Market Update

December 31, 2018

Increased stock price volatility and fears of a global recession combined during the fourth calendar quarter of 2018 to produce the most negative quarterly returns in the last ten years. From the September 20, 2018 high for the S&P 500 to the Christmas Eve low, this index declined by 20%, the standard definition of a bear market.

Full year returns for 2018 in U.S. Markets were down, but the declines of 4.4% for the S&P 500, 3.5% for the Dow Jones Industrials and 3.9% for NASDAQ were much better than the fourth calendar quarter returns taken in isolation.

Foreign markets fared much worse than their United States counterparts for all of 2018 with European markets down 13%, Japan down 12%, Shanghai down 25% and Emerging Markets down 17%.

As is often the case when the stock market declines, interest rates on the U.S. Treasury Ten Year Note also declines, in this case from 3.05% at the end of September to 2.70% at the end of December. The yield on that Treasury Note stood at 2.40% at the beginning of 2018, thus ending the year at the mid-point of its range during the year. This is significant because it occurred within the context of the Federal Reserve raising short term rates four times for a total increase of 1% during the year to a level of 2.25-2.50%.

One effect of higher interest rates in the United States was the strengthening of the U.S. Dollar in relation to the currencies of our major trading partners. That relative increase was 4.4% in 2018 and is expected to stay at roughly that level in 2019.

The price of a barrel of oil declined by 25% in 2018 to $48, which is good news for consumers but not for the energy industry. Most analysts attribute the decline to the large increase in U.S. production coupled with a slowing global economy reducing demand for oil. Expectations for 2019 are for prices to stabilize in and around $50 a barrel.

Real GDP growth for 2018 should be close to 3.0% with a projected slowdown to roughly 2.5% in 2019. Unemployment numbers continue to be at multi-decade lows and wages are rising at an annual rate in excess of 3.2%. Corporate profit forecasts for 2019 are being reduced in light of global economic concerns, but expectations are still for a 5% increase over 2018 results.

When all these data are weighed, the inescapable conclusion is that the equity valuation of the average U.S. company stock is very attractive. We are fully invested in equities, in anticipation of participating in much better 2019 investment returns.

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