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Dear Clients of MacDougall Financial , Jan 18, 2019

"Nothing is more responsible for the 'good old days' than a bad memory"

The world is experiencing an outbreak of nostalgia, from democracies to autocracies, all are recalling, a bit too fondly, the glories of yesteryear. Slogans like "Make America Great Again", "The Chinese Dream", AMLO's mission to restore Mexican economic sovereignty, and the widespread desire for "old fashioned values" in Poland, Hungary and elsewhere are all symptoms of the glorification of yesterday. The causes are many and varied but one common denominator is a feeling of decline, a sense of precariousness in one's life leading to anxiety and anger. Large majorities in both rich and poor countries think that life used to be better, tech is worsening our employment prospects and inequality is on the rise. To dismiss these feelings as lies or half-truths leads one to a misunderstanding of the power of nostalgia. The digital revolution is altering all aspects of society and individuals naturally feel powerless and adrift. Nostalgia is reassuring, gives one self-esteem, a sense of belonging and most importantly, the illusion of control. Populists are feasting on nostalgia which progressives dismiss as prejudice given the often-present smorgasbord of xenophobia. In fact, it can be a force for good or evil and to improve the likelihood of positive outcomes, politicians need to find new ways to deal with insecurity and alienation. This will involve a lifelong public commitment to education, the devolving of power from central to regional authorities and wise handling of controversial issues like immigration and climate change. Demagogues have a simple powerful message – the glories of yesteryear. It is time for those committed to progress and harmony to remind all that a) our memories are faulty and b) problems always abound. Progress is made by solving them.

Volatility is very much the "new normal" for in the first 4 months of 2018, we more than tripled the number of 1% daily moves in the S&P 500. 2% moves in the NASDAQ rose from 3 in 2017 to 10+ by April 2018. It was a year when nearly all asset classes lost value. Here are the 3 top and bottom 2018 sector performances from worst to best: Energy -18.1%, Materials -14.7%, Industrials -13.3% and the 3 positive sectors are Consumer Discretionary +0.8%, Utilities +4.1%, and Health Care +6.5%. While this was the worst sector performance in years, let us remember that 14 of the past 16 years have been positive for the S&P 500, 39 of the last 50 years have been up and the current 10 year average annual return of the S&P 500 is north of 13%! You can be forgiven for thinking 2018 was worse than the actual -4.4% S&P 500 decline (incl. dividends) because the financial press was full of gloom, doom and recessionary forecasts. Q4 saw heightened uncertainty and a startling 14% decline in the S&P 500. Weighing on everyone's minds are the rising interest rates, quantitative tightening, slowing growth, trade wars, jobs and inflation. The closing weeks of 2018 saw a negative feedback loop beginning with lower trade figures flowing through to corporate profit reductions and ending with lower equity valuations. Many overseas markets have been in 'bear' territory (declines of 20%+) in 2018 and truly, the slowing Chinese growth affects everyone. Counterbalancing these negatives, to some degree, are three key strengths: US government spending is rising significantly (infrastructure anyone?), the consumer is healthy and business investment and profits are firm to rising (more jobs!). However, these strengths are built on a mountain of debt and with slowing GDP growth, more volatility is guaranteed. Debt is a double-edged sword and the 'cutting' is beginning in certain sovereign and private debts. We can hope that the restructuring of debts wakes up all politicians to its perils; but realism leads me to believe

they will do all they can to deny and obfuscate their profligacy. The US will not be immune, credit downratings will occur, but we have the largest, deepest and most active capital markets and ultimately, we can monetize the debt through the printing press. Not pretty, but a fact. Other countries and companies will feel more pain but fortunately the restructuring path is well trod (aka extend and pretend) so 'solutions' will be found. While few prognosticators see a high probability for a recession in 2019, many see one happening in 2020. I see regularly in my readings the words "uncharted waters" describing the actions of the Central Banks and from experience, I know that navigating such waters requires higher levels of caution.

Turning now to our portfolios and in keeping with the aforementioned caution, we have been defensive for some time, reduced our client's indebtedness, and are raising cash where appropriate. In the attached spreadsheet, you will see a mix of positive and negative returns with international funds leading to the downside along with small caps. Fortunately, these are also in most cases our smaller allocations. It was, unfortunately, a year of across the board negative equity index returns and most funds and ETF's followed suit. Once again, value funds in general underperformed growth funds. While most equity funds reported losses in the -2 to -15% range, bond funds rallied in the 4th quarter to end the year with circa 1% gains. It is a difficult investment environment because bonds are averse to rising interest rates and stocks don't like slowing growth. Typical of late stage investing is the feeling that it is too early to buy bonds and too late to buy stocks. However, the core economic indicators, at least in the US, look good. Strong labor growth, rising wages, low inflation, and strong corporate profitability, all bode well for the near term (1 yr.). One of the lessons of the 2018 correction is that diversification works to one's benefit especially when there was a wide disparity in negative returns (last year). By maintaining most individual fund allocations in the 3-8% range, the performance results are smoother. The other lesson from a decline in portfolio values is to look at the 3, 5, and 10 year returns and invariably you will be happier. You will see in your Asset Allocation report that inflows were high in 2018 due to large mutual fund payouts and these inflows should be netted against the loss shown in the Market Results row to arrive at the net performance for the year. We will be in touch with you about your portfolio and any recommended adjustments. In these cautionary times and depending on your circumstances, we like to carry in cash and bonds an amount that covers 1-3 years of your expenses. These "safer" funds are tapped when equities go south thus giving the equities time to recover. Also, we can now earn circa 1.8% on s/t prime obligation funds so cash is not as "dead" as it used to be. It was in fact the best performing asset class in 2018…..sad to say.

Looking ahead, our key worries center around the polarization of the urban rural divide with its political ramifications; and the ongoing impact of the digital revolution on all industries. Price transparency is upending all business models and underscores the uncertainties about jobs, the future and our lives. In the media business, within one generation, we have gone from broad casting (TV networks) to narrow casting (cable) to now monocasting via the internet. Rapid change shreds the ties that bind us and true national, not partisan, leadership is required for progress to prevail. Where that will come from is anyone's guess….but it is darkest just before dawn. In closing, I will paraphrase Yogi Berra and say that nostalgia is not what it used to be! Please contact us with any queries.

Best, Lanny