Economic & Market Overview

Brutal finish for stocks in 2018
Equity markets fell sharply in December despite being a month with historically strong returns. There were large daily swings in equity prices as lingering concerns over Federal Reserve policy, trade policy, the partial government shutdown, and economic growth shook investor confidence. Despite a late rebound in December, U.S. equity markets ended with their worst quarterly performance since 2011 and first annual decline since 2008. Foreign market equities also saw large declines but fared moderately better, partly due to more severe underperformance earlier in the year. Refer to Table 1 for trailing returns across equity markets.

What worked in December?
The market’s steep sell-off hit all sectors, with more subdued losses in the utilities, materials, and communication services sectors. Energy shares led the declines, weighed down by a third consecutive monthly drop in oil prices. The financial and industrial sectors were also notably lower, recording double-digit losses during the month. Investors leaned towards larger capitalization and growth-oriented stocks while showing a small preference for higher dividend paying stocks. Refer to Chart 2 for trailing returns across sectors in equity markets.

Bonds erase earlier losses
High quality fixed income assets benefited from the market’s risk-off sentiment, finishing the month with solid gains and rebounding from poorer performance during the year. Even as the Federal Reserve hiked rates by 25 basis points in its December meeting, Treasuries rallied strongly across the yield curve, with rates on the 10-year Treasury notes ending the year at 2.69%, their lowest level since January. High-yield bonds delivered the only negative returns among major fixed income sectors as spreads widened further. Refer to Table 1 for trailing returns across fixed income sectors.

2018’s issues continue into the New Year
Concerns about a global economic slowdown, continuing trade wars, Federal Reserve policy and high political risk have continued into 2019. Equity markets have already adjusted to these concerns to some extent as stock market valuations are now below historic averages. Fixed income markets have also reacted to growth concerns as both short- and long-term U.S. rates have fallen to reflect a slower growth outlook. Last year at this time markets were anticipating a sharp increase in U.S. growth due to tax reform. Now, the ‘sugar high’ of tax cuts has largely faded. Analysts expect 2019 S&P 500 earnings growth to be under 8% after more than 20% growth last year. Earlier in 2018 market concerns focused on the potential for rising interest rates and

(continued on back)
inflation due to strong economic growth and tight labor markets. The new, lower growth forecasts significantly reduce inflation concerns and may extend the current expansion. Economic growth will clearly be lower this year and markets may continue to be cautious until there is more clarity about the impacts of tariffs, Brexit, and the Federal Reserve’s interest rate path on 2019 corporate earnings.

A wild year for oil ends on a low note
Oil was one of the most notable commodities during 2018 as its price fell almost 25%. Interestingly, oil prices rose for most of the year amidst healthy economic growth and concerns about crude supplies due to renewed U.S. sanctions against major oil producer Iran. OPEC and other producers increased their production ahead of U.S. sanctions that would prohibit all countries from buying Iranian oil after October. The U.S. postponed these sanctions at the last minute which led to unexpected sharp increases in oil inventories. At the same time global growth expectations have been falling due to the impact of trade tariffs and other issues. This led to a sharp decline in oil prices which continued throughout the fourth quarter despite an agreement by OPEC and other producers to pull back on production.

**TABLE 1 – Index Returns (%)**  
Performance for periods ending December 31, 2018

<table>
<thead>
<tr>
<th>Index Type</th>
<th>1-Month</th>
<th>3-Month</th>
<th>YTD</th>
<th>1-Year</th>
<th>3-Year (annualized)</th>
<th>5-Year (annualized)</th>
<th>10-Year (annualized)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Small Cap (Russell 2000®)</td>
<td>-11.88</td>
<td>-20.20</td>
<td>-11.01</td>
<td>-11.01</td>
<td>7.36</td>
<td>4.41</td>
<td>11.97</td>
</tr>
<tr>
<td>U.S. Value (Russell 3000® Value)</td>
<td>-9.78</td>
<td>-12.24</td>
<td>-8.58</td>
<td>-8.58</td>
<td>7.01</td>
<td>5.77</td>
<td>11.12</td>
</tr>
<tr>
<td>Foreign Developed Markets (MSCI® EAFE®)</td>
<td>-4.85</td>
<td>-12.54</td>
<td>-13.79</td>
<td>-13.79</td>
<td>2.87</td>
<td>0.53</td>
<td>6.32</td>
</tr>
<tr>
<td>U.S. Bonds (Bloomberg Barclays U.S. Aggregate)</td>
<td>1.84</td>
<td>1.64</td>
<td>0.01</td>
<td>0.01</td>
<td>2.06</td>
<td>2.52</td>
<td>3.48</td>
</tr>
<tr>
<td>U.S. TIPS (Bloomberg Barclays U.S. TIPS)</td>
<td>0.55</td>
<td>-0.42</td>
<td>-1.26</td>
<td>-1.26</td>
<td>2.11</td>
<td>1.69</td>
<td>3.64</td>
</tr>
<tr>
<td>U.S. HY Bonds (Bloomberg Barclays U.S. HY 2% Issuer Cap)</td>
<td>-2.14</td>
<td>-4.54</td>
<td>-2.08</td>
<td>-2.08</td>
<td>7.23</td>
<td>3.84</td>
<td>11.14</td>
</tr>
</tbody>
</table>

Sources: SAAMCo and Wilshire Compass. Indices are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.
The price of equity securities may rise or fall because of changes in the broad market or changes in a company’s financial condition, sometimes rapidly or unpredictably. 

Bonds may cause the value of your investment to go up or down in response to changes in interest rates or defaults (or even the potential for future defaults) by bond issuers. 

Futures contract is a legal agreement to buy or sell a particular commodity or asset at a predetermined price at a specified time in the future. Futures contracts are standardized for quality and quantity to facilitate trading on a futures exchange. The buyer of a futures contract is taking on the obligation to buy the underlying asset when the futures contract expires. The seller of the futures contract is taking on the obligation to provide the underlying asset at the expiration date.

Housing performance return is the year-over-year gain in the median existing-home price for all housing types, reported by the National Association of Realtors® every month.

Value Investing - The investor’s judgment that a particular security is undervalued in relation to the company’s fundamental economic value may prove incorrect.

Growth Investing - These stocks normally carry higher price/earnings ratio than many other stocks. If earnings expectations are not met, market price of growth stocks will often decline more than others stocks.

International investing involves a greater degree of risk and increased volatility. In emerging countries, these risks may be more significant.

S&P 500® Index tracks the common stock performance of 500 large-capitalization companies publicly traded in the United States.

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index and is widely recognized as representative of small-cap stocks.

Russell 3000® Growth Index measures the performance of those Russell 3000® Index companies with higher price-to-book ratios and higher forecasted growth values.

Russell 3000® Value Index measures the performance of those Russell 3000® Index companies with lower price-to-book ratios and lower forecasted growth values.

MSCI® EAFE® Index is a free float-adjusted market capitalization index designed to measure the equity market performance of developed markets. It includes stocks from 21 developed markets, but excludes U.S. and Canada.

MSCI® Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Bloomberg Barclays 1-3 Month U.S. Treasury Bill is designed to measure the performance of public obligations of the U.S. Treasury that have a remaining maturity of greater than or equal to 1 month and less than 3 months. The Index includes all publicly issued zero coupon U.S. Treasury Bills that have a remaining maturity of less than 3 months and at least 1 month, are rated investment-grade, and have $300 million or more of outstanding face value.

Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index of domestic investment-grade bonds, including corporate, government and mortgage-backed securities.

Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index is a component of the Bloomberg Barclays U.S. Corporate High-Yield Bond Index, which covers fixed-rate, non-investment grade corporate debt of issuers in non-emerging market countries. It is not market capitalization-weighted—each issuer is capped at 2% of the index.

Bloomberg Barclays U.S. Treasury Inflation Protected Securities (TIPS) Index consists of Treasury inflation-protected securities issued by the U.S. Treasury with a remaining maturity of one year or more.

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