# RWM Monthly Market Commentary

*January 2019*

ReDefine
Wealth Management

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# Market Performance Roundup *As of 12-31-2018*

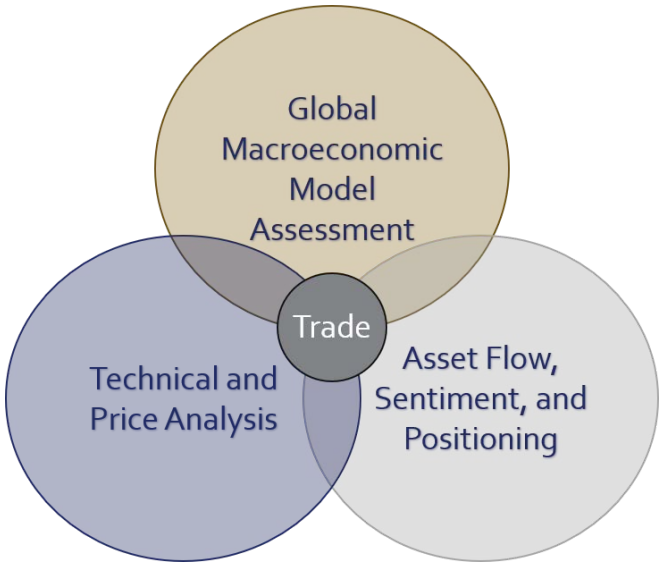
ReDefine Wealth Management

WORLD MARKETS

| | | DEC 31, 2018 | QTD | YTD | 1 YR. | 3 YR. | 2017 |
|---|---|---|---|---|---|---|---|
| **Global Equities** (USD, % chg.) | *MSCI All Country World (Total Return)* | *(7.00%)* | *(12.65%)* | *(8.93%)* | *(8.93%)* | *7.17%* | *24.62%* |
| | *MSCI World (Total Return)* | *(7.57%)* | *(13.31%)* | *(8.20%)* | *(8.20%)* | *6.90%* | *23.07%* |
| | *MSCI EAFE (USD) (Total Return)* | *(4.83%)* | *(12.50%)* | *(13.36%)* | *(13.36%)* | *3.38%* | *25.62%* |
| | *MSCI Emerging Markets (Total Return)* | *(2.60%)* | *(7.40%)* | *(14.25%)* | *(14.25%)* | *9.64%* | *37.75%* |
| **Country Equities** (Local, % chg.) | *Dow Jones Industrial Average (Total Return)* | *(8.59%)* | *(11.31%)* | *(3.48%)* | *(3.48%)* | *12.92%* | *28.11%* |
| | *S&P 500 (Total Return)* | *(9.03%)* | *(13.52%)* | *(4.38%)* | *(4.38%)* | *9.25%* | *21.83%* |
| | *NASDAQ (Total Return)* | *(9.40%)* | *(17.29%)* | *(2.84%)* | *(2.84%)* | *11.09%* | *29.64%* |
| | *Russell 2000 (Total Return)* | *(11.88%)* | *(20.20%)* | *(11.01%)* | *(11.01%)* | *7.36%* | *14.65%* |
| | *Nikkei 225 Stock Average (JPY) (Total Return)* | *(10.28%)* | *(16.78%)* | *(10.29%)* | *(10.29%)* | *3.67%* | *21.33%* |
| | *STOXX Europe 600 Euro (Total Return)* | *(5.44%)* | *(11.52%)* | *(10.22%)* | *(10.22%)* | *0.73%* | *11.22%* |
| | *FTSE 100 (Total Return)* | *(3.49%)* | *(9.64%)* | *(8.73%)* | *(8.73%)* | *6.75%* | *11.95%* |
| | *DAX 30 (Total Return)* | *(6.20%)* | *(13.78%)* | *(18.26%)* | *(18.26%)* | *(0.57%)* | *12.51%* |
| | *Shanghai Composite* | *(3.64%)* | *(11.61%)* | *(24.59%)* | *(24.59%)* | *(11.00%)* | *6.56%* |
| **Global Fixed Income** (USD, % chg.) | *Barclays Global Treasury (Total Return)* | *2.59%* | *2.12%* | *(0.38%)* | *(0.38%)* | *2.80%* | *7.29%* |
| | *Barclays US Treasury (Total Return)* | *2.15%* | *2.57%* | *0.86%* | *0.86%* | *1.40%* | *2.31%* |
| | *Barclays Global Aggregate (Total Return)* | *2.02%* | *1.20%* | *(1.20%)* | *(1.20%)* | *2.70%* | *7.39%* |
| | *Barclays US Aggregate (Total Return)* | *1.84%* | *1.64%* | *0.01%* | *0.01%* | *2.05%* | *3.54%* |
| | *Barclays Global High Yield (Total Return)* | *(0.75%)* | *(3.49%)* | *(4.06%)* | *(4.06%)* | *6.58%* | *10.43%* |
| | *Barclays US Corporate High Yield (Total Return)* | *(2.14%)* | *(4.53%)* | *(2.08%)* | *(2.08%)* | *7.22%* | *7.50%* |
| | *S&P Leveraged Loan Index (Total Return)* | *(2.54%)* | *(3.42%)* | *0.47%* | *0.47%* | *4.83%* | *4.11%* |
| | *Barclays Emerging Markets (Total Return)* | *1.37%* | *(0.18%)* | *(2.46%)* | *(2.46%)* | *5.05%* | *8.17%* |
| **Real Assets** (USD, % chg.) | *USD DXY* | *(1.13%)* | *1.09%* | *4.40%* | *4.40%* | *(0.84%)* | *(9.87%)* |
| | *Dow Jones US Real Estate Index (Total Return)* | *(7.68%)* | *(5.97%)* | *(4.03%)* | *(4.03%)* | *4.27%* | *9.84%* |
| | *Bloomberg Commodity Index* | *(6.89%)* | *(9.41%)* | *(11.25%)* | *(11.25%)* | *0.30%* | *1.70%* |
| | *S&P GSCI Gold* | *4.51%* | *7.11%* | *(2.14%)* | *(2.14%)* | *6.51%* | *13.68%* |
| | *S&P GSCI Precious Metals (Total Return)* | *5.17%* | *7.05%* | *(3.58%)* | *(3.58%)* | *5.39%* | *11.98%* |

**January 4, 2019:** *ReDefine Wealth Management* provides clients and business partners with a differentiated suite of services and products. This monthly commentary encapsulates how our team is looking at the world and the practical implications of our approach. It is designed to illuminate the process behind the implementation of investment decisions within ReDefine Wealth Management portfolios.

# ReDefine Investing with *Global Thematic* Portfolio Management




Anecdotal and historical evidence suggest that mitigating portfolio draw-down has the greatest impact on portfolio success.

*Quite simply, it is more efficient to grow wealth by not losing wealth.*

In order to facilitate portfolio success, ReDefine Wealth Management employs a Global Thematic approach to our investment portfolios. Meaning that our *Global Macroeconomic Analysis* provides the basis for attractive reward versus risk within global investment opportunities.

The findings of our macro analysis help to narrow down the field of potential investments and, coupled with our asset flow and sentiment analysis, works to inform our *Strategic Asset Allocation.*

Wherein we divide assets between the best opportunities that we can source within three primary portfolio components – *Global Equities, Fixed Income/Cash, and Real Assets*

Then we work to further divide the primary components into sub-components, for example Global Equities may be divided between disparate geographies and various capitalization sizes.

Once the general allocation is decided, we begin our *Tactical Investment Selection* to specifically choose the financial instruments we will use to implement our globally thematic strategic asset allocation. During this phase we employ our technical and price analysis to pinpoint our investments. It is important to note that our tactical investments are also directional – i.e. long and short.

Our disciplined processes allow us to handpick and tactically manage highly-liquid financial instruments, such as: *ETFs, Mutual Funds, Stocks, Bonds, CEFs, and Options.*

So, while we may hold similar "investments" as traditional portfolios, it is our approach and flexibility that allows for asymmetric returns relative to risk.

## Fundamental Global Macroeconomic Backdrop

### Goldilocks Has Left The Building

The last couple of years have delivered investors a mix of historically low interest rates, higher than average liquidity, abundant capital, quantitative easing, and low inflation. This provided a "just right" mix allowing for economic growth and risk-taking activities.

*Companies bought back record amounts of their own stock and investors couldn't get enough of the so-called FAANG stocks and high-yield bonds.*

The quality of investment fundamentals mattered little, as did traditional metrics like price-to-earnings ratios or book value per share.

This low volatility environment created a cyclical effect in which investors lost concern for potential downside and flooded index-based ETFs with money, leading to the proliferation of passive investing. It didn't matter what one owned, just that one owned as much as possible.

And anytime cracks appeared in the system, central bank leaders would swoop in providing enough liquidity to patch over any cracks in the foundation.

### 2018 Was The Year That Environment Changed

The "just right" Goldilocks conditions came to an end, caused primarily by the Federal Reserve's changing policy and expectations for the European Central Bank to follow suit. Throw in talk of trade wars and general political vitriol, the result was spiking volatility – headlined by an over 10% sell off in the S&P 500 in a few days in early February. *Exhibit 1.*

*After clawing its way to new highs by September, a more prolonged selloff in the S&P 500 - this time close to 20% - occurred.*

RWM has been voicing concern from the early days of quantitative easing and interest rates near zero. The difficult part as always, is timing. *It appears that timing has been revealed - and it is now.*

This is not to say that the sky is falling. However, it does mean that Goldilocks is on her way out of town.

### Where Do We Go From Here?

*As a reminder, our four major **Global Investment Themes** and general market assumptions at the beginning of 2018 were:*

**Stock Prices Will Stair-step Higher While Bond Prices Stair-step Lower**

**Global Inflation and US Interest Rates Will Rise**

**US Dollar Will Strengthen and Global Political Unrest Will Increase**

**Global Market Volatility Will Rise**

## Fundamental Global Macroeconomic Backdrop (cont.)

We will cover that question in much more detail in our 2019 Market Outlook, due to hit shelves (and inboxes) later in January. For now we will review 2018 and merely foreshadow our 2019 opinions in the pages that follow.

We will end this month's fundamental backdrop with a statement we made last commentary:

*"We also believe it likely that 2019 will be greeted by a challenging market due to continued volatility and heightened liquidity issues."*

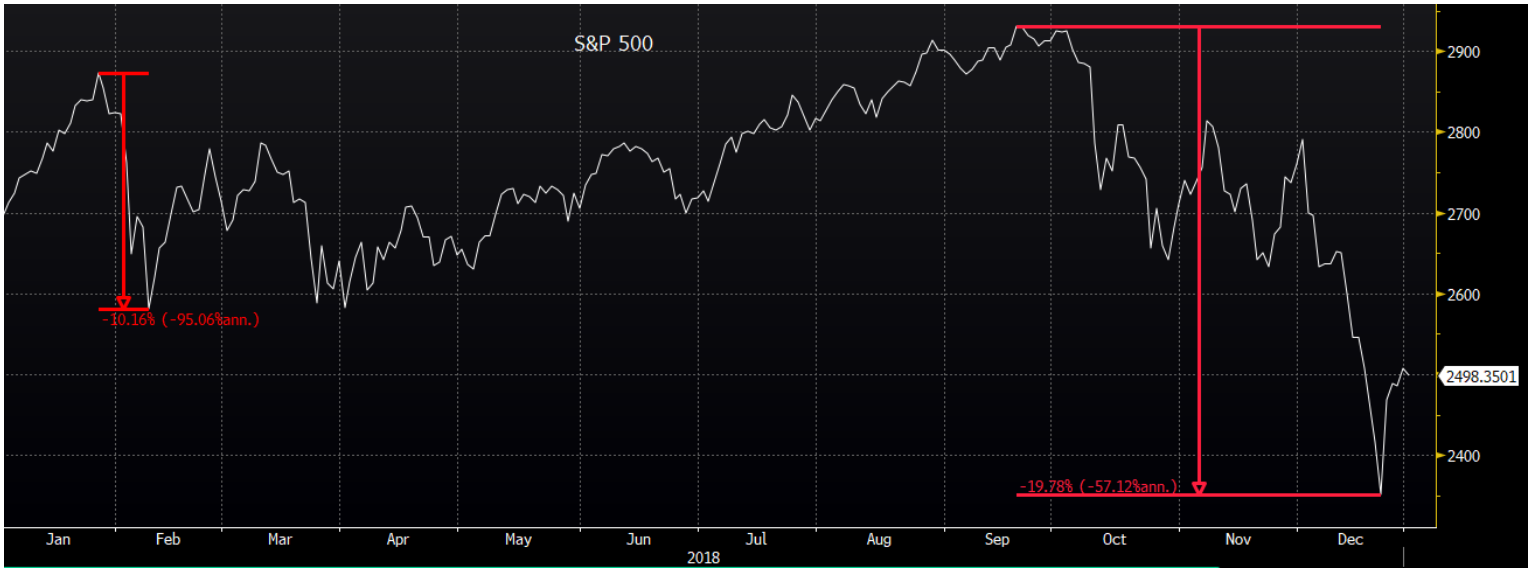



**Exhibit 1** ***Source: Bloomberg***

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## Global Equities

Volatility increased through December 2018 and investors experienced the *worst December performance for the S&P 500 since 1931*, and the worst monthly return – of any month - since 2009.

We believe, for reasons discussed throughout the year, that the investing environment has changed. Since 2010, specifically since 2016, there has been a "buy the dip" mentality within US equity markets. Meaning that investors would use any selloff as an opportunity to add stocks to their portfolio. This is a general bull market function. It appears that 2018 served as the potential transition from a bull market to a bear market. Increasingly shifting the investor mindset from "buy the dip" to "sell the rally". We do expect a scattered helping of market rallies over the next several months, however we fear the overall trend will remain lower lows and lower highs with increased volatility.

*This market change presents unique opportunities for investors, especially investors not bound by traditionally diversified portfolios.*

Growth stocks, those bought for expected future growth instead of current fundamentals or income, benefited the most from easy monetary policy over the last decade.

*Now that global central banks have employed a tightening policy through higher rates and ending easing operations, we believe that company fundamentals will matter once again.*

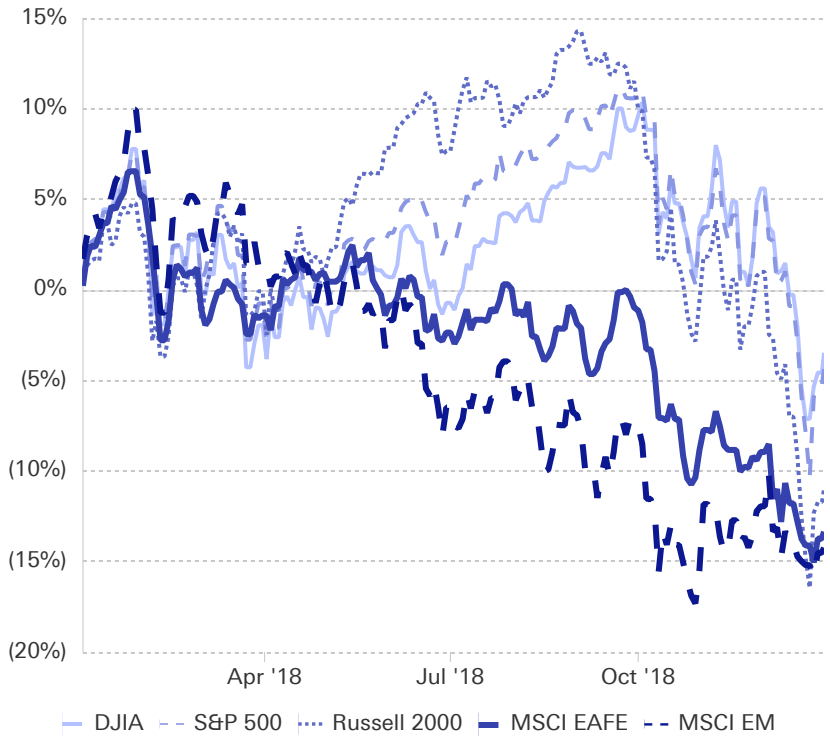
This should benefit value stocks to the chagrin of growth. Beginning in October, value stocks have outperformed growth stocks, which we expect to continue (yellow line on Exhibit 2).

Last month we wrote:

*"...we are not seeing higher highs and higher lows. We are seeing lower highs and lower lows."*

We found that trend disturbing to say the least, and a potential harbinger of clouds on

### Year to Date Global Equity Performance




| | CURRENT PERIOD | YTD |
|---|---|---|
| **Dow Jones Industrial Average (TR)** | (8.59%) | (3.48%) |
| **S&P 500 (TR)** | (9.03%) | (4.38%) |
| **Russell 2000 (TR)** | (11.88%) | (11.01%) |
| **MSCI EAFE (TR)** | (4.83%) | (13.36%) |
| **MSCI Emerging Markets (TR)** | (2.60%) | (14.25%) |

## Global Equities (cont.)

the horizon for global equities.

### Strangely, a Bright Spot in the Forecast is Volatility.

More precisely, the ability to invest our clients to benefit from rising volatility. Investors should pay close attention to volatility, as investing in volatility can provide returns in an otherwise declining market environment. Even when removing the short-term spikes that occur in the volatility market, generally higher levels have been set over the last two years - since the Fed began raising rates. *Exhibit 3.*

*In general, we believe the stage is set for a return to an environment favoring active managers.*

Meaning that asset managers who build portfolios through more traditional, fundamental, balance sheet analysis methods will provide more consistent returns and less volatility than passively buying the index. A winning recipe may be to make active management the portfolio's core equity exposure with shorter-term thematic trades added around such a core.


**Exhibit 2** ***Source: Bloomberg***

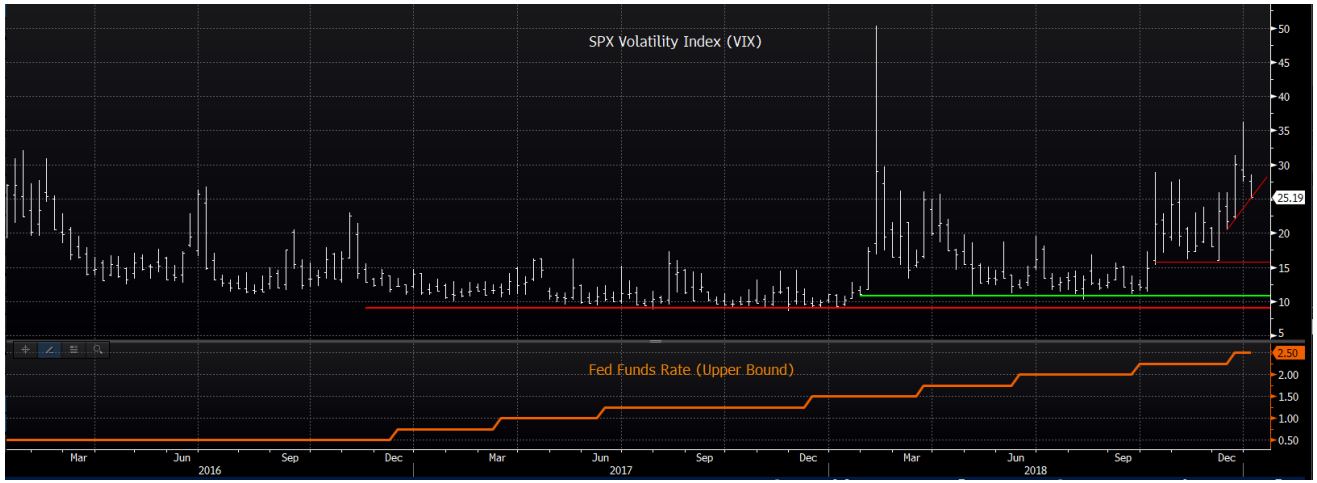



**Exhibit 3** ***Source: Bloomberg***

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## Global Fixed Income & Cash

*In a similar manner to equities, fixed income will experience a shift toward quality and away from risk-taking yield.* In fact, beginning with the equity market selloff in October we have seen that shift start in earnest. Interestingly, this happened while the Fed continued to raise rates, which is historically a time when bonds are supposed to sell off. Exhibit 3 demonstrates the out-performance of investment grade bonds over high-yield bonds. We believe this trend will continue into 2019.

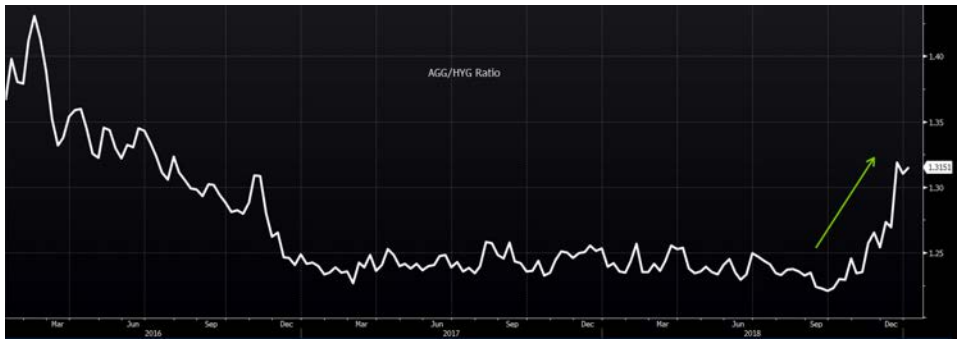


**Exhibit 4** ***Source: Bloomberg***

As publicly-traded companies face higher interest rates, lower ratings, less liquidity, and lower demand for their debt, it can be expected that their bonds continue to sell off. Potentially, bond managers will run into trouble attempting to sell less liquid, lower-quality holdings. *Creating an environment where bond managers may be forced to sell their higher quality bonds to fund redemptions.* Such environments were seen at extreme levels in 2008 and to a lesser extent in 2011 and 2015.

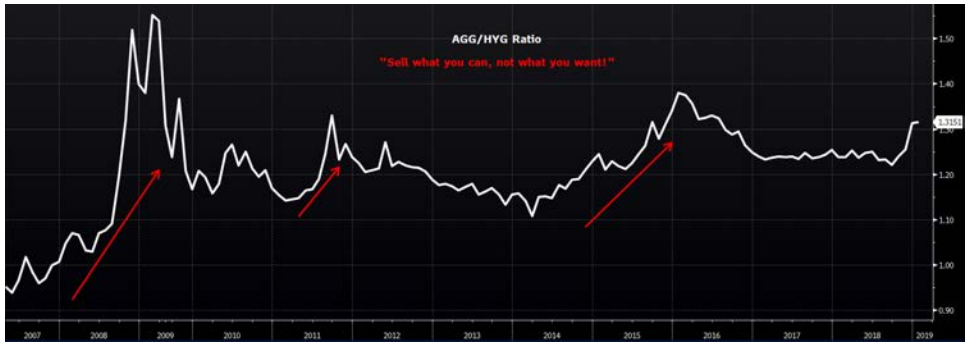


**Exhibit 5** ***Source: Bloomberg***

## Year to Date Global Bond Performance


| | CURRENT PERIOD | YTD |
|---|---|---|
| US Aggregate Bond | 1.84% | 0.01% |
| US HighYield | (2.14%) | (2.08%) |
| Global Aggregate Bond | 2.02% | (1.20%) |
| Barclays Emerging Ma... | 1.37% | (2.46%) |
| US 1-3 YR Treasury | 0.81% | 1.56% |

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## Global Real Assets

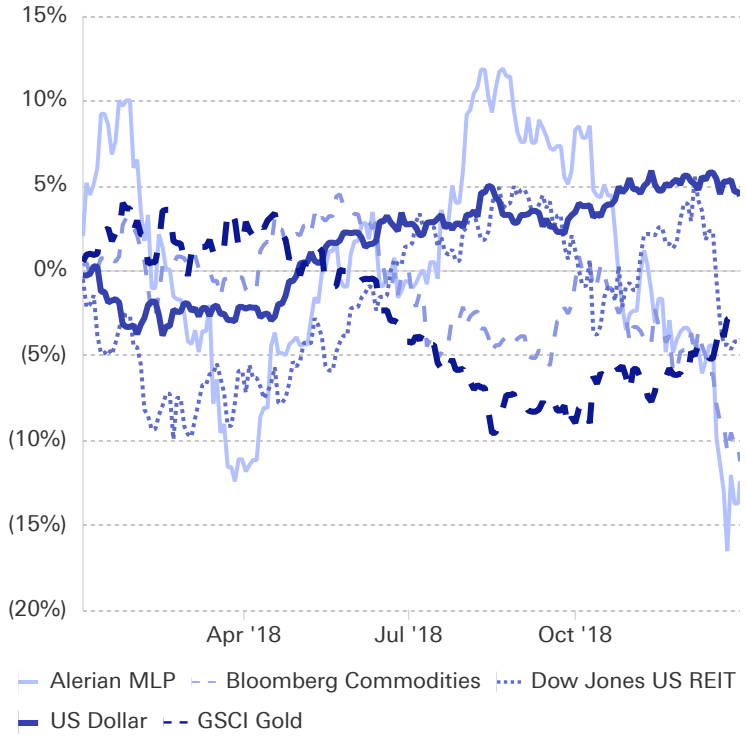
While not breaking out in dramatic fashion, the US dollar index strengthened throughout 2018 thus causing pressure throughout the global markets. *During 2018 we expressed our belief that commodities will not rally until the US dollar peaks,* which shouldn't happen until the Federal Reserve changes its current tightening policies. This change can manifest through a variety of actions, such as: pausing rate hikes, cutting rates, pausing the current quantitative tightening (QT) program, or beginning a new quantitative easing (QE) program.

As mentioned in last month's Commentary, precious metals have begun to rise along with the dollar over the last quarter. *We see this as a temporary "safe haven" move, meaning that investors will buy historically safe assets during times of market volatility.* There will be an opportunity for significant returns in precious metals, however we believe that it is farther down the road.

As an update, crude oil has dropped even more since last month's commentary, down as much as 44% from the peak in October - Exhibit 6. Oil appears to have found support, at least for the time being. And while oil precipitous decline may continue, we believe that if global trade issues ease and the dollar weakens in 2019, the oil market and associated companies may become very attractive.


**Exhibit 6** ***Source: Bloomberg***

## Year to Date Global Real Asset Performance




| | CURRENT PERIOD | YTD |
|---|---|---|
| **Alerian MLP** | (9.36%) | (12.42%) |
| **Bloomberg Commodities** | (6.89%) | (11.25%) |
| **Dow Jones US REIT** | (7.68%) | (4.03%) |
| **US Dollar** | (1.13%) | 4.40% |
| **GSCI Gold** | 4.51% | (2.14%) |

## Conclusion

With Goldilocks on sabbatical and fundamentals coming back into the picture, the beginning of 2019 promises to be exciting. Any major market rally should be taken with a grain of salt at this point, as the general trend appears to be headed lower. In our opinion, there is no cause for panic. Rather an opportunity to dodge bullets and seek out diamonds in the rough. We continue to closely watch monetary policy, both here and abroad. Once monetary policy shifts or changes, the currency effects will provide ample prospects for growth. More on that in our 2019 Market Outlook.

As always, please do not hesitate to reach out with any questions or concerns.

Happy New Year. May 2019 be a blessing for you and yours.

# Disclosures

INVESTMENT RETURNS PRESENTED IN THIS STATEMENT ARE NOT AUDITED RETURNS. INVESTOR PERFORMANCE MAY DIFFER DUE TO FACTORS SUCH AS THE TIMING OF INVESTMENTS, TIMING OF WITHDRAWALS, CUSTODIAL AND OTHER FEES.

Investment returns are compared to the performance of several indexes shown herein. Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. The number and types of securities found in the index can differ greatly from that of the accounts held in the strategy shown. Investments cannot be made directly in an index. Diversification does not guarantee a profit nor protect against loss. The investment portfolio does not seek to replicate or correlate with these indices. Market conditions vary between the investment portfolios and the indices, and the indices do not include reinvestment of capital as to the investment portfolios. Furthermore, investment portfolios invest in strategies and positions not included in these indices.

The standard deviations, information ratios and allocation targets may be higher or lower at any time. There is no guarantee that these measurements will be achieved. The information provided should not be considered a recommendation to purchase or sell a particular security. Any specific securities identified do not represent all of the securities purchased, sold or recommended for advisory clients, and may be only a small percentage of the entire portfolio and may not remain in the portfolio at the time you receive this report.

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