

## ECONOMIC HIGHLIGHTS

It was a light week for economic news last week. The Conference Board did release December numbers for Consumer Confidence which came in at a reading of 128.1 versus 136.4 for November. Two components of the report showed consumers rate the Present Situation at 171.6 versus Expectations six months forward at 99.1. This is one of the widest gaps between the two numbers on record. The December Chicago Purchasing Manager survey came in at 65.4 for December. Still strongly in expansionary territory as 50 is the baseline for neither expansion nor contraction within the sector. Initial jobless claims for the week of December 15 continue to remain historically low at 216,000 claims filed.

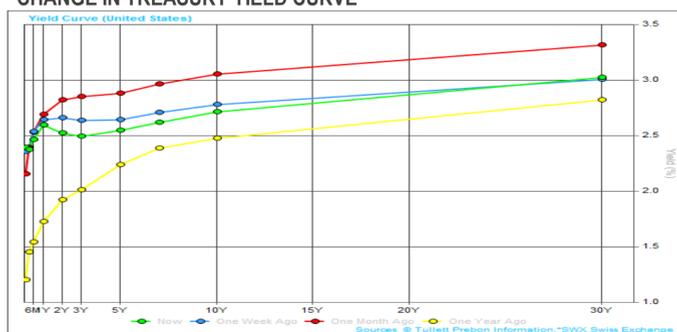
## FIXED INCOME

Federal Reserve Chairman Jerome Powell pledged to be patient with any future interest-rate hikes, allaying Wall Street concerns that the central bank will snuff out the U.S. economic expansion and pledging to stay even if President Donald Trump asks him to resign. Potentially laying the groundwork for a pause in the Fed's campaign of gradual rate hikes, Powell said that he's "listening sensitively to the message that markets are sending" about downside risks to growth. "With the muted inflation readings that we've seen, we will be patient as we watch to see how the economy evolves," Powell said Friday on a panel with his predecessors Janet Yellen and Ben Bernanke at the American Economic Association's annual meeting in Atlanta. "We will be prepared to adjust policy quickly and flexibly and to use all of our tools to support the economy should that be appropriate to keep the expansion on track," he said, adding "there is no pre-set path for policy." The dollar weakened, Treasury yields moved higher and U.S. stocks surged as investors interpreted the Fed chairman as sounding as if he sees scope to wait and see how the economy performs before raising rates again. Powell's Fed hiked rates four times last year and projections from its December meeting show officials expect two more hikes in 2019. Sliding equity prices, weakness abroad and mixed economic data at home have prompted calls for the Fed to put rates on hold, but the U.S. labor market remains red-hot. Data released last Friday showed U.S. employers added the most workers in ten months as wage gains accelerated. Powell called the employment figures a "very strong report" and showed no concern about the advance in wages. "Average hourly earnings moved up and that's quite welcome and also for me at this time does not raise concerns about too-high inflation," he said. Former Fed Vice Chairman Donald Kohn praised Powell's message. "Patience is the right approach," when the Fed is getting conflicting signals from hard data, which is backward-looking, and the financial markets, which are forward looking, said Kohn, now a senior fellow at the Brookings Institution in Washington. The event in Atlanta offered a rare show of public unity by a sitting Fed chairman and his two immediate predecessors. Ben Bernanke said, "everyone would be better off if it was made clear that the Fed is making its decisions based on its mandate and on its assessment of the long-term needs of the economy, which I'm completely confident that they will do."

### CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.41%	3 mo	2.44%	3 mo	2.69%	3 mo	1.70%
6 mo	2.50%	6 mo	2.45%	6 mo	2.75%	6 mo	1.75%
1 yr	2.56%	1 yr	2.46%	1 yr	2.81%	1 yr	1.79%
2 yr	2.49%	2 yr	2.56%	2 yr	2.97%	2 yr	1.83%
5 yr	2.50%	5 yr	2.59%	5 yr	3.24%	5 yr	2.01%
10 yr	2.67%	10 yr	3.08%	10 yr	3.65%	10 yr	2.45%
30 yr	2.98%	30 yr		30 yr	4.15%	30 yr	3.32%

### CHANGE IN TREASURY YIELD CURVE



## EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	2.75%	-4.58%
S&P 500 (Large Cap)	2.89%	-5.21%
S&P 400 (Mid Cap)	2.23%	12.00%
Russell 2000 (Small Cap)	3.62%	-11.74%
NASDAQ Composite	4.00%	-3.56%
MSCI EAFE (International)	1.96%	-13.94%
iShares Real Estate	0.03%	-4.59%

Stocks rallied sharply on Friday following a much better than expected jobs report – pushing the equity market to a weekly gain in the holiday-shortened week and booking the second straight week of gains following the recent low of December 24. For the week, 9 of the 12 major sector groups rose led by Energy, Telecommunications and Communication Services. The three declining sectors were Technology, Real Estate, and Utilities.

Shares of Apple fell -10% on Thursday following the preannouncement of Q1 revenue which came in lower than expected. iPhone sales are expected to be softer than expected and drove the miss. Management blamed a slowing economy in China and other emerging markets for the lower guidance.

With Q4 2018 coming to an end, Ned Davis Research wrote in a report last week that the S&P 500's -19.3% decline for the quarter was its worst quarterly decline since Q4 2008 and the 10<sup>th</sup> worst quarter since 1926. Historically, in quarters where the S&P 500 has declined at least -15%, the following quarter has posted strong gains on average. In all cases since 1946, the index has only declined once over the next quarter and has never been lower in the two, four, and eight quarters later. The median post-war gains have been 23.5% one year later and 43% two years later.

Volatility certainly returned to more normal levels in 2018. Bespoke noted that in 2018 the S&P 500 saw 18 trading days where the index moved up or down more than 2% - that follows a year in 2017 where there were no plus or minus 2% days. There were also 62 trading days in 2018 where the index had a 1% move up or down – that compares to 8 such days in 2017. The historical average for all years going back to 1928 is 59 1% days – so last year was more of a return to normal volatility and highlights just how unusual 2017 was in terms of volatility.

The waterfall decline into the Christmas Eve bottom pushed many of the sentiment indicators we follow into extreme pessimistic and oversold levels. For example, only 6% of all S&P 500 stocks were trading above their 50-day moving averages according to data from Bespoke. Also a short-term sentiment indicator from Ned Davis Research plunged to pessimistic extremes – marking levels the reading has only reached 9 times since 1995. In 8 of the 9 cases stocks were higher three months later.

Adding to the difficulty of 2018 was that cash was the only major asset class to post a positive return for the year. Data from Ned Davis Research showed that 2018 was the first year since at least 1972 that none of the eight main asset classes posted a return of least 5% - and only one was positive. Gold, Treasury Bonds, Nasdaq, S&P 500, Emerging Market stocks, Developed International stocks, Commodities, Real Estate, and the Dow Jones Industrial Average all posted negative returns for 2018.

For the week ahead there are several earnings releases taking place on Wednesday with the homebuilders in focus. Notable releases are expected from – Lennar, Bed, Bath, and Beyond, Constellation Brands, and KB Home. The economic calendar will be highlighted by ISM and Factory Orders out on Monday, Trade Balance on Tuesday, and Fed speakers and minutes on Wednesday. Friday will see the latest inflation readings with CPI due out.

The Q4 decline did a great deal of technical damage to the S&P 500 chart. We will mark the Christmas Eve lows of 2351 as first support – while 2630 would act as resistance for any rallies. The index closed Friday at 2531.

## ASSET ALLOCATION

### CURRENT SENTIMENT

Cash	Neutral
Short Fixed Income	Neutral
Intermediate Fixed Income	Neutral
Inflation-Adjusted Fixed Income	Unfavorable
High Yield Fixed Income	Neutral
International Fixed Income	Unfavorable
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Neutral
Real Estate	Neutral
Commodities	Unfavorable

Below is a summary of our current stance on most asset classes:

**Cash** - Neutral weighting now that Fed Funds rate is above 2%. Any exposure is for defensive positioning or liquidity needs.

**Short Term Bonds** - Relative to Intermediate Bonds, the reduced duration is preferable given the outlook for higher interest rates.

**Intermediate Term Bonds** - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in floating rate securities.

**Inflation-Adjusted Bonds** - Low inflation expected in near-term providing zero real return.

**High Yield Bonds** - Spreads have tightened considerably and do not warrant exposure to unnecessary credit risk when compared to Treasuries.

**International Bonds** - Foreign bonds offer good diversification qualities and higher yield opportunities, however, risks have been elevated recently and investment should be made cautiously.

**Equity Income** - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.

**Large Cap Stocks** - A favorable weighting is recommended. Growth continues to be a more favorable style and should be overweighted versus Value.

**Mid Cap Stocks** - Mid cap exposure remains an attractive market capitalization. Mid cap stocks continue to provide the "sweet spot" of market capitalization - large enough to provide stability, but small enough to be more nimble.

**Small Cap Stocks** - In broad market corrections, small cap stocks will suffer most with increased volatility. However, a recent divergence of relative strength between small caps and large caps warrants a neutral exposure.

**International Stocks** - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight to neutral weight is recommended.

**Emerging Market Stocks** - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. However, trade uncertainty and dollar strength provides a headwind for EM in the near term.

**Real Estate** - Pricing has stabilized and long-term valuations appear attractive. Real Estate has performed well of late and should continue to be a strong alternative to other asset classes.

**Commodities** - Global demand should support higher prices if the global recovery remains on track. Volatility will be higher and commodities will be susceptible to short-term price shocks, however, if used in conjunction with other asset classes, risk can be reduced substantially within a diversified portfolio. Used alone though is not recommended as the short-term outlook is not favorable.

Sources of statistical information are Bloomberg and Ned Davis Research.

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