

MARKET COMMENTARY

Q4 2018 COMMENTARY

Economic Summary

It was a turbulent fourth quarter for the stock market as volatility picked up due to headline risks including uncertainty from the White House, global slowdown in growth, and Federal Reserve (“Fed”) action. Despite the headlines, the U.S. economy looks strong. Consumer confidence, CEO confidence, and small business optimism (Chart 1) are near record highs. Additionally, ISM Manufacturing and ISM Non-Manufacturing statistics are still in the expansionary category. Based on these statistics, a recession doesn’t look to be in the cards for 2019.

Unemployment is currently below 4% (Chart 2) and at a multi-decade low. Gross Domestic Product growth is over 3%, much better than the sub 2% growth achieved prior to the Trump Administration. With inflation above 2% since the middle of 2017, the Fed increased short-term interest rates a total of four times in 2018. More rate increases are expected in 2019.

Corporate earnings were up 24% in 2018, aided by tax reform enacted in late 2017. Even though earnings were exceptionally strong, the S&P 500 stock market index had a total return in 2018 of -4.4%. Many high-quality common stocks appear increasingly attractive on an earnings basis. Looking forward to 2019, corporate earnings are forecasted to rise by 5% to 10%.

The Bond Market

In 2018, long-term interest rates were poised to rise as inflation, real growth, and low unemployment pointed to a strong economy. Yet much of the headline risks that roiled stocks also put downward pressure on interest rates. The 10-year U.S. Treasury Note started 2018 yielding 2.4%, and after spending much of the year above 3.0%, ended the year close to where it started.

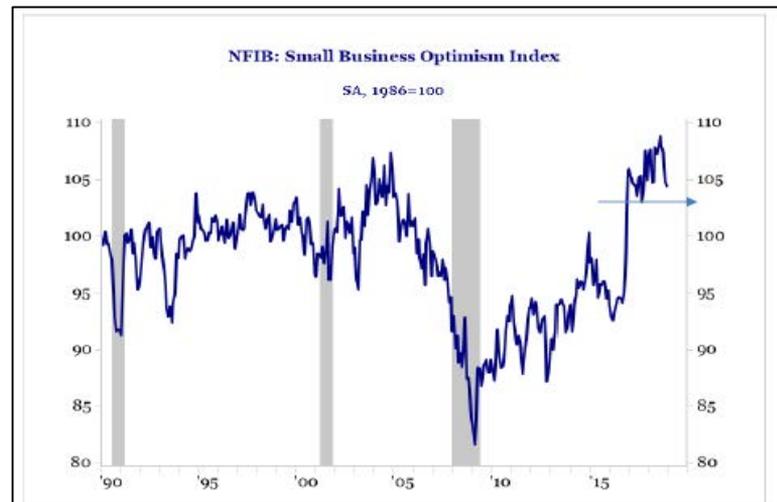


Chart 1

Source: Strategas Research Partners, “Weekend Reader”, 1/12/19

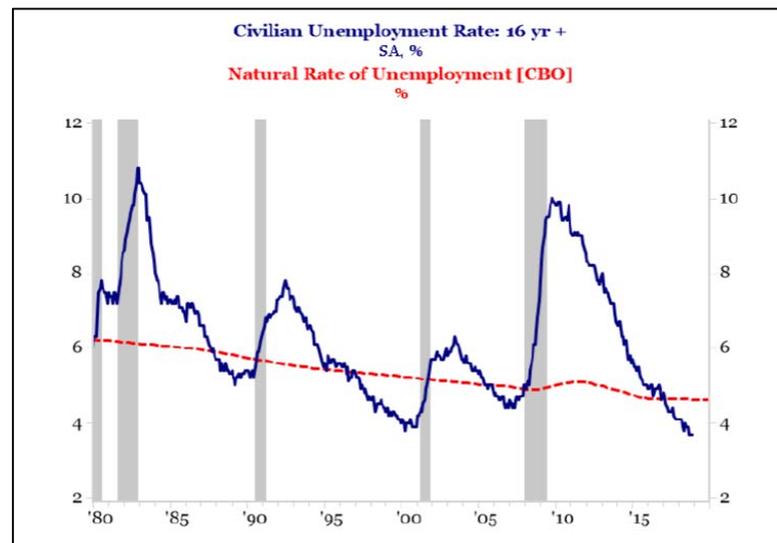


Chart 2

Source: Strategas Research Partners, “Quarterly Review in Charts”, 1/2/19

The Bond Market (continued)

One relationship many investors are watching closely is the inversion of the U.S. Treasury yield curve. An inversion happens when the yield of the 2-year U.S. Treasury Note exceeds the yield of the 10-year. A yield curve inversion is generally seen as a reliable indicator of a forthcoming recession. The curve continued to approach inversion going into the end of the year, with the spread between the 2- and 10-year Treasury yields ending the year at a paltry 0.19% (Chart 3). While not currently inverted, we are watching this relationship carefully.

The Stock Market

The fourth quarter was lousy for equity returns. Major indexes posted double-digit declines, dragging year-to-date numbers into negative territory by year-end (Chart 4). As in recent years, growth stocks vastly outperformed value stocks during 2018 (Chart 5). Likewise, larger capitalization companies outperformed smaller ones. In a historical context, stocks now look relatively attractive based upon valuation metrics, such as price-to-earnings and price-to-cash flow. The past few months have seen some jaw-dropping declines in equity prices, but astute investors know that the most opportunistic times to invest are often when fear is in the driver's seat. Market participants often extrapolate negative (and positive) headline information too far into the future, which can cause volatile swings. Such swings provide opportunity.

We remain optimistic on the long-term investment merits of well-selected common stocks. Economic growth near 3%, rising corporate profits, strong employment measures, low inflationary pressures, and interest rates that are still highly accommodative could support a

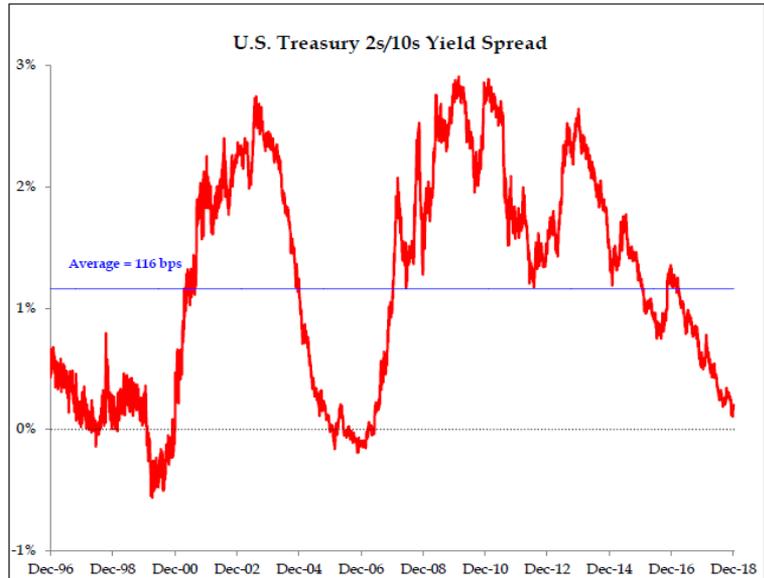


Chart 3
Source: Strategas Research Partners, "Quarterly Review in Charts", 1/2/19

The Stock Market (continued)

rising stock market in 2019. Resolution of any political uncertainties may give a boost to consumer and business confidence. As always, we remain focused in our efforts to invest in high-quality companies in sound financial condition selling at attractive valuations.

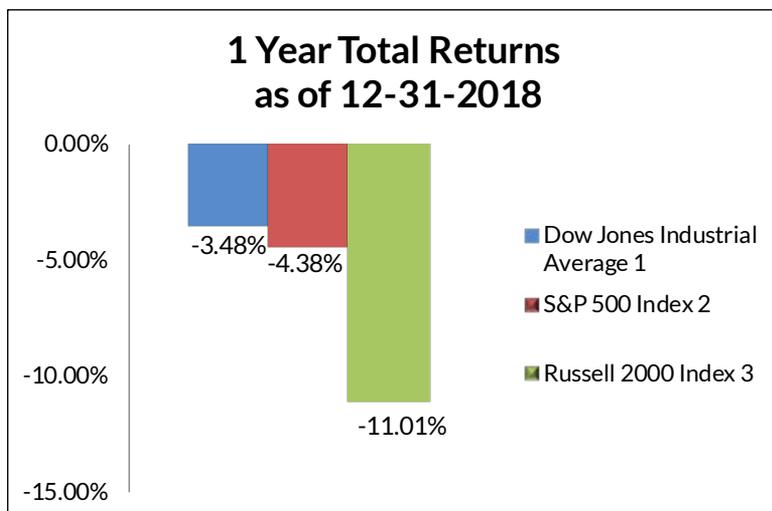


Chart 4
Source: Morningstar Direct

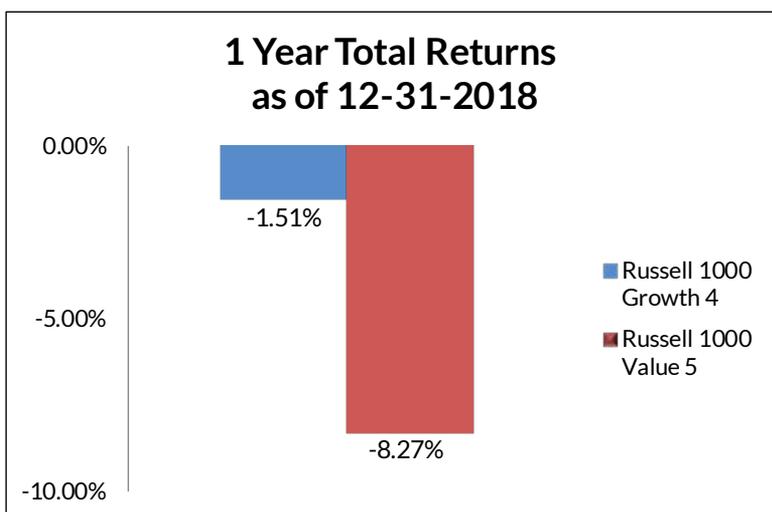


Chart 5
Source: Morningstar Direct

¹ The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. ² The S&P 500[®] Index is a capitalization weighted unmanaged index of 500 widely traded stocks, created by Standard & Poor's. The index is considered to represent the performance of the stock market in general. ³ The Russell 2000[®] Index is an unmanaged index of the smallest 2,000 stocks in the Russell 3000[®] Index. ⁴The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. ⁵The Russell 1000 Value Index Measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. You cannot invest directly in an index.

Past performance does not guarantee future results.

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