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4th Quarter 2018 – Market Commentary

THE QUARTER IN BRIEF

Wall Street saw many ups and downs in the last three months of 2018. The fourth quarter concluded with bulls and bears vying for control of the market and with the S&P 500 suffering a 13.97%, three-month loss. The Federal Reserve sent conflicting signals about its implementation of monetary policy normalization, to the frustration of investors. No real progress was made in resolving the U.S.-China trade war, and the Brexit appeared to reach a standstill. The price of oil dropped sharply. The housing market gained a bit of momentum as home prices and mortgage rates both declined. The quarter was quite newsworthy, but its major headlines raised some troubling questions about the direction of the markets.[1]

DOMESTIC ECONOMIC HEALTH

On the whole, the economy looked quite good in the fall. Consumer spending increased 0.8% for October and 0.4% for November, with retail sales up 1.1% in the tenth month of the year and 0.2% in the eleventh. Retailers benefited from a great holiday sales season: on an annualized basis, consumer purchases made between November 1 and December 24 were up 5.1% compared to the same period in 2017.[2,3]

Consumer confidence indices declined from strikingly high levels, but were still notably strong. The Conference Board index hit 137.9 in October, 136.4 in November, and 128.1 in December. Having its best year since 2000, the University of Michigan's monthly consumer sentiment gauge came in at 98.6 for October, 97.5 for November, and 98.3 for December; it averaged 98.4 for 2018.4,5 Both the service and factory sectors were booming, according to the Institute for Supply Management's monthly purchasing manager indices. ISM's non-manufacturing index was above 60 in both October and November (60.3, then 60.7); its manufacturing index rose from 57.7 in October to 59.3 in November.[6]

How was the jobs picture? Nonfarm payrolls expanded with 237,000 net new jobs during October; the November gain was 155,000. During both months, average yearly wage growth was at 3.1%. The main jobless rate held at 3.7%; the underemployment (U-6) rate moved north from 7.4% to 7.6%.[2,7]

Inflation was advancing just 2.2% a year by November; the 12-month increase had approached 3% as recently as July. Falling fuel costs helped tame inflation pressure. As a result, the average non-supervisory worker saw his or her inflation-adjusted income rise 1.0% in the 12 months ending in November, the most since 2016. On the wholesale front, producer prices jumped 0.6% in October, but rose only 0.1% during November. (Speaking of producers, industrial production was up 3.9% year-over-year in November; overall durable goods orders rose 0.8% for November after a 4.3% fall during the prior month.)[2,8]

In late December, the Bureau of Economic Analysis stated the economy had expanded 3.4% in the third quarter, revising its previous estimate of 3.5%. With growth like that, it not be surprising that the Federal Reserve made its fourth rate move of the year in December, taking the target range on the federal funds rate to 2.25-2.5%. Top Fed officials sounded alternately dovish and hawkish during the fourth quarter. In October, Fed chair Jerome Powell commented that interest rates were "a long way" from neutral, irritating Wall Street. A month later, both he and Fed vice chair Richard Clarida remarked that the benchmark interest rate was close to a "neutral" level. December's rate increase came with a relatively hawkish dot-plot, projecting two more hikes in 2019.[2,9]

The U.S. and China did little to address the tariffs they had imposed on each other earlier in the year. At the start of December, both nations did agree to a 90-day truce on introducing new import taxes. Even so, the U.S. was slated to hike tariffs on as much as $200 billion of Chinese imports as the year began.[10]

GLOBAL ECONOMIC HEALTH

Overseas, manufacturing economies in the east and west seemed to be decelerating. In fact, December marked the eighth consecutive month of a downward trend in weighted average Markit flash PMI readings of U.S., Japan, and European Union member countries. The mean factory PMI reading among those nations was the poorest in two years last month. China's economy slowed in each month of the quarter, according to a Bloomberg Economics tracker, which cited reduced consumer demand for goods and

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"Time is the most valuable thing a man can spend."

\- THEOPHRASTUS

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services as much as the impact of tariffs. In November, the nation's official factory PMI sat at 50.0, the break-even point between sector growth and contraction. In Q3, China's annualized gross domestic product was expanding at a 6.5% pace; in Q1, the annualized GDP reading had been at 6.8%.[11]

The European Union (and the world) waited for the Brexit to proceed. U.K. leaders, however, spent the quarter debating if it should unfold according to the deal that Prime Minister Theresa May had presented to the European Union. By December, May's deal faced almost certain rejection in Parliament. There were three other options: another national referendum on the Brexit, a no-deal Brexit that would leave big businesses with headaches, or a "managed," no-deal Brexit with some bilateral trade arrangements put in place. The deadline for the Brexit was still set for March 29. On December 13, the European Central Bank confirmed that its longstanding, asset-purchase program would wrap up at the end of 2018. Interest rate hikes could be in the ECB's plans this year; euro-area consumer prices have been rising only about 1% annually for the past six years. Real, annualized GDP for the euro area through the first three quarters of 2018 was just 1.2%, a pace far off the 2.7% GDP seen in 2017.[12,13]

LOOKING FORWARD

The fourth quarter of 2018 was the poorest quarter on Wall Street in 11 years. Was the welcomed, large-cap rebound at the end of December a hint of better times ahead? Earnings season is about to start, and it might be just what the Street needs; before it begins, investors may tread cautiously. Wall Street cannot "resume normal programming" fast enough for some market participants, but the path toward stability may not be an easy one; the volatility seen in December may take weeks to moderate. In sum, 2019 presents investors with many more uncertainties than 2018 did, and patience will be required to contend with them. Patience, in fact, may be an investor's greatest friend this quarter and year.[23]

WE ARE MOVING AND WILL BE IN OUR NEW LOCATION ON JANUARY 28TH. OUR NEW OFFICES ARE LOCATED AT 180 S 32ND STREET WEST.