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To say that 2018 was a challenging year for capital markets would be putting it mildly. Despite healthy fundamentals, the extreme volatility experienced during the 4th quarter was enough to set new records, both bad and good. Volatility ranged from the worst Christmas Eve ever for U.S. markets to the largest one-day gain within the Dow Jones Industrial Average (DJIA) of over 1,000 points. A bombardment of negative news made it extremely difficult to focus on fundamentals and objectively identify ongoing concerns. Nevertheless, we held steady in an environment that could easily unnerve both individual investors and professionals alike.

U.S. equity markets convincingly broke below our fundamental DJIA support level of 23,750, resulting in what we perceived as an oversold market. The question was “How far down will it go?” before we initiated portfolio changes to take advantage of beaten down positions with the greatest upside potential relative to fundamentals. After bouncing back from a point slightly under 22,000, we started to make some changes in portfolios, where deemed appropriate, to take advantage of attractive entry points. We will continue cautiously with any needed portfolio adjustments, including cash, under the cloud of unresolved issues involving the trade war with China and the current partial government shutdown. We believe a timely resolution of these two factors is currently more important than the street’s focus on the Fed and the fear of an inverted yield curve. It has been noted that much of the market volatility has been attributable to automated trading programs utilizing algorithms involving the yield curve.

Based on our latest analysis, our 2019 DJIA target has been revised slightly downward from 26,200 to 26,000 due to recent negative earnings adjustment trends. The softness on the bottom line has been caused by an anticipated slowdown in U.S. GDP growth as well as rising labor & materials costs and other expenses. Despite the lowered DJIA target, the possibility of a 10%+ return for 2019 is not out of the question due to a lower year-end close of approximately 23,300 in 2018. Looking at the point-to-point scenario, we see most of the returns for 2019 driven by a recovery from oversold levels and not the continuation of a strong economic bull cycle. We believe domestic GDP growth for 2019 will be in a healthy range of 2.5% to 2.9%, in line with the International Monetary Fund’s projections. However, it should be noted that our expectations are contingent on a near-term partial resolution of the trade war with China. Should the situation not be resolved in a timely manner, expect an even lower GDP growth projection with the possibility of a recession.

The Fed should be taking a back seat now after raising rates again last December. We believe there was not a real need for the last rate increase due to many uncertainties, including the trade war. We believe that inflationary pressures will ease as we look at the three non-demand factors referenced in our prior commentary: the U.S. dollar, oil prices and tariffs. During the past quarter, the strengthening of the dollar and the significant drop in oil prices should provide some relief regarding inflation concerns and the need to raise rates. The decision on tariffs remains the unknown variable moving forward. Of course, employment and wage growth readings will continue to be monitored closely. Like the mystery surrounding strong employment figures without immediate significant wage growth, is it possible for a recession to occur while the employment environment remains robust? We shall see.

We would like to express our greatest appreciation to our clients who remain confident in our approach as we move through one of the most volatile market environments on record. In closing, we would also like to wish everyone a prosperous and Happy New Year! As always, please do not hesitate to reach out to your consultant if you should have any questions or concerns.