CHARTWELL REVIEW

January 2019 **FOURTH QUARTER 2018** *Volume XXV, Issue No.4*

RUDE Awakenings

Since its bottom on March 9, 2009, the S&P 500 index has gone 3,600 days without a 20% correction. But that's a technicality. Exceptionally weak market conditions during October and December left the index down 19.9% on Christmas Eve, from its record high close on September 20th. The NASDAQ and Russell 2000 dropped 24% and 27% from their late August highs. Talk about the Grinch that stole Christmas!

Since Christmas, the S&P is up 13%, the NASDAQ is up 15% and the R2000 has advanced 17%. These might all be dead cat bounces, with the really heavy stuff going to come down later this year (apologies to "*Caddyshack*"). But, and we know this sounds like Pollyanna, maybe investors got too far ahead of themselves in December. Maybe continued economic growth, the highest levels of employment ever, moderately growing real wages, relatively low inflation, growing industrial production, and real interest rates that remain low by historical standards, all count for something. Maybe corporate earnings will still *grow modestly* this year after 2018's blow-out experience, PE ratios will re-rate slightly upward after falling well over 20% in 2018, leading to equity returns bettering long-term historical averages of 10%. It could happen. In fact, with stock and bond valuations now below median, this is a quite possible scenario.

What stands in the way? For the first time in many years, markets are now pricing in pessimism instead of optimism. Viable investor concerns include higher interest rates, rising employment costs, a very poor international trade picture, a China slowdown, pressure on operating margins, etc., – the list is long, and points to a global economic slowdown in 2019. Credit spreads rose sharply in Q4, and aren't expected to be coming down soon. We're almost certainly past peak earnings growth for this cycle. All in all, we recommend investors look to strategically limit risk (volatility) exposures and increase liquidity, but not look to collapse risk assets.

(This is our 100th "Chartwell Review". Thanks for all your support!)

Figure 1: Index Benchmarks

Market Index	Trailing Returns *				
	4Q 18	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
S&P 500	(13.5)	(4.4)	9.3	8.5	13.1
U.S. Top-cap Stocks	(13.2)	(3.1)	9.9	9.0	13.0
U.S. Mid-cap Stocks	(15.4)	(9.1)	7.0	6.3	14.0
U.S. Small-cap Stocks	(20.2)	(11.0)	7.4	4.4	12.0
Non-US Stocks (**EAFE**)	(12.5)	(13.4)	3.4	1.0	6.8
Non-US Stocks (**Emerg**)	(7.4)	(14.3)	9.7	2.0	8.4
3 mo. T-Bills	0.6	1.9	1.0	0.6	0.4
U.S. Aggregate Bonds	1.6	0.0	2.1	2.5	3.5
High Yield Bonds	(4.7)	(2.3)	7.3	3.8	11.0
Global Aggregate Bonds	1.2	(1.2)	2.7	1.1	2.5
Consumer Prices	*(0.5)*	*1.9*	*2.0*	*1.5*	*1.8*
Blmbrg Commodities	(9.4)	(11.3)	0.3	(8.8)	(3.8)
MSCI World REITS	(4.5)	(5.0)	2.8	6.3	9.8

Figure 2: Average Mutual Fund Returns

Fund Category	Trailing Returns *				
	4Q 18	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
U.S. Large-cap	(13.6)	(6.3)	7.8	6.9	12.3
U.S. Mid-cap	(16.6)	(11.8)	5.6	4.3	12.3
U.S. Small-cap	(19.5)	(12.7)	6.1	3.6	11.8
International Lg. Cap	(13.2)	(15.1)	2.8	0.4	6.6
International Sm. Cap	(17.0)	(19.3)	2.5	2.2	11.3
Emerg. Mkt. Equity	(6.8)	(16.1)	7.4	1.1	7.9
Balanced/Hybrid	(7.6)	(5.0)	4.8	3.8	8.2
General Bond	1.0	(0.5)	2.2	2.4	4.5
High Yield Bond	(4.2)	(2.3)	5.6	3.0	9.2
Hedge Funds, Equity	(8.3)	(6.9)	3.6	2.3	5.7

*Annualized trailing returns for periods ending 12/31/18.

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Economies, Economics, Prices, and Policy

	2018	2017
CPI - headline, y-o-y	1.9%	2.1%
CPI - core, y-o-y	2.2%	1.8%
Unemployment Rate	3.9%	4.1%
Labor Force Growth (000's)	2,600	857
Employment Growth (000's)	2,880	1,789
Growth in Hourly Earnings %	3.2%	2.7%

The core inflation rate rose last year, while lower energy prices allowed the headline inflation rate to weaken. The unemployment rate declined only moderately during the year because labor force growth tripled 2017. Actual employment growth was robust, and hourly earnings grew 1% more than inflation. At the end of 2009, there were 15.1 million persons in the labor force without a job. At the end of 2018, that was down to 6.3 million.

Figure 3: Breaking Down 3rd Quarter* Real GDP

	% Change from Preceding Period			
Factor	3Q '18	2Q '18	1Q '18	4Q '17
Real GDP Growth	3.4%	4.2%	2.2%	2.3%
Nominal GDP Growth	4.9	7.6	4.3	5.1
Real Final Sales	1.0	5.4	1.9	3.2
Personal Spending	3.5	3.8	0.5	3.9
Private Investment	15.2	(0.5)	9.6	0.8
- Fixed, Businesses	2.5	8.7	11.5	4.8
- Fixed, Residential	(3.6)	(1.3)	(3.4)	11.1
*- Chg. In Inventories (**$bn**)*	*$93*	*($11)*	*$36*	*$21*
Export growth	(4.9)	9.3	3.6	6.6
Import growth	9.3	(0.6)	3.0	11.8
Government Spending	2.6	2.5	1.5	2.4

** BEA final estimate on 12.21.18*

The 3.4% annualized increase in real GDP in Q3 was paced by continued moderate growth in consumer spending for goods and services, and a rather stunning turnaround in private inventories. Inventory growth contributed 2.3% of the GDP change, the same as consumer spending. Increased government spending was more than offset by a big negative from net exports, which dropped sharply. All in all, it was a weak report.

Consensus estimates of 4th quarter growth remain positive. The Atlanta Fed's GDP Nowcast estimates real growth of 2.8%, modestly less than its peak forecast in December. This compares to the *Blue Chip* consensus estimate of 2.7%, in a range of 2.2-3.1%.

Businesses continued to hire during the quarter. The pace of payroll jobs growth remained highly favorable, with 762k created compared to 560k in Q3. Non-farm payroll jobs increased by 2.64 million during 2018.

Inflation rates in Q4 continued the decline we began to observe in Q3 -

⇒ **"Headline" CPI** declined (0.50%), or an annualized rate of (2.1%), and was up only 1.9% year-over-year;

⇒ **"Core" CPI** (*ex-food & energy*) rose only 1.0% annualized during the quarter and 2.2% during the past year.

⇒ The headline **Producer Price Index** for final goods and services rose 2.5% during the past year. The increase was 2.8% before food and energy.

On the monetary policy front, the Fed again raised the upper limit target Fed Funds rate by 25bps following its December meeting, to 2.50%. Real rates across the yield curve are modestly positive for the first time in a decade.

The market's reaction was very negative. Global equities sold off sharply on the Fed chairman's observations the US economy was doing well, the Fed would continue to reduce its balance sheet, and look to further "normalize" (raise) its base rate in 2019. Despite confusing media coverage, market bond yields actually d**eclined** across the curve during December, by an overall 26bps (the Barclays Aggregate Bond Index).

Existing-home sales ran at a seasonally adjusted annual rate of just 4.99mm in December, a 6% decline for the month and a 10% decline from a year ago. New housing starts were 1.33mm in November, 3.6% below a year ago. Weak housing data, given high employment, is a concern.

December data showed a 0.3% increase in total industrial production (IP) and a nice 1.0% increase in the crucial manufacturing component. In addition to December's gains, November output for overall IP and factory IP were both revised up. Simply, the manufacturing weakness observed in the summer did not continue into the fall. Third quarter labor productivity rose at an annualized rate of 2.3%, which bodes well for wages.

The IMF now forecasts the global economy will grow 3.5% this year and 3.6% in 2020, which is off 0.2% from October's outlook. They forecast U.S. growth slows to 2.5% this year and below 2% in 2020; Europe's growth drops to a very low 0.7% this year; and pan-Asia to 6.3% (from 6.5% for 2018). It sees China's growth slowing to 6.2% in 2019 and 2020, down from 6.6% for 2018 (we've seen lower numbers for China from US economists).

The IMF's dour forecast incorporates the impact of continued announced tariffs in its baseline forecasts (i.e., no March truce). It also cautions that, "a range of catalyzing events in key systemic economies could spark a broader deterioration in investor sentiments and a sudden, sharp repricing of assets amid elevated debt burdens." China's growth slowdown is also a risk that the IMF suggests investors don't fully appreciate.

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Treasury Yields Fall; Credit Spreads Widen

Per Figure 4, opposite, there were two themes which dominated fixed income returns during the 4th quarter :-

- *Falling* treasury bond yields, and;
- *Rising* credit spreads.

Both of these are fully consistent with the risk-off environment we experienced during the quarter. The former was responsible for the Long Treasury index dominating relative performance amongst the bond sub-sectors, followed by near-government agency mortgage-backed securities. The parallel shift in market rates favored long duration bond prices. Rising credit spreads drove high yield bonds and leveraged loans to by far their worst relative performance in two years. The high yield bond index saw its option-adjusted spread widen out 2% in the quarter, despite no elevation in default rates.

During the quarter, the Federal Reserve raised the federal funds rate by 25 basis points for the fourth time this year, to a target range of 2.25% to 2.5%, and lowered the expected number of rate hikes for 2019 from three to two. However, subsequent remarks by Fed governors has led the futures market to now price in **zero** Fed hikes for the first half of 2019. The market has completely flipped on this issue since December, and is now pricing in a small decline in the Fed Funds rate late this year.

The US Treasury curve experienced a fall in term rates, as the 10-year Treasury peaked at 3.23% in October only to end the quarter at 2.69%. The US 10yr-3mo yield curve spread flattened throughout 2018 (see figure 5), as the Fed pushed short-term rates higher. It flattened by 60 bps in the 4th quarter, ending the year at +24 bps compared to September's +84bps. The yield on 30-year Treasury was 3.01% at the end of December, also down 18 bps.

Investment grade (IG) spreads widened in the quarter, and accelerated in December. Fed rhetoric and declining oil prices rattled investors. A number of idiosyncratic events weighed on different parts of the IG market. Concerns about an oversupply of BBB-rated credits dominated the press, and we saw this sub-sector underperform the broad IG credit market by 0.9%.

Contrary to the rest of 2018, high yield bond and leveraged loan portfolios led the bond market down in Q4. They were joined at the bottom of the return charts by emerging market bonds, which were the worst performing fixed income sector for the year. Looking over the past three years cumulatively paints a very different picture. Top of the charts is global and US high yield (the lower rated the better), followed by emerging markets bonds, and leveraged loans. The top performing high quality sector during that time was the Long Gov't/Credit index.

Money market funds netted $162 bn of inflows in 2018; Taxable bond funds took in $125bn, despite seeing $43bn of outflows in December.

Figure 4: Primary Bond Sector Returns (%)

Index	4Q '18	1 Yr	3 Yrs	5 Yrs
US Aggregate Bond index	1.6	0.0	2.1	2.5
US Gov't/Credit: (1-3yrs)	1.2	1.6	1.2	1.0
US Treasury: Long	**4.2**	**1.8**	2.6	**5.9**
US TIPS (1-10yrs)	(0.1)	(0.3)	1.9	1.2
Mortgage-Backed (MBS)	2.1	1.0	1.7	2.5
CMBS	1.7	1.0	2.7	2.6
Asset-Backed (ABS)	1.3	**1.8**	1.8	1.7
Inv. Grade US Credit	0.0	(2.1)	3.2	3.2
Leveraged Loans	(2.9)	1.0	4.3	3.5
US High Yield Credit	**(4.7)**	(2.3)	**7.3**	3.8
Municipal Bonds, broad	1.7	1.3	2.3	3.8
Global Agg., ($ hdgd)	1.7	**1.8**	2.9	3.4
Global Credit, ($ hdgd)	(0.2)	(0.8)	4.1	3.7
Emerg. Mkts Bonds (US$)	(1.2)	(4.6)	4.7	4.2

Figure 5: Fixed Income Yields – 4th Quarter 2018

(YTM, % p.a.)	Dec-18	Sep-18	Dec-17	Dec-16	*1-Year Change*
US Treasuries					
3-month	2.45	2.21	1.39	0.50	***1.06***
2-year	2.5	2.81	1.89	1.20	***0.61***
5-year	2.51	2.95	2.20	1.92	***0.31***
10-year	2.69	3.05	2.41	2.43	***0.28***
30-year	3.02	3.20	2.74	3.05	***0.28***
BarCap Aggregate	3.28	3.46	2.72	2.61	***0.56***
BBB Credit	4.65	4.39	3.59	3.80	***1.06***
AA Credit	3.37	3.49	2.70	2.64	***0.67***
Agency MBS	3.39	3.59	2.91	2.85	***0.48***
Emerging Mkts ($)	5.95	6.40	5.26	5.79	***0.69***
US High Yield	7.95	6.34	5.84	6.17	***2.11***
UST 10yr - 3Mo	0.24	0.84	1.02	1.93	***(0.78)***

Figure 6: Sovereign Bond Yields, selected countries

10-year yields (%)	*Dec-18*	Sep-18	Dec-17	Dec-16	*1-Year Change*
Switzerland	(0.15)	0.13	(0.10)	(0.15)	***(0.05)***
Japan	0.02	0.10	0.04	0.04	***(0.02)***
Germany	0.16	0.51	0.45	0.27	***(0.29)***
Britain	1.34	1.59	1.25	1.27	***0.09***
Spain	1.41	1.36	1.50	1.43	***(0.09)***
Australia	2.29	2.75	2.68	2.79	***(0.39)***
United States	2.69	3.05	2.41	2.43	***0.28***
Italy	2.70	2.91	2.07	1.88	***0.63***
Poland	2.75	3.24	3.30	3.71	***(0.55)***
China (5 year)	2.97	3.49	3.88	2.93	***(0.91)***
Greece (new bonds)	4.40	4.04	4.08	6.72	***0.32***
Brazil	7.22	9.45	8.62	11.31	***(1.40)***
India	7.35	8.07	7.32	6.37	***0.03***
Russia	8.81	8.77	8.13	8.45	***0.68***

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Risk Off: US Stocks Fall Sharply

The market turmoil that began in early 2018 intensified during the 4th quarter, as the benchmark S&P 500 index declined nearly 20% between its September 20th peak and December 24th trough. This slide put US equities firmly in correction territory – and has raised questions about whether this could be the start of a much bigger decline.

The quarter's weakness came in three insidious parts –

1. A weak October, which saw the worst calendar monthly return for US equities in seven years. The powerful sell-off was initially triggered by rising Treasury bond yields;
2. A recovery in November amid signs the Fed might soften its monetary tightening stance in 2019. Defensive stocks outpaced cyclical sectors, as higher yielding stocks generally topped growth. Apple shares plunged 18%;
3. December happened. Thus, US stock indices experienced their worst quarter since 2011. The tech stock-heavy Nasdaq Composite and small-cap indices each plummeted more than 20%, into bear territory. The selling became indiscriminate, with many blue chip names declining 20-40% in market value.

Figure 7: U.S. Equity Market - Size/Style Returns

			Trailing		
	4Q '18	**1-year**	**3-yrs**	**5-yrs**	**10-yrs**
Growth					
Large Cap	(15.9)	(0.5)	11.4	11.2	15.2
Mid Cap	(16.0)	(4.8)	8.6	7.4	15.1
Small Cap	(21.7)	(9.3)	7.2	5.1	13.5
Value					
Large Cap	(10.1)	(6.2)	7.5	6.2	10.5
Mid Cap	(15.0)	(12.3)	6.1	5.4	13.0
Small Cap	(18.7)	(12.9)	7.4	3.6	9.6

In terms of style, defensive stocks held up best, including utilities companies, real estate, consumer staples (like Procter & Gamble, up 11%), and health care. This led the Value indices to outperform. In terms of cap size, the traditionally higher beta small cap stocks held true to form. They underperformed across the style spectrum.

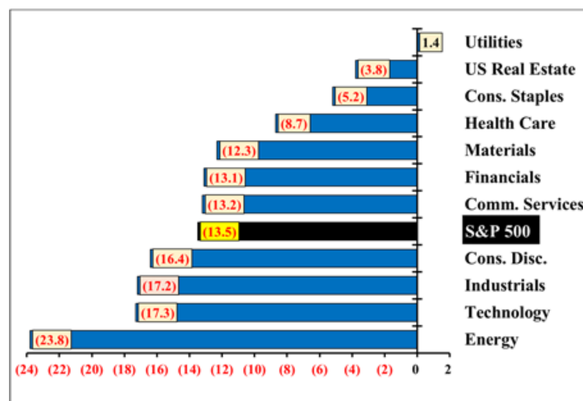
The trailing 1-year performance numbers dramatically favor growth stocks, as Figure 7 attests. This holds true across 3-10 years, although somewhat less so for small-cap stocks. We are currently in the longest and largest large growth long-term outperformance cycle in history, at 60 months. After such a period, historical experience is that value outperforms over the next three years.

Sector return differences in Q4 were rather dramatic, as Figure 8 reflects. The best performing S&P 500 sector was utilities, up 1.4% because equity investors favored the safety and security of high dividends. Far at the other end of the return spectrum were energy stocks, down 24%.

Among the larger sectors, tech stocks dropped over 17% for the quarter, with Apple and NVIDIA down 30% and 52%, respectively. The five largest negative contributors to the S&P's performance were all tech stocks, with Facebook, Microsoft and Amazon added.

The second-largest sector, health care, posted an above average (less negative) decline of 8.7%. Merck and Eli Lilly returned 8.5% each, and UnitedHealth Group was up 4.5%.

Figure 8: US Sector Returns – 4th Quarter 2018



Per Figure 9, trailing PE ratios at quarter's end were crushed. After eliminating companies with negative earnings, the S&P 500's 17.3x PE was 26% below its year-end 2017 figure. The Russell 2000 small-cap indices' 16x PE was 39% below year-end 2017. But, small-growth stocks took the worst hit to fundamental valuation, as the year-end PE of 19.5x was 44% below the year earlier.

Emerging and Developed Markets PE ratios declined by "only" 25% last year, because they were already trading at their lowest relative PE's in a decade.

Figure 9: Trailing P/E Ratios – December 2018

	Value	Blend	Growth
US Large	13.5	17.3	22.9
US Mid	13.5	15.7	20.8
US Small	13.7	16.0	19.5
EAFE		**12.3**	
Emerg. Mkts		**11.3**	

75% of the years following a 20+% decline in market PE's have seen a rebound in stock prices averaging 12%.

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International Markets – Good Riddance to 2018

Signs of slowing global economic growth pressured stocks as companies struggle to deal with deteriorating trade relations. Global stocks posted their worst quarterly returns since 2011. Developed international markets fell -12.5%, while emerging markets dropped "only" -7.5%. Oil prices plunged during the quarter, pulling the Canadian market down -15.3%. The all-inclusive MSCI AC World ex-US index fell -11.5%. For the first time since 2015, international equities posted negative annual returns; EAFE -13.8%, emerging markets -14.6% and the AC World ex-US index -14.2%.

In currency markets, the US dollar strengthened 2% during the quarter versus the euro and British pound, but weakened 3.5% versus the Japanese Yen. Plunging oil prices helped energy-importing countries and currencies – the Turkish lira soared 13%, and the Indian rupee and Indonesian rupiah each gained 4%. The Brazilian real rose 3%, and stocks rebounded after a sharp sell-off earlier in the year.

Figure 10: International Equity Markets – Returns

	U.S. Dollar Returns (%)		Local Currency Returns (%)	
thru 12/31/18	4Q '18	1-Yr	4Q '18	1-Yr
World ex-USA	**(12.8)**	**(14.1)**	**(12.1)**	**(10.9)**
- MSCI Growth	*(13.5)*	*(13.1)*	*(12.8)*	*(10.0)*
- MSCI Value	*(12.1)*	*(15.1)*	*(11.2)*	*(11.8)*
- Europe	(12.7)	(14.9)	(11.2)	(10.6)
- Pacific, ex-Japan	(7.9)	(10.3)	(6.6)	(4.5)
- Japan	(14.2)	(12.9)	(17.2)	(15.2)
- United Kingdom	(11.8)	(14.2)	(9.7)	(8.8)
Int'l Small Caps	**(16.2)**	**(18.1)**	**(15.7)**	**(15.2)**
Emerging Mkts	**(7.5)**	**(14.6)**	**(7.4)**	**(10.1)**
- EM Asia	*(9.3)*	*(15.5)*	*(9.6)*	*(13.1)*
- EM Europe	*(6.1)*	*(12.1)*	*(4.1)*	*2.5*
- EM Lat Amer	*0.4*	*(6.6)*	*0.9*	*3.8*
- EM BRIC	*(5.3)*	*(13.4)*	*(6.0)*	*(9.2)*

Within developed markets, Europe (-12.7%) and the Pacific (-12.2%) regions posted similar results in Q4. Japan was the weak link in the Pacific region, falling -14.2% despite the favorable currency effects. The Pacific *ex-Japan* index fell only -7.9%. Economic and fiscal readings diverged in Japan in Q4. Economic growth recovered from a 2.5% decline in Q3 GDP, when natural disasters hurt exports and tourism. The BOJ's accommodative monetary policy reached a negative milestone in November, as its balance sheet holdings exceeded the country's annual economic output. For perspective, the US Federal Reserve's balance sheet equals about 20% of US GDP.

In other areas of the Pacific region, Australian stocks fell by 8% on slowing growth, property market weakness and drought repercussions. Markets in Hong Kong (-4.5%), Singapore (-6.7%) and New Zealand (-6.6%) experienced single-digit declines.

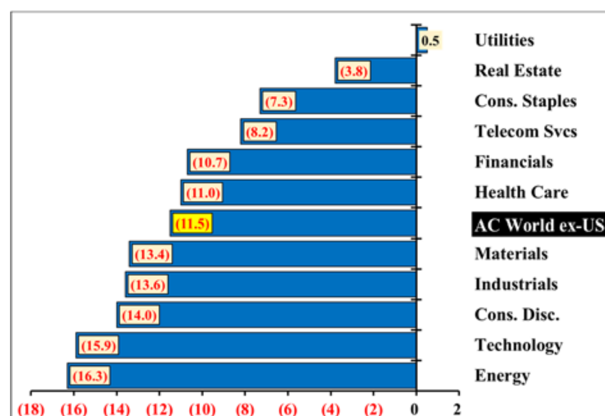
European markets declined sharply as economic growth slowed, uncertainty regarding a "deal or no deal" Brexit loomed, and the negative impact of the US/China trade dispute on Europe's trade-dependent economy set in. The GDP of Europe's 19-member union fell to only 0.6% in 3Q, down from 2.7% at the end of 2017. Spanish (-8.8%), Swiss (-8.9%) and Danish (-9.8%) markets dropped the least, while larger members of the union fell most; Germany (-15.5%) and France (-15.1%). The UK (-11.8%) Brexit plan crafted by Prime Minister Theresa May and approved by EU leaders was soundly defeated in Parliament, increasing the likelihood and uncertainties of a "no deal" exit in March.

Emerging markets (-7.5%) fell less than developed markets but still posted their third consecutive negative quarter. In Q4, Latin America (0.4%) was once again the best performing region (and best YTD, -6.6%), led by a rebound in Brazil (+13.4% in 4Q; -0.5% YTD). Large private sector banks surged, as did state-owned energy giant Petrobras after a right-wing candidate defeated the socialist candidate in October's presidential election.

Emerging Asian markets (-9.3%) dropped the most. Chinese stocks (-10.7%) suffered their worst quarterly loss since 2015, pressured by a slowing economy and uncertainty over trade tariffs. Internet and technology companies plunged with the global sell-off. Falling oil prices helped energy-importing countries like India (2.5%) and Indonesia (9.7%) rebound. In emerging Europe, Russia (-9%) was weakest performing country for the quarter but the best YTD (-0.7%).

From a sector standpoint, cyclicals lagged defensive sectors in Q4. Energy, technology, industrials, materials, and consumer discretionary stocks all underperformed. Utilities, telecomm services, healthcare and consumer staples stocks fared much better (declined less).

Figure 11: Ex-USA Sector Returns – 4th Qtr 2018



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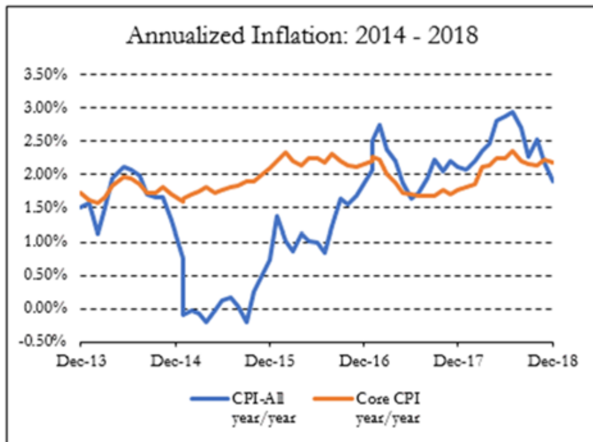
Back Page Perspectives

We observed last quarter that bull markets usually run a long time, while bear markets are short and savage. At 9.5 years old, the current recovery was longer than average. In a real sense we were set up for a good correction and the feeling amongst some CIO's is that many investors were looking for a reason as markets made new highs in Q3. Yet, we see the primary conditions that triggered this correction were all in place earlier this year. Thus, why Q4? Why now, and not six months ago or six months from now? Impossible questions to answer. Many are pointing to September's and December's 25bps rises in the Fed Fund's rate as the trigger (to give credit where it's due, T. Rowe Price's analysis lists 12 "key concerns").

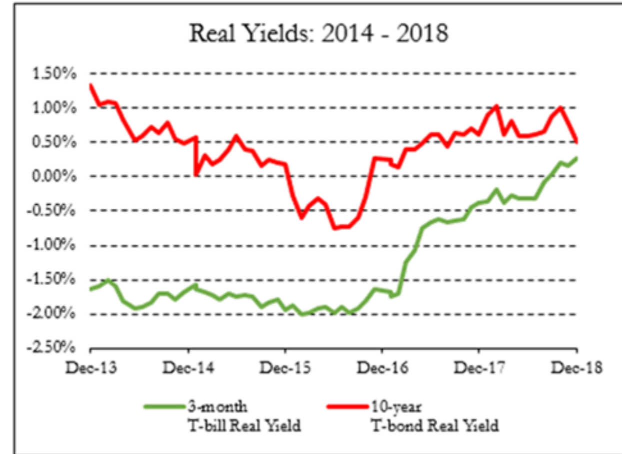
We're not seeing that. The issue with impactful market rates has always been their real levels. Nominal yields minus expected inflation. And, historically, the critical number has been 2%. For instance, short rates at 4% and current/expected CPI at only 2%.

We're not close to that spread. First, as the graph below indicates, core inflation outcomes during the last five years have been rising moderately, to just above 2%;



While real short-term and long-term yields have been rising (see following graph) during the last 2+ years, they remain solidly in the 0-1% range. Not really indicative of much tightness.

FWIW, we think the Federal Reserve's balance sheet liquidation exercise (aka, "quantitative tightening") is the much bigger deal at this juncture than a rising base rate. The QT program drains over $40bn per month from market liquidity, as the Fed does not reinvest the proceeds of bonds maturing on its balance sheet. We think the reason the domestic stock markets soared 3% on 1/4/19 (and have continued rising) was because Fed Chairman Powell essentially took the quantitative tightening program off autopilot during an interview that day, as well as backing off from any additional rate hikes in early 2019. Some are calling it the "Powell put."



The quarter's other big "trigger point" discussion is the recent markdown in earnings growth forecasts. We looked at the S&P's forecast in April versus the one it posted at year-end. There isn't any meaningful difference, yet we've seen continuing references to only mid-single digit growth in 2019, which will be a dramatic slowdown from 2018's pace. The pessimistic take is that S&P data is behind the curve, and its 2019 numbers will soon be weakening. We'll see. Continued earnings growth is huge.

S&P Operating Earnings Growth	4/23/18 Forecast	12/31/18 Forecast
2018	+25%	+26%
2019	+10%	+9%

Everyone's crystal ball gets very cloudy after a quarter and year like we've just had. It's being called "the year when nothing worked." There are many constructive elements in play now, but they all revolve around low valuations. If we're pitched into a global recession, employment will tank along with corporate earnings. All bets will be off.

Therefore, it continues to look to us like a good time to ensure that portfolios are well balanced (albeit equity-biased), diversified, conservatively positioned in terms of downside capture potential (low beta), and **holding liquidity for the next 6-12 months of net spending.** In a volatile market environment, staying power is critical.

Sell high, buy low. See you next quarter!

Natalka Bukalo
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