



Monthly Market Commentary December 2018

ECONOMY: Mixed Economic Signals To End 2018

Q4 GDP ESTIMATES INCREASING

Strong consumer spending is giving a boost to fourth-quarter GDP growth, pushing it up to 3%, according to a survey of economists. Economists, participating in a CNBC/Moody's Analytics GDP survey increased their forecast by 0.2% following a stronger-than-expected November retail sales report. Excluding automobiles, gasoline, building materials and food, retail sales gained 0.9% in November, on top of a revised 0.7% increase in October.

HOW MUCH MORE?

At its last policy meeting in December, the Federal Reserve voted unanimously to raise rates 0.25%. Moreover, the Fed's forecasts indicated that most members thought that 0.50% of further rate hikes would be appropriate in 2019. However, there is also a willingness to delay further interest rate hikes given the volatility in the financial markets, weak inflation, and slowing global growth. Fed officials stressed that policy is not on a pre-set course.

BLOCKBUSTER JOBS REPORT

The Labor Department report showed one of the strongest months of job gains in the last decade. Employers added 312,000 jobs in December, while economists had expected only 181,000. Wages, which had been lagging, showed impressive gains, up 3.2%. The unemployment rate rose from a 50-year low of 3.7% to 3.9% as an additional 419,000 Americans began working or looking for jobs.

LEADING INDICATORS REMAIN POSITIVE

The Conference Board Leading Economic Index® (LEI) for the U.S. increased 0.2% in November, following a 0.3% decline in October, and a 0.6% increase in September. *"The LEI increased slightly in November, but its overall pace of improvement has slowed in the last two months. Despite the recent volatility in stock prices, the strengths among the leading indicators have been widespread. Solid GDP growth at about 2.8% should continue in early 2019, but the LEI suggests the economy is likely to moderate further in the second half of 2019."*

MONETARY POLICY WATCH

- The Bank of England voted unanimously to maintain interest rates at 0.75% as the economic uncertainty of Brexit negotiations was considered.
- Sweden raised rates 0.25% for the first time since 2011 as inflation moved closer to the central banks target of 2.0%.
- The Bank of Japan (BoJ) left rates unchanged and will maintain its accommodative monetary policies.
- The Bank of Canada held rates steady at 1.75% while noting the drop in oil prices and slowing global demand.
- Mexico raised rates 0.25% to 8.25%, the highest level since 2008 to strengthen their peso and lower inflation.
- Despite expected growth in 2019, the Bank of Russia raised rates 0.25% to 7.75% to combat inflationary pressures which they expect to head towards 5% in 2019.

ITALY COMPROMISES

Tensions around Italy have lessened substantially as the coalition government has submitted to pressure from Brussels and agreed to a 2019 budget that will avoid triggering the Excessive Debt Procedure (EDP), which would have forced significant financial and economic penalties. Italy's current debt load is equal to 131% of its GDP, more than double the eurozone limit.

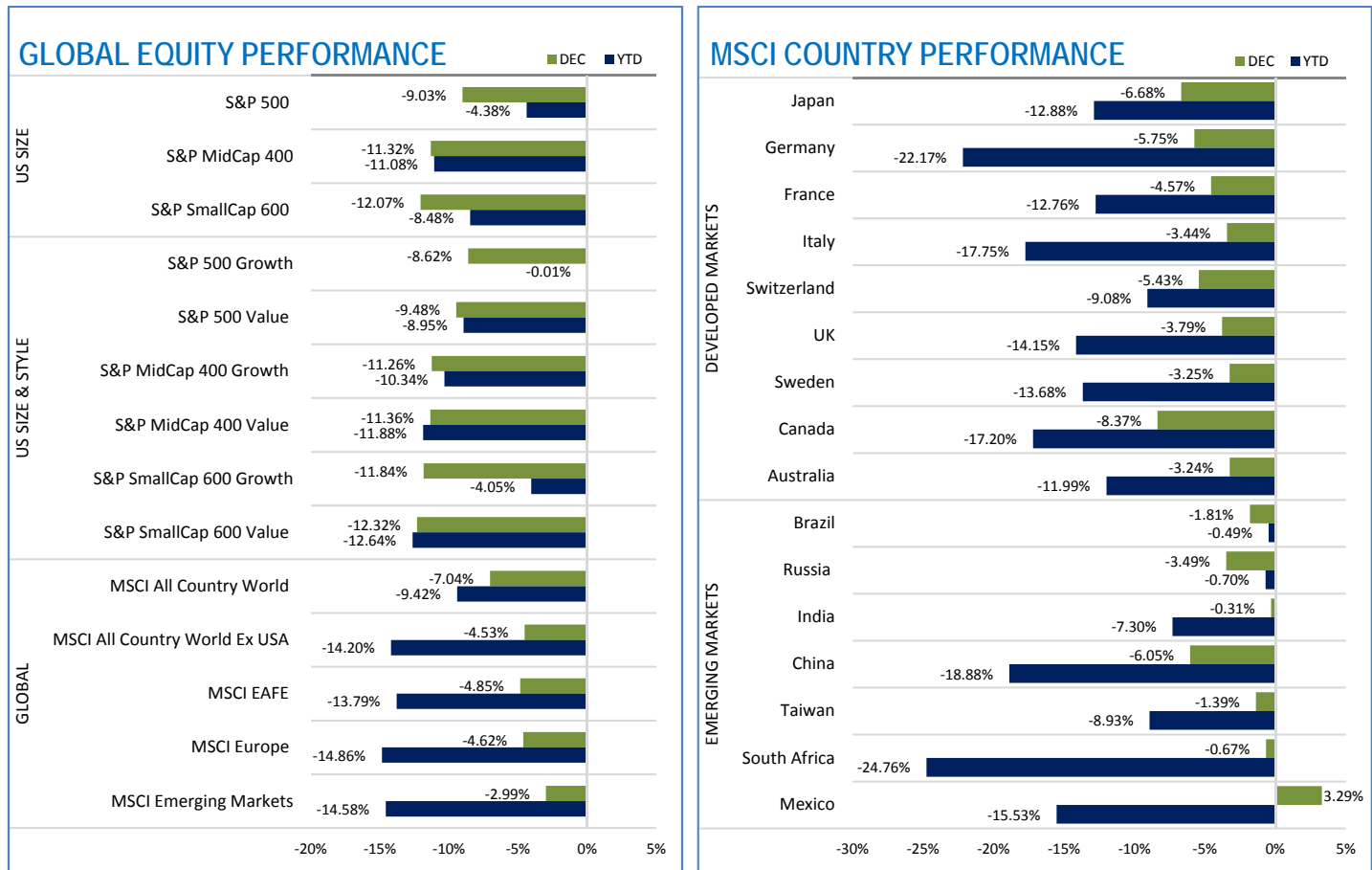
WARNINGS FROM EUROPE

European Central Bank President Mario Draghi warned lawmakers that the eurozone economy has weakened unexpectedly amid rising headwinds, including an economic slowdown in China, ongoing Brexit negotiations, and international trade tensions.

RESULTS OF THE TRADE WAR?

Monthly economic data from China pointed to a further softening in growth as retail sales, exports and industrial activity disappointed. China is looking to stimulate its economy through monetary stimulus and infrastructure investment. Reuters reported that China is planning on lowering its growth target to 6-6.5% after expected growth of 6.6% in 2018, the slowest pace in 28 years.

GLOBAL EQUITIES: A 'Bah Humbug' For Global Equities



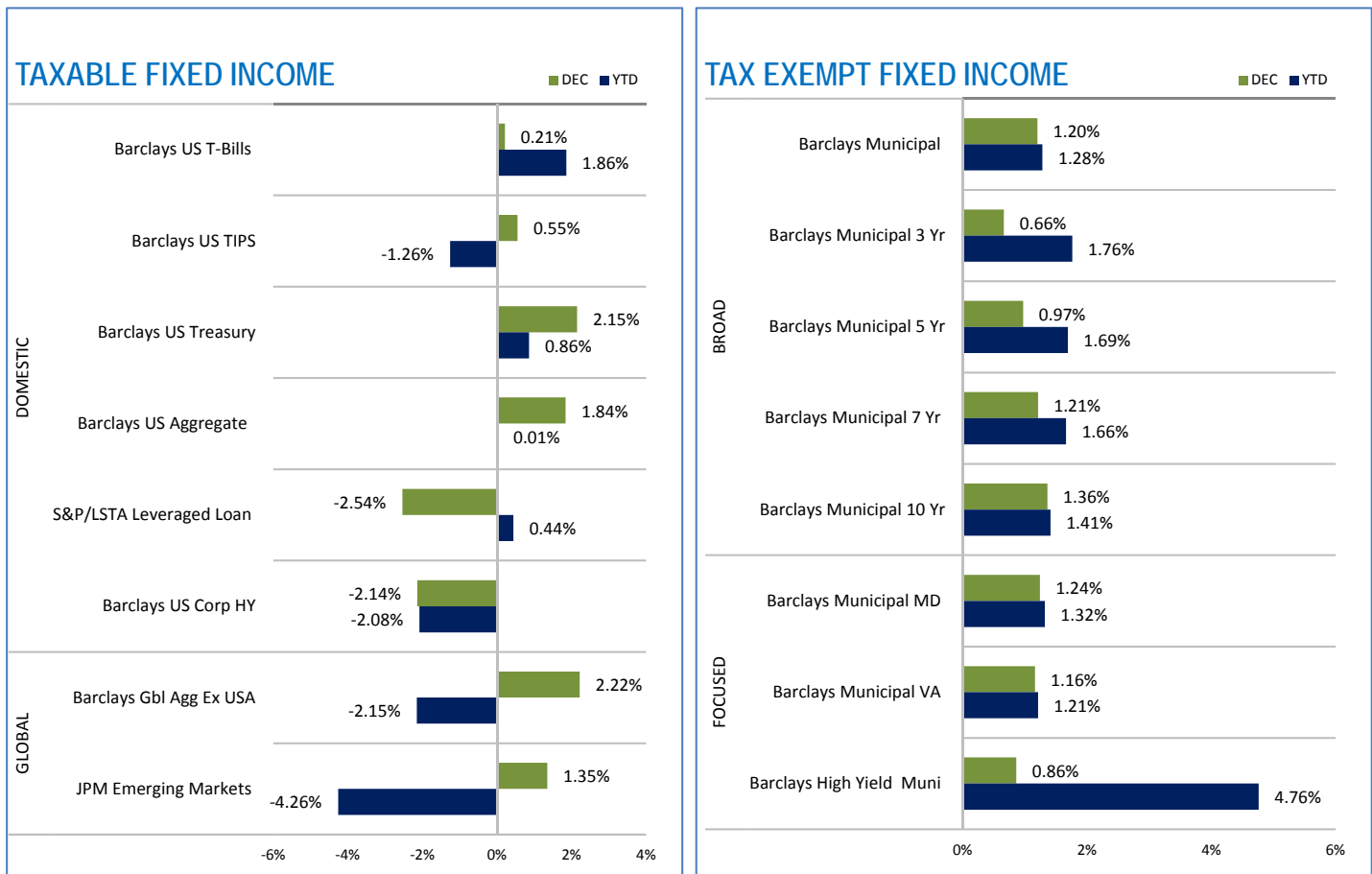
A HISTORICALLY BAD DECEMBER

Volatility returned to the U.S. equity market in December as the S&P 500 flirted with entering a bear market before Christmas. The S&P 500 fell 19.8% from its peak on September 20th to December 24th (a bear market is generally considered a fall of 20% or more). The December slump, a 9.03% loss for the S&P 500, was the worst in since 1931 and 2018 marked the worst year for stocks since 2008. Market sentiment was driven by concerns that the Federal Reserve was raising interest rates too quickly, and negatively impacted by political turmoil in Washington. Concerns over earnings and economic growth also weighed heavily on stocks to end the year.

EMERGING OVER DEVELOPED TO END YEAR

Slowing global growth and continuing trade frictions between the U.S. and China rattled world equity markets in December. Emerging equities were not immune to the broad sell-off but losses were much smaller than those registered in developed markets, as the MSCI Emerging Markets Index declined only 2.99% in December. Asia was the weakest performing region, dragged lower by a 6.05% decline for China. A stronger currency helped push Mexico up 3.29%, the leading emerging equity market for the month. Market sentiment towards the country was bolstered by a fiscally responsible 2019 budget and a proactive central bank.

FIXED INCOME: Improved Fiscal Conditions for Municipals



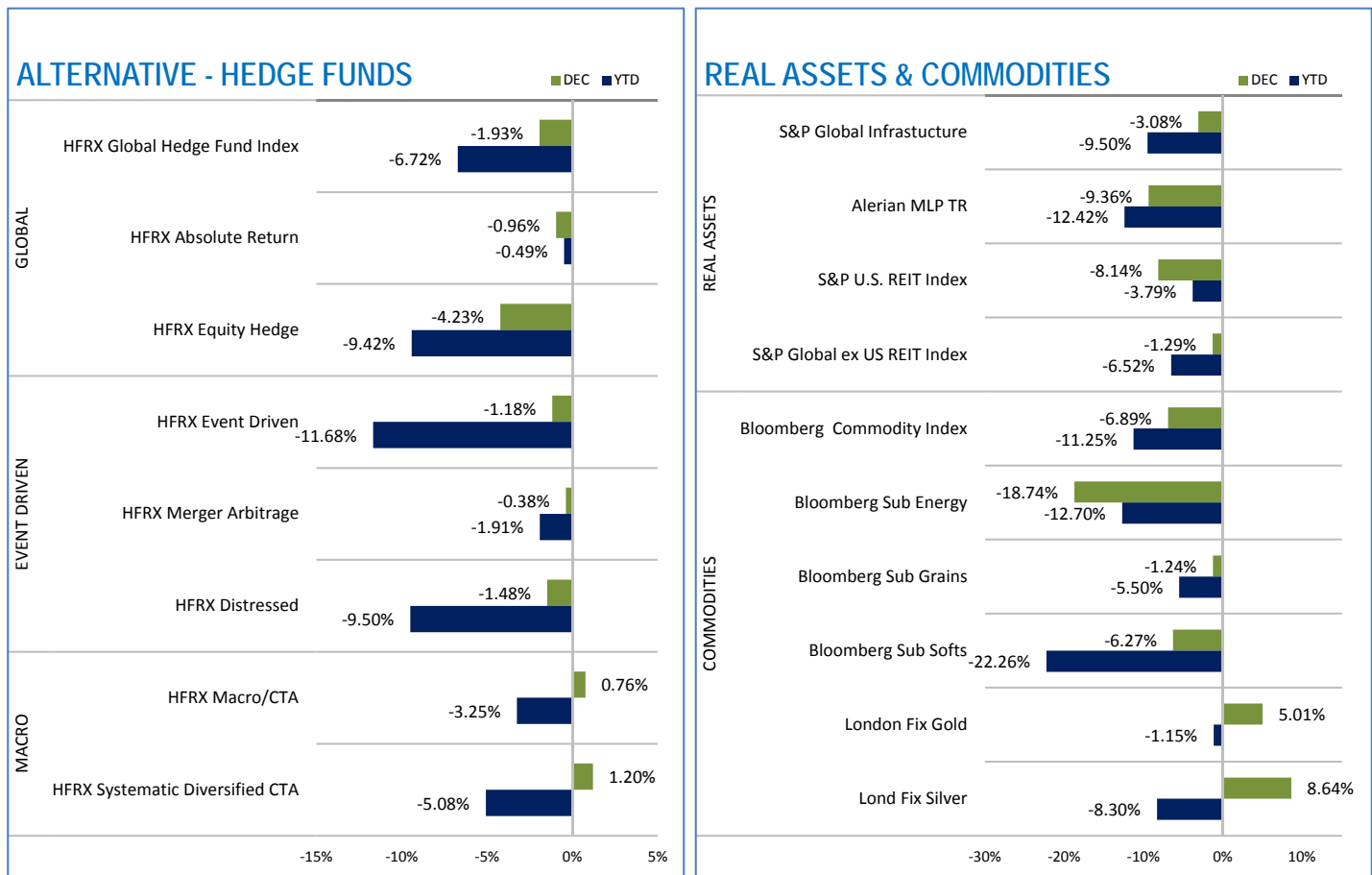
QUALITY OVER CREDIT

The market entered 2018 anticipating 3 fed funds rate hikes of 0.25% each, but the strength of the U.S. economy allowed the Fed to hike by 0.25% a fourth time in December to the 2.25% - 2.50% target range. This is widely considered the bottom end of their estimated “neutral” range of 2.5%-3.0%. The last hike was not without controversy, however, given recent signs of slowing growth in the U.S. and continued weak growth abroad. High quality bonds generated gains in December amidst the heightened volatility in the equity markets. The Barclays U.S. Aggregate Bond Index was up 1.84% for the month and turned positive for the year on the last trading day of 2018. Credit sectors suffered as bank loans declined 2.54% and high yield corporates fell 2.14% to end the year.

MUNI CREDIT FUNDAMENTALS IMPROVE

Investors received positive returns across all segments of the municipal market in 2018 as municipal credit fundamentals improved and interest rates moved modestly higher. Municipal yields benefitted from stronger U.S. growth and rising Treasury yields. The Barclays Municipal Index returned 1.20% in December and 1.28% for the year. Despite limited new supply due to the tax reform legislation, municipalities were able to leverage strong economic growth into increased tax revenues and improved fiscal budgets. State and local tax revenues have grown in 32 of the last 35 quarters and according to the National Association of State Budget Officers (NASBO), state general fund revenues grew 6.4% in fiscal year 2018. Legalized sports gambling and sales tax collection on online purchases are poised to continue this trend.

ALTERNATIVES: Precious Metals Rally



HEDGE FUNDS MIXED

December turned out to be a difficult month for the financial markets and hedge funds posted mixed performance, with declines in equity and event driven strategies partially offset by gains in macro and trend following CTA (commodity trading advisory) strategies. The HFRX Global Hedge Fund Index declined 1.93% in December and 6.72% for the year.

REAL ASSETS CRUMBLE

Amidst the equity market declines, real assets offered little protection in December. While the S&P 500 declined 9.03%, the S&P U.S. REIT Index fared only slightly better, falling 8.14% for the month. MLPs, measured by the Alerian MLP Index, lost 9.36% to end the year. MLP spreads over the 10-year U.S. Treasury ended the year at 6.30% compared to an average spread since 2000 of approximately 3.70%. Lastly, commodities fell 6.89% led by an 18.74% loss for the energy sector in December. On a positive note, gold gained 5.01% and silver was up 8.64% for the month.