate of 2.00% is still quite low and accommodative. Ten years-ago that rate was 4.25%[v]. Rising rates in general make borrowing (a lot has been done lately) more expensive and makes "cash" and other short-term investments relatively more attractive to investors

In addition to concerns about the impact of Fed tightening, and escalating (very little) inflation, data compiled from global sources showed some economic weakening in Europe and Asia (combined they account for approximately one-half of U.S. company sales[vi]), particularly China. Those issues, the GE mess, declining oil prices (a plus and a minus) in addition to the potential negative impact brought about by the trade/tariff "wars" was enough uncertainty to undermine investors' confidence, increase volatility and precipitate a sell-off.

**Our Expectations:**

We take our responsibility as conservators of our clients' assets seriously, and as such, spend a great deal of time, effort and resources monitoring and analyzing current market and economic trends in order to both grow and preserve those assets. As such, and consistent with our view of high equity valuations late this summer that lead to client portfolios at or near the top of their stock guidelines, equity positions were modestly reduced several months ago, and the proceeds used to purchase short-maturity fixed-income and/or cash equivalents.

Federal Reserve policy (raising or not raising interest rates), the continuing trade/tariff "wars", slowing global growth and the direction of oil prices are all important factors which require careful scrutiny and which can and will have an impact on financial assets.

At this time though, we remain biased toward the positive case in the short-to-intermediate term. Inflation is losing steam, and the Fed appears to be turning a little more "dovish" (fewer rate hikes) while estimates for U.S. and even global economic growth in 2019 remain close to this year's rates[vii]. In addition, U.S. corporate profits continue to grow rapidly, unemployment is very low, wages are rising and consumer and business sentiment are quite high. In addition, much of the "fluff" has been taken out of equity prices. In fact, stock valuations as measured by price/earnings multiples are back to where they were in early 2014. If the current estimates for S&P 500 earnings per share in 2019 and 2020 are correct, equity valuations are quite reasonable, less expensive than they have been for some time, and should provide the rationale for a rebound in stock prices. Patience is warranted.

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**Bottom Line:**

As we have shared with you previously, and one of the reasons that you employ us is, the disciplined investment process that we follow as we manage your investment assets. That process emphasizes the importance of a "longer-term" investment horizon (rolling 3-5 years) and emphasizes the construction of a ***strategically diversified*** portfolio of fundamentally sound, high quality stocks representing companies with sustainable business models and the ability to ***consistently*** grow both earnings and dividends. Bonds and "cash" in portfolios are managed to increase diversification, provide income and to reduce volatility. The balance between stock, bond, and cash investments in portfolios is based upon our understanding of a number of factors that are unique to you e.g., financial objectives, income requirements, family/charitable obligations, age, health, etc.

During times of volatility and near-term uncertainty such as we have seen lately, it is time well spent to restate and emphasize our process and the importance of staying focused on the objectives and the discipline.

We welcome your comments and critique.

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The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.

All indexes are unmanaged indexes which cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of performance of any investment. Past performance is no guarantee of future results.

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[i] NYU Stern School of Management, Stocks, Bonds & Bills – 1928 to Current
[ii] Wall Street Journal, 11/24/2018
[iii] FactSet Research, 3/31/2018
[iv] U.S. Federal Reserve.com 11/23/2018
[v] U.S. Federal Reserve.com 11/23/2018
[vi] Wall Street Journal 11/24/2018
[vii] The Economist, 11/16/2018