Beacon Trust
INNOVATING WEALTH STRATEGY

Market Outlook 4Q 2018 Review — January 2019

Fourth Quarter Summary

Looking back at 2018 stock market performance, Charles Dickens' classic line, "It was the best of times, it was the worst of times…" comes to mind. Stocks started with a bang in January with the S&P 500 rising 5.7%. The year ended with a thud, with the S&P 500 turning in its worst monthly return (-9.0%) since the midst of The Great Depression (1931). As the year came to a close the S&P 500 was down 4.4% on a total return basis, its first calendar year loss since 2008, and flirted with entering a formal bear market, usually defined as a drop of more than 20% from a prior peak.

On a quarterly basis, the S&P 500 fell 13.5%. Bonds rebounded in the last quarter, rising 1.6%, barely pushing the Barclay's Aggregate Bond Index into positive territory for the calendar year. Within the equity space, small cap and international also had disappointing performance. The Russell 2000, the most widely followed small cap index, plunged a harrowing 20.2% during the fourth quarter and 11.0% for the full calendar year. The MSCI World Index (ex US), a widely followed international index, fell 12.8% over the fourth quarter and steep 14.1% in 2018. Cash like investments were among the few asset classes in positive territory for the full calendar year. There was no single factor that explained the decline across most equities, but rather a varied mix, namely: the escalation of U.S.-China trade tensions; slowing global growth; concerns that the Fed is raising rates too fast; the ongoing Mueller investigation; the government shutdown; and sudden changes in Trump administration personnel.

Market Outlook

Despite the turmoil in equites, we believe the economic fundamentals are on reasonably firm footing. GDP growth exceeded 3% in 2018 and is poised to slow in 2019, but still grow at a reasonably attractive 2%+ rate. The unemployment rate is at its lowest levels in almost 50 years. Inflation is tame, holiday spending increased solidly, real estate prices are at all-time highs at the national level and business and consumer confidence remain strong, although down from their most recent highs. In this backdrop we believe stocks may gain in proportion to earnings growth in 2019, with most analyst estimates ranging from the mid to high single-digit gains for the S&P 500. We believe the Fed will remain largely on hold throughout 2019, with a slight bias towards upward rates across the yield curve given the increasing federal budget deficit. In this backdrop, we expect investment grade fixed income investments, of both the taxable and tax-exempt categories, to earn very low single-digit returns. Fixed income also provides important diversification benefits as most investors rediscovered during the last quarter of 2018.

What would change our minds on this modestly optimistic market outlook, besides data pointing to an upcoming recession? We are closely watching two events that will occur during the first quarter of 2019. Specifically, the Federal Reserve Open Market Committee meeting on January 29-30 and the U.S.-China tariff deadline on March 2nd. If both events conclude in a market friendly manner, the bull market, which began in March 2009, may continue. However, if one or more of these events unfolds in a negative manner, we expect to see continued volatility and may consider making an asset allocation change near those time frames. In addition to the risks of rising interest rates and a worsening of U.S.-China trade relations, we remain concerned with geopolitical risks in Russia, North Korea, Europe, Venezuela, and the Middle East. The Mueller investigation is expected to formally close in 2019 and its findings (thus far largely unknown) may result in increased market volatility.

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