4Q2018

THE INVESTOR QUARTERLY

MARKET COMMENTARY AND INVESTMENT PERSPECTIVES

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WELCOME

Greetings,

The fourth and final calendar quarter of 2018 was not a good one for equity markets. Investors had to contend with rising U.S. Central Bank (Federal Reserve Bank, aka "the Fed") interest rates, weaker than expected Chinese economic growth, a sharp slowdown in Eurozone business confidence, and rising geopolitical concerns, including, but not limited to, "Brexit", Italian banking problems, and the ongoing trade conflict between the U.S. and China. The "decoupling" of the U.S. economy from the global economies we observed last quarter was less pronounced in the fourth quarter, with most major global economies trending in the same direction, collectively evidencing slower growth than in previous quarters in 2018. As this is written, the U.S. Bureau of Economic Analysis ("BEA") hasn't published its initial reading for growth in Q4 2018 U.S. Gross Domestic Product ("GDP"), but the Atlanta Federal Reserve's "GDP Now" estimate for Q4 2018 GDP is +2.7% [(1)], which if ultimately proven correct, while still quite respectable, would reflect a substantial slowdown in the rates of economic growth in GDP seen in Q3 (+3.5%), and in Q2 (+4.2%).

According to Trading Economics, the Eurozone grew its collective GDP by just +1.2% in Q4, down from +1.6% in Q3 [(2)]. Like the U.S., virtually every major European economy saw continued expansion, but also like the U.S., most delivered much lower rates of growth than in the previous quarters. The "Big Four" European economies, Germany, the United Kingdom, France and Italy, were generally illustrative of this slowdown. Germany's economy grew by 1.1% in Q4, following a +2.0% report in Q3. The U.K economy was the exception in the region, improving slightly over its Q3 report of +1.4% with Q4's growth coming in at +1.5%. France grew its GDP by 0.9% in Q4 (Q3 was up +1.3%), and Italy managed to barely keep its expansion going, growing a meager +0.1% in Q4, versus the +0.6% growth it experienced in Q3 [(3)].

Most Asian economies suffered the same weakening economic growth rates. China, the world's second largest economy, reported +6.4% growth in its GDP during Q4, versus the +6.5% it reported the previous quarter. Japan's GDP was completely "flat" (0.0%), quarter over quarter, following the +1.4% growth rate it reported in Q3. India's GDP grew +7.1% in Q4, versus a robust +8.2% in Q3. South Korea's economy bucked the trend, growing its economy by +3.1%, versus the +2.0% it reported in Q3, while Indonesia grew its economy by +5.17%, down slightly from the +5.27% it reported in Q3 [(4)].

All major global equity markets posted large losses in the 4th Quarter. In local currency terms, the best performing markets were the MSCI Emerging Markets, collectively losing (-7.4%), followed by MSCI Asia ex-Japan (-8.9%), U.K.'s FTSE 100 Index (-9.6%), MSCI Europe ex-U.K (-11.8%), the U.S. S&P 500 Index (-13.5%), and the worst performing equity market, Japan's TOPIX Index, which declined by (-17.6%) during the fourth quarter [(5)]. For all intents and purposes, there was nowhere to hide in the global equity market last quarter.

The fourth quarter of 2018 saw the S&P 500 Index decline by (-20.2%) from its all-time high reading of 2,940.91 reached intraday on September 21st, to its intraday low reading of 2,346.58 the day after Christmas. Technically, this ended the longest "bull market" in history, an incredible market advance of +341% that began nine years, 295 days ago, when the violent market crash that accompanied "The Great Recession" ended March 6th, 2009 with an intraday reading of 666.79 [(6)].

The Russell 2000 Index also experienced a severe decline, falling (-27.27%) from its intraday "peak" reading of 1,742.09, to its intraday "trough" of 1,266.92, recorded on December 24th. The NASDAQ

(1) https://www.frbatlanta.org/cqer/research/gdpnow.aspx
(2) https://tradingeconomics.com/euro-area/gdp-growth-annual
(3) https://tradingeconomics.com/country-list/gdp-annual-growth-rate?continent=europe
(4) https://tradingeconomics.com/country-list/gdp-annual-growth-rate?continent=asia
(5) https://am.jpmorgan.com/gb/en/asset-management/gim/adv/insights/market-insights-monthly-market-review-december-2018
(6) https://www.marketwatch.com/investing/index/spx/historical

WELCOME

Composite fell (-23.89%) from its intraday peak reading of 8,133.30 on August 30th, to its intraday low of 6,190.17, recorded on December 24th. The Dow Jones Industrial Average was the only domestic stock index to avoid a bear market decline of (-20%) or more, falling (-19.44%) from October 3rd, when it reached its all-time high of 26,951.81, to its intraday low reading of 21,712.53 recorded on December 26th [7].

For U.S. investors deploying capital overseas the U.S. Dollar was a bit of a tailwind in 2018. The U.S. Dollar Index (DXY), a measure of the Dollar's value versus a trade-weighted basket of foreign currencies (the Euro, Japanese Yen, Pound Sterling, Canadian Dollar, Swedish Krona and Swiss Franc) [8] appreciated +4.40% during 2018, with +1.09% of that appreciation occurring in Q4 [9]. For U.S. Dollar-denominated investors, the worst performing developed foreign markets in Q4 were Germany (-15.5%), France (-15.0%), Japan (-14.2%), Sweden (-14.1%), Italy and the U.K., each declining (-11.8%), the Netherlands (-11.0%), and Australia (-10.0%). The emerging markets were a mixed bag for U.S. Dollar-denominated investors, as investment losses in Mexico (-18.7%), Taiwan (-13.7%), and South Korea (-12.8%) were contrasted by gains of +13.6% in Brazil, +9.8% in Indonesia, and +2.5% in India [10]. Much of the U.S. Dollar's appreciation in 2018 was the result of the Fed's four quarter-point hikes of the Federal Funds Rate, the overnight lending rate the Fed charges member banks, the most recent of which was announced December 20th, bringing the rate to 2.25% - 2.50% [11]. Rates that high attract capital from the Eurozone economies, where the ECB has overnight lending rates of just +0.4%, and from countries like Japan (-0.1%), Sweden (-0.25%), Denmark (-0.65%), and Switzerland, which has the lowest overnight interest rate at (-0.75%) [12].

In addition to leading major global Central Banks in their efforts to "normalize" (increase) interest rates, the Fed is also aggressively reducing its Balance Sheet. From December 2008 through December 2013, the Fed employed what it called "Quantitative Easing" ("QE") policies in addition to mainlining a "Zero Interest Rate Policy". QE was the previously unseen practice of printing money to purchase debt instruments to keep interest rates low all along the yield curve. The Fed's Balance Sheet consists of those purchased securities, and it peaked on January 12th with a whopping $4.516 Trillion in debt securities. In 2018, the Fed began to "unwind" (reduce) its Balance Sheet in earnest and finished the year with a Balance Sheet of $4.058 Trillion [13]. That $458 Billion reduction in its Balance Sheet, coupled with the four quarter-point hikes in the Fed Funds Rate they announced last year combined to "spook" investors in Q4, and along with the threat of a "Trade War" with China, certainly contributed to the equity market's decline.

The U.S. Bond market had a challenging year as well, as the Fed pushed rates on the short end of the yield curve sharply upward, actually "inverting" portions of the yield curve during the latter part of the third quarter. After three consecutive quarterly declines in bond prices, the bond market "rallied" a bit in Q4, with the Bloomberg Barclays U.S. Aggregate Total Return Bond Index, a proxy for the U.S. bond market overall, rising +1.64% to finish December 2018 at 2,046.60, just a fraction of a point higher than where it finished calendar-year 2017 (2,046.37 on 12/29/2017) [14].

Broadly speaking, we continue to see risks to both equity and debt markets as we head into 2019. The prospects for trade wars, overly-aggressive monetary policy, government shutdowns, the potential for slowdowns in both corporate earnings, and global economic growth, as well as geopolitical risks, are at the forefront of investors' minds today. Investors should be mindful of "headline risks", and tolerant of market volatility, especially in the near-term, as many of the uncertainties

(7) https://www.marketwatch.com
(8) https://en.wikipedia.org/wiki/U.S._Dollar_Index
(9) https://www.marketwatch.com/investing/index/dxy/historical
(10) https://content.rwbaird.com/RWB/Content/PDF/Insights/Quarterly-Market-Chart-Book.pdf
(11) https://www.federalreserve.gov/monetarypolicy/openmarket.htm
(12) https://en.wikipedia.org/wiki/List_of_countries_by_central_bank_interest_rates
(13) https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm
(14) https://www.bloomberg.com/quote/LBUSTRUU:IND

WELCOME

mentioned will manifest themselves in the first half of 2019 if they manifest themselves at all.

As always, we appreciate your continued support of our efforts, and welcome your comments.

Thank you,

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THE MARKET AT A GLANCE

U.S. EQUITIES:

The U.S. equity markets experienced its worst quarter since 2011. Concerns over the deepening trade conflict with China, as we'll as the partial "inversion" of the yield curve renewed concerns about the sustainability of the current economic expansion, and those concerns ended the longest bull market in history.

Every sector of the U.S. markets declined except Utilities, which posted a meager +1% gain for the quarter. The worst performing sector in Q4 was the Energy sector, which declined by (-24%) as West Texas Intermediate Crude Oil prices fell (-38%) during the period ending December 31st. Following the Energy sector in decline, Information Technology stocks and Industrials fell (-17%) each. Consumer Discretionary stocks depreciated by (-16%) for the quarter, followed by Communication Services and Financial stocks, each declining (-13%). Materials stocks fell (-12%), Health Care companies gave back (-9%), Consumer Staples declined by (-5%), and Real Estate stocks were off by (-4%) by the end of the quarter [15].

Large Cap stocks continued their dominance over Small Cap stocks during the fourth quarter of 2018, with the Russell 1000 Index declining (-13.8%) during the period, while The Russell 2000 Index declined by (-20.2%). That said, for the first time in several years "Value" stocks outperformed their "Growth" counterparts, with the Russell 3000 Value Index declining (-12.2%) during Q4, while the Russell 3000 Growth Index fell by (-16.3%). The rotation to "value" during times of market volatility is not unusual, as investors seek the shelter of companies with solid balance sheets and earnings when markets are volatile [16].

From a traditional, "fundamental valuation" perspective, relative to the earnings U.S. corporations have delivered, stock prices have been elevated above historical "norms" for several years now. Using the S&P 500 Index as a proxy for large U.S. companies, "fair value" has historically ranged from 13 X four-quarters' (trailing) Operating Earnings, to 17 X four-quarters' trailing earnings. If the Index were to trade at a "P/E Ratio" below 13 X four-quarters' (trailing) Operating Earnings, stock prices would traditionally be considered inexpensive, if not downright "cheap". When the Index has traded above 17 X its four-quarters' (trailing) Operating Earnings, stocks have been considered "expensive", and in some cases, "overbought". Since the end of 2013, the S&P 500 Index has continuously traded above 17 X its four-quarters' (trailing) earnings per Index share, with the P/E Ratio reaching 21.17 X at the end of 2017. With Operating Earnings over the four quarters ended Q4 2018 expected to reach $155.56 per Index share, and prices falling as they did in the quarter, the four-quarters' (trailing) P/E Ratio of the S&P 500 Index has now been compressed to 16.12 X on December 31st, 2018. While certainly not "cheap", investors can be cheered by the fact that large-cap stocks are no longer considered grossly "overvalued" [17].

The S&P 400 Index, a proxy for Mid-Cap domestic stocks having a median market capitalization of $3.8 Billion, saw its four-quarters' trailing Price/Earnings Ratio compress to 22.72 X earnings per Index share, from the 23.57 X it posted on September 30th [18]. The S&P 600 Index, a proxy for Small-Cap domestic stocks having a median market capitalization of $1.1 Billion, actually saw its trailing four-quarters' P/E Ratio expand slightly during the quarter, from 42.21 x Index earnings on September 30th, to 43.03 X Index Earnings at December's end [19].

Yale University Finance Professor Robert Shilling's CAPE Index, which "smooths" the impacts of earnings volatility by dividing the current S&P 500 Index Price by the average of its 10-Year's earnings saw a dramatic decline in the P/E Ratio, from September's ending P/E of 32.80, to December 31st's reading of 28.41 X. That is still historically elevated,

(15) https://www.capitalgroup.com/content/dam/cgc/shared-content/documents/reports/TI_WMR_PDF_4Q.pdf
(16) https://content.rwbaird.com/RWB/Content/PDF/Insights/Quarterly-Market-Chart-Book.pdf
(17) https://us.spindices.com/indices/equity/sp-500
(18) https://us.spindices.com/indices/equity/sp-400
(19) https://us.spindices.com/indices/equity/sp-600

with the median reading (going back to 1870) for the Index being 15.70 X, but it's far below the December 1999 reading of 44.19, or even the 30.00 reading recorded back in 1930 [20].

INTERNATIONAL DEVELOPED MARKETS:

Foreign equity markets were not spared from the stock market sell-off, but generally held up better than the S&P 500 Index, which declined (-13.5%) during Q4 2018. Germany and France were the worst performing foreign developed stock markets, declining (-15.5%), and (-15.0%) respectively during the quarter. Japan (-14.2%) and Sweden (-14.1%) were the only other two developed foreign equity markets that declined more that the S&P 500 Index. The MSCI E.A.F.E. Index, a proxy for non-U.S. developed markets declined (-12.5%) in Q4 with countries like Spain (-8.5%), Switzerland (-8.9%) and Australia (-10.0%) experiencing the smallest market declines. Like the U.S., the only sector to deliver positive performance in foreign developed equity markets during Q4 was the Utilities sector, which gained a modest +0.5% during the period. The worst performing sectors in the foreign developed equity markets in Q4 were Information Technology, which declined by (-14.6%), followed by Consumer Discretionary stocks (-14.1%), Industrial stocks (-13.7%) and Materials stocks (-13.4%). The best performing sectors in foreign developed equity markets besides Utilities, were Communication Service stocks declined just (-5.5%) during the quarter, and Consumer Staples, which declined by (-7.4%) for the period [21].

As was the case in the U.S., foreign "Value" stocks generally outperformed their "Growth" stock counterparts last quarter, with the MSCI E.A.F.E. Value Index declining (-11.7%), versus the (-13.3%) decline the MSCI E.A.F.E. Growth Index experienced. Regionally speaking, Europe declined less than Japan in Q4, with the MSCI Europe Index falling (-12.7%), while the MSCI Japan Index fell (-14.2%) for the quarter[22].

Like the U.S., foreign corporate earnings rose, while valuations for foreign equities fell to some of the most attractive levels in years. The forward-looking P/E Ratio for the MSCI E.A.F.E. (Europe, Australia, Far East) Index finished 2018 at a very attractive 11.8 X earnings [23].

EMERGING MARKETS:

The MSCI Emerging Markets Index declined for the third consecutive quarter, falling by (-7.4%) in Q4, both in local currency terms as well as in U.S. Dollar terms, meaning the U.S. Dollar wasn't the headwind to U.S. investors in that market as it has been in previous quarters in 2018. The Index declined (-10.5%) for the calendar year in local currency terms, versus the (-15.0%) it posted in U.S. Dollar terms [24]. China's slowing economy, along with uncertainty over the Chinese – U.S. trading relationship weighed heavily on the sector. Given the emerging markets reliance on commodity prices, the weakening energy prices we mentioned previously also hurt investor sentiment. China's stock market declined by (-10.7%) in Q4, the worst performing quarter they've experienced since 2015 [25]. Emerging Markets equities were the best performing equity markets in 2017, up +31.0% in local currency terms,[26] but the combination of the slowdown in China and a strong U.S. Dollar doomed its prospects for a follow-up in 2018.

COMMODITIES:

The Bloomberg Commodity Index declined by (-9.4%) in Q4 2018 and finished the entire year down (-11.2%). The price of various commodities were generally in decline, but there were some notable exceptions. In the Agricultural products markets, Barley futures declined by (-5.23%), Live Hog futures declined by (-5.13%), and Canola futures fell by (-3.93%). Contrasting these declines, Potatoes futures appreciated by +8.87%, Live Cattle futures grew by +3.66%,

(20) http://www.multpl.com/shiller-pe/
(21) https://content.rwbaird.com/RWB/Content/PDF/Insights/Quarterly-Market-Chart-Book.pdf
(22) https://content.rwbaird.com/RWB/Content/PDF/Insights/Quarterly-Market-Chart-Book.pdf
(23) https://content.rwbaird.com/RWB/Content/PDF/Insights/baird-market-update.pdf
(24) https://www.capitalgroup.com/content/dam/cgc/shared-content/documents/reports/TI_WMR_PDF_4Q.pdf
(25) https://content.rwbaird.com/RWB/Content/PDF/Insights/Quarterly-Market-Chart-Book.pdf
(26) https://am.jpmorgan.com/gb/en/asset-management/gim/adv/insights/market-insights-monthly-market-review-december-2018

THE MARKET AT A GLANCE

Wheat futures appreciated by +2.56% and Corn Futures grew by +3.10%. Energy prices generally declined, with Crude Oil futures falling (-15.23%) and Coal futures declining by (-11.45%) during the quarter. Offsetting those losses were Natural Gas futures which appreciated by a whopping +29.69% during the quarter.

Forest products fell across the board during Q4, with Lumber futures declining (-32.23%), Pulp futures falling by (-0.32%), and Newsprint futures fell (-0.52%) per ton.

Non-precious metal and mineral prices were mixed, with Uranium prices growing by +11.55%, Iron Ore prices rose +7.79%, Zinc rose +4.00% and Copper prices grew by +1.08%. Offsetting those gains were losses in Nickel prices (-13.29%), Lead fell by (-6.31%), Aluminum declined by (-4.30%), and Potash prices were flat. Precious metals were also mixed during the quarter, with Gold futures rising by +1.23%, while Silver futures declined by (-2.67%) [27].

REAL ESTATE:

The MSCI U.S. Real Estate Index, a proxy for U.S. based Real Estate Investment Trusts with 153 individual constituents, depreciated by (-6.72%) in Q4 2018, and in so doing, bringing its calendar year 2018 performance negative as well, to (-4.57%) [28].

The National Association of REIT's, or "NAREIT" breaks REIT's into seventeen different sub-sectors by type of real estate. In Q4, thirteen of the seventeen sub-sectors delivered losses to investors. The worst performing REIT sub-sectors were Timber REIT's which were the worst performing REIT's last quarter, and declined by (-28.73%) in Q4, followed by Lodging/Restaurant REIT's, down by (-20.46%), Data Center REIT's, which depreciated by (-13.34%), and Office REIT's, which fell by (-11.87%). The four REIT sub-sectors with positive performance during the quarter were Infrastructure REIT's, which appreciated by +3.63%, followed by Health Care REIT's, which rose +3.08%, Self-Storage REIT's, up +2.09% in Q4, and finally, Manufactured Housing REIT's which posted a +0.35% gain for the quarter [29].

FIXED INCOME:

The broad U.S. bond market, as measured by the benchmark Bloomberg Barclays U.S. Aggregate Bond Index, delivered positive performance in Q4 2018, rising +1.8% for the quarter to finish flat (0.0%) for calendar year 2018. The best performing sub-set in the bond market were U.S. Treasuries, which delivered +2.6% return to investors for the quarter [30]. Investor sentiment was uncertain in the quarter, with stocks in steep decline, pushing investor capital into the bond markets, U.S. Treasury Bonds in particular. Headwinds to bond prices include the Fed's efforts to "normalize" interest rates while simultaneously reducing its bloated balance sheet.

Corporate issuance experienced selling pressure, with the Bloomberg Barclays Corporate Bond Index declining (-0.2%) during the quarter, as uncertainty over the Fed's plans for 2019, and the possibility of an economic slowdown worried investors. The lower-credit quality high yield market was particularly hard hit, as the ICE Bank of America AML U.S. High Yield Bond Index declined by (-4.7%) in Q4, bringing its performance for the year to a negative (-2.3%) [31]. In addition, energy sector bonds, which make up a large percentage of the high yield bond sector, underperformed as oil prices plunged to an 18 – month low amid fears of oversupply. Floating rate bank loans, which generally benefit from a rising rate environment, also came under pressure during the quarter as investors revised downward their expectations for the number of future Fed rate hikes. Bank loans had been one of the bond market's strongest performers earlier in 2018.

(27) http://www.rbc.com/economics/economic-reports/pdf/other-reports/cpm.pdf
(28) https://www.msci.com/documents/1296102/1335386/MSCI+US+REIT+Index+comparison+factsheet.pdf/e94d4243-ce3c-15df-eb5d-e7343b1ffad0
(29) Source: Bloomberg, through AACA
(30) https://content.rwbaird.com/RWB/Content/PDF/Insights/baird-market-update.pdf
(31) https://content.rwbaird.com/RWB/Content/PDF/Insights/baird-market-update.pdf

THE MARKET AT A GLANCE

Globally, bond prices appreciated as well during the quarter, with the Bloomberg Barclays Global Aggregate Bond Index appreciated by +1.2%, bringing its 2018 total return to (-1.2%). As was mentioned earlier in this essay, the European Central Bank has discontinued its Quantitative Easing program in December but has stated that it doesn't expect to begin the unwind of its balance sheet buildup or raising interest rates until the summer of 2019.

Investor concerns about slowing global growth, volatile equity markets, and the impact of falling oil prices weighed on Emerging Market bond prices. The strength of Emerging Market currencies versus the U.S. Dollar varied widely during the quarter. The Argentine Peso and the Turkish Lira strengthened during Q4 after falling against the Dollar earlier in 2018. The Mexican Peso lost ground versus the U.S. Dollar despite the Mexican Central Bank's efforts to support the currency.

THE WORLD ECONOMY AT A GLANCE

The U.S. continues to lead all developed economies in terms of economic growth, and as of this writing, the Atlanta Fed's "GDP Now" forecast for U.S. GDP growth in the fourth quarter of 2018 is that a reading of +2.7% will be delivered. Unemployment in the U.S. hovers near all-time lows, and inflation data remains in check. The housing market is soft in terms of volume, but prices continue to move higher in most regions. The December jobs report showed that 312,000 jobs were added in the final month of the year, and the markets cheered. Annual wage growth ended 2018 up +3.2%, well ahead of the rate of inflation [32].

The Eurozone economies grew at a +0.2% growth rate in Q4 2018, matching its third quarter rate, which had been the lowest rate of economic growth since the second quarter of 2014. Among countries that have already reported Q4 economic GDP data, Italy reported the worst result, with its economy contracting by (-0.2%) in the quarter. With its Q3 2018 contraction of (-0.1%), Italy is now officially in recession for the first time since 2013. France, Belgium and Austria saw their economies expand by a modest +0.3% in Q4. Spain's economy expanded at a faster pace, up +0.7% in the quarter. Lithuania's economy delivered the best results among countries that have reported Q4 GDP growth, expanding +1.6% during the quarter. The Eurozone's largest economy, Germany, has yet to report its GDP estimates for Q4 2018 [33].

China's slowdown continues, as official data for Q4 2018 GDP growth (year-over-year) came in at 6.4%, meeting expectations. The official data for calendar year 2018 came in at +6.5%, the slowest pace of growth since 1990 [34].

While economic growth continued for most developed countries in Q4, important events unfolded during the quarter that contributed to a sense of uncertainty entering 2019. The signing of the U.S./Mexico/Canada Trade Agreement has yet to be ratified by each countries' legislators, contributing to a lack of clarity about what the final agreement will mean for North American trade. The Brexit deal agreed to by the EU and U.K. Prime Minister Theresa May failed miserably in the British House of Commons, leaving investors wondering how the U.K. will leave the European Union, scheduled for March of 2019. Trade disputes between the U.S. and China, the world's two largest economies, are far from resolved, with a March 1st deadline looming to avoid significant increases in U.S. tariffs on Chinese imports. And the U.S. government faces another partial shutdown on February 15th, unless legislators can come to terms on border security. The Congressional Budget Office says that the partial government shutdown just ended cost the U.S. economy $11 Billion, almost double the amount the legislators were arguing over [35].

(32) https://www.peoplescout.com/2018-q4-global-economic-snapshot/
(33) https://tradingeconomics.com/euro-area/gdp-growth
(34) https://www.cnbc.com/2019/01/21/china-2018-gdp-china-reports-economic-growth-for-fourth-quarter-year.html
(35) https://www.nbcnews.com/politics/politics-news/shutdown-cost-u-s-economy-11-billion-budget-office-says-n963531

THE U.S. ECONOMY IN FOCUS

GROWTH

Projected GDP Growth of +2.7% in Q4 2018 is lower that the two prior quarters' reports, but remains well above averages in recent decades. Forecasts for full year 2019 are for U.S. GDP growth of +2.4% [36].

JOB CREATION

The U.S. Economy added 635,000 jobs in Q4 2018, a sharp increase over the 492,000 jobs delivered in Q3 2018 [38].

CORPORATE PROFITS

With 216 of the S&P 500 Index constituents having reported their Q4 2018 Operating Earnings, 154 beat their consensus estimates, 51 missed, and 11 met their estimates. Operating profit margins are estimated to come in at 11.14%, lower than Q3's 12.13%, but still higher that any quarter prior to 2018 going back to 2006 [37].

INFLATION

According to the Bureau of Labor Statistics, the Consumer Price Index (CPI-U), declined by (-0.1%) in December, after being unchanged in November, and finished 2018 at a +1.9% rate, year-over-year [39].

INTEREST RATES

Interest rates are expected to continue to rise all along the yield curve, especially on the shorter-end, as the Fed continues its efforts at "rate normalization". Investors are cautiously eyeing the potential for a yield curve inversion, which historically is a precursor to economic recession.

RISK TO CONTINUED U.S. ECONOMIC GROWTH

While a slowing in the rate of growth in the U.S. economy is apparent, there is little risk to a recession in the near term. The primary threats to continued economic expansion would be an overly-aggressive Fed that would raise rates too quickly, and/or a deterioration in the trading relationship between the U.S. and China.

(36) https://www.stlouisfed.org/publications/regional-economist/fourth-quarter-2018/forecasters-gdp-growth-2019
(37) https://us.spindices.com/indices/equity/sp-500
(38) https://www.bls.gov/web/empsit/ceshighlights.pdf
(39) https://www.bls.gov/news.release/cpi.nr0.htm

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