# Economic & Market Overview

as of December 31, 2018

Fourth quarter market performance disappointed investors with the S&P 500 Index dropping 13.5 percent and the Russell 1000 Value Index dropping 11.7 percent on a total return basis. From the market closing high on September 20th to the near-term low on December 24th, the S&P 500 Index declined 19.4 percent on a total return basis, just missing the 20 percent decline that is normally associated with a bear market. Other markets also fared poorly. International stocks as measured by the MSCI All World Excluding the U.S. Index declined 12.7 percent in the fourth quarter. Bonds rallied moderately as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, gaining 1.6 percent in the fourth quarter, but year-to-date, the index finished essentially flat providing investors with little solace.

Several concerns continued to weigh on markets including trade conflicts, domestic politics and slowing growth in China. On top of these is a growing concern that the U.S. Federal Reserve may be tightening monetary policy too quickly. In 2018, U.S. GDP growth accelerated to an estimated 3.0 percent rate according to the December 19th Federal Reserve projections up from 1.6 percent in 2016 and 2.2 percent in 2017. Growth in 2018 was aided by tax cuts and increased federal spending. This led the Federal Reserve to raise the federal funds rate by 25 basis points, or 0.25 percent, four times in 2018. The federal fund rate has a direct impact on short term interest rates. This is up from three hikes in 2017 and only one hike in 2015 and 2016. At the same time the Federal Reserve is reducing the size of its balance sheet by reducing the holdings of bonds it purchased during the downturn, which could impact interest rates and/or asset prices, since it will increase the available supply of bonds in the market. While the Federal Reserve's December 19th statement also estimated for GDP growth to slow to 2.3 percent and estimated rate hikes would slow to only two in 2019, investors worried the Fed might overestimate growth and tighten too quickly. Typically, there is a lag between interest rate increases and their impact on the economy. Wall Street forecasters were hoping for more "dovish" language from the Fed, erroring in favor of moving too slowly rather than the continued moderate tone and measured pace that was projected.

Recessionary risk indicators have increased but remain low on a relative basis. If the Federal Reserve were to respond to market signals by further tempering its rate hike outlook, markets could respond positively. Also, potential resolution of the U.S. China trade conflict could be a positive market catalyst extending the length of the current business cycle. However, these potential positive outcomes should be balanced with the risk that given slower growth, there is less margin for error. Given this backdrop, we are looking to opportunistically add modest equity exposure that will increase diversification while still maintaining a moderate underweight to balance out market risks.



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