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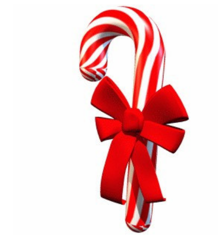
Fourth-Quarter 2018 Market Review



A Lump of Coal & A Candy Cane

January 2019 - Investors received a lump of coal when stocks posted their worst Christmas Eve trading session in history. The gloom was soothed with a candy cane during the day-after-Christmas session as the Dow Jones Industrial Average generated its biggest one-day point-gain ever (1,086). With stocks in or near "bear market" territory (a drop of 20% or more from a recent high) leading into the holiday, markets were on track for the worst December since the Great Depression year of 1931. But the Santa Claus Rally was "better late than never" as market bellwethers surged by mid-single digits on December 26.

Concerns about rising interest rates, trade tensions with China, a slowing global economy, and political turmoil resulted in stocks sinking by double-digits in the fourth quarter of 2018. The Dow Jones sagged 11.8%, the Standard & Poor's 500-Stock index (total return) slumped 13.5%, and the NASDAQ Composite index plummeted 17.5%. During the carnage, the S&P 500 (price index) came close to a bear market with a loss of 19.8% from its recent peak. Small cap stock indexes landed in the bear grip, finishing the quarter approximately 23% off their 52-week high.

U.S. stocks were mostly above water for the first three quarters of 2018, spurred on by double-digit profit growth resulting from lower tax rates enacted at the end of 2017. As the tax-stimulus wore off, investors began to focus on diminished earnings growth forecasts for 2019, leading to the fourth-quarter downturn. As the closing bell rang for 2018, U.S. stocks were mostly down by single digits, the largest annual decline since the 2008 financial crisis. International markets fared worse, tumbling by double-digits across the board.

Relative volatility returned to the stock market in 2018. As measured by the S&P 500 (price index), for the entire year there were 110 intra-day swings of one percent or more, compared with a subdued 10 in 2017. Nevertheless, 2018's count was considerably below the annual average of 169 swings since 1962.

With a stronger economy and rising interest rates, bond returns started 2018 lower and mostly remained in negative territory for the first three quarters. With equity markets in turmoil, government bond prices rallied in the fourth quarter, while U.S. Corporate High Yield faltered by 4.5%. The final tally for the year had U.S. Aggregate flat, Global Aggregate (hedged) ahead 1.8%, while International Emerging Markets slipped 2.5% and U.S. Corporate High Yield dipped 2.1%.

The Federal Reserve met twice during the quarter, leaving interest rates unchanged at the first meeting, while raising its short-term target by a quarter percent at the second to a range of 2.25% to 2.50%. It was the fourth rate hike in 2018 and the ninth since the Fed began lifting rates off near-zero in December 2015. Central bankers reduced their "neutral target" for short-term rates from 3.0% to 2.8% and said that the current rate range is at the lower end of the neutral range.

Their consensus for additional rate increases for 2019 fell to two from three and the growth forecast for next year declined to 2.3% from 2.5%.

With a strong economy, low unemployment, and firming wages, Treasury yields moved higher for the first three quarters of 2018. The yield on the 10-year U.S. Treasury note rose above 3.0% in April, its first time since 2014, and hit a high of 3.24% in October. As stock market volatility returned in earnest in the fourth quarter, the 10-year note closed the year at 2.68%. The yield curve flattened considerably for 2018, with the three-month-bill/ten-year-note spread sliding to 22 basis points from 101 at the start of the year.

Below are rates of return for selected market indices for the fourth quarter of 2018, full-year 2018, and the three, five, and 10-year compound annual returns as of December 31, 2018.

	4Q:2018	2018	3-Year	5-Year	10-Year
Equity (Stock) Indices					
Domestic					
Russell 1000 - Large Cap	-13.82%	-4.78%	9.09%	8.21%	13.28%
Russell Midcap	-15.37%	-9.06%	7.04%	6.26%	14.03%
Russell 2000 - Small Cap	-20.20%	-11.01%	7.36%	4.41%	11.97%
Real Estate (FTSE NAREIT Equity REITs)	-6.73%	-4.62%	2.89%	7.90%	12.12%
Commodity (S&P Global LargeMidCap)	-12.61%	-8.93%	12.43%	-1.29%	4.83%
International					
MSCI EAFE Developed Large Cap	-12.50%	-13.36%	3.38%	1.00%	6.81%
MSCI EAFE Developed Small Cap	-16.02%	-17.58%	4.11%	3.42%	10.88%
MSCI Emerging Markets	-7.40%	-14.25%	9.65%	2.03%	8.39%
Global - MSCI All Country IMI	-13.19%	-9.61%	7.06%	4.72%	10.32%
Fixed-Income (Bond) Indices					
Bloomberg Barclays					
Global Aggregate - Unhedged	1.20%	-1.20%	2.70%	1.08%	2.74%
Global Aggregate - Hedged	1.74%	1.76%	2.91%	3.34%	NA
U.S. Aggregate	1.64%	0.01%	2.06%	2.52%	3.48%
U.S. Treasury TIPs	-0.42%	-1.26%	2.11%	1.69%	4.37%
U.S. Corporate High Yield	-4.53%	-2.08%	7.23%	3.83%	10.72%
Municipal	1.69%	1.28%	2.30%	3.82%	5.16%
International Emerging Markets	-0.18%	-2.46%	5.05%	4.23%	9.05%

Source: ftserussell.com, reit.com, us.spindices.com, msci.com, bloombergindices.com

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