2018 Year in Review

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"Listening to and understanding our client's financial goals allows us to provide the highest level of investment planning advice and service."

Equity Markets

U.S. stock markets as defined by the S&P 500 were down 4.4% in 2018[1], the 4th quarter alone dropping 14.0%[2]. All gains of the first 3 quarters were erased and then some. Contributing factors were the rise in short term interest rates by the Fed as well as break downs in trade talks between the U.S. and China. Going into 2018, stocks were trading at a Price to Earnings ratio (P/E) of 25 which has since fallen to 19. Historical P/E over the past 100 years has been 15[3].

Day to day volatility has certainly increased with the VIX (market indicator of volatility) increasing from 12 to 36 in the 4th quarter[4]. As a reference point the VIX at the worst of the 2008 recession was above 80[5].

Let's consider the markets of 2008 to get a sense of how far we've come. At the end of 2008 the S&P 500 was 865, while at the end of 2018 the S&P 500 was at 2789[1].

Fixed Income Markets

A portion of the Yield Curve went negative. For a few days in the 4th quarter, the 2-year yield was higher than the 5-year yield[6]. While only a small part of the overall yield curve, it reflected the move by the fed of increased short-term rates. This inversion of yield curves is often interpreted as an indication of the start of a recession. Long term 10-year U.S. Treasury rates rose from 2.48% to 2.68%[7] from the start of the year. Compare that to the 2-Year which rose from 1.92% to 2.48% during 2018[8]. Many market participants were concerned that President Trump was commenting on the Feds changes to the Fed Fund rates as well as Chairman Powell's response. Our view is that the presidents' comments created some uncertainty in markets about the direction of the interest rates.

Real Estate and Commodities

The real estate markets vary by region but overall the market remains healthy[9]. Our view is that the real estate markets will be highly influenced by the 10-year rate which has remained stable or even fallen a bit in the 4th quarter.

A significant correction in the 4th quarter was the fall in the price of WTI oil from $75 per barrel to $45 by years end[10].   The 40% fall just in the 4th quarter was unexpected as growth in the economy was strong in 2018 and GDP averaging 3.3% through the first 3 quarters[11]. A variety of factors influenced this drop. Advanced technology has increased supply to the point where the U.S. is a net exporter. This has reduced OPEC's influence even further which creates a virtuous cycle of supply.

Market economists view that overall GDP growth may slow in 2019 and a common "risk off" trade is to sell oil putting further pressure on oil prices. With every negative is a positive and the low gas prices to the consumer can act as a cash infusion leading to increased consumer spending in other parts of the economy.

World Economics

Europe has been affected by geopolitical issues that have mostly been negative. British Exit (Brexit) from the EU has gone back and forth creating uncertainty. Italy's debt issues have started to catch the attention of economists[12]. Russia remains an issue in terms of possible conflict in the area. China and Emerging Markets have seen a fall-off in growth and growth expectations. Trade discussions between the U.S. and China have not led to any strong agreements. The Shanghai Index was down 26% in 2018 with nearly half of that in the 4th quarter alone[13].

2019 Forecast

Our 2019 forecast is for equity markets to continue the higher volatility we saw in the 4th quarter, at least until the China trade talks have been settled and the Fed has established their rate hikes without over doing it. Long term, the S&P 500 over the past 90 years has averaged annual returns of 9-10%[14]. Should those two variables remain in doubt, we expect lower than average equity returns for 2019. If the fed pauses the rate hikes, and China trade talks get resolved, we would expect higher annual returns. The long-term interest rates we see as staying range bound near current levels. Should the Fed continue their rate hikes, the long-term rates should fall slightly. However, with a rate hike pause by the Fed we should see rates rise slightly. Overseas markets will continue to struggle economically but we see value there with much of the troubles already priced in with the 2018 losses in most indices.

An important reminder with any forecast or market moves: We believe investors should not attempt to time the market and that the key to successful wealth management is to coordinate with your financial planner and establish the risk and return expectations for your unique situation.

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