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FOURTH QUARTER COMMENTARY
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The stock market had the worst quarter since the 2008 financial crisis. Every stock index had negative returns for the quarter and full year. The following are sample returns:

	4th Quarter	2018
S&P 500	(13.52%)	(4.38%)
Russell 1000 Growth (Large Cap)	(15.89%)	(1.51%)
Russell 1000 Value (Large Cap)	(11.72%)	(8.27%)
Russell 2000 (Small Cap)	(20.20%)	(11.01%)
Russell Mid Cap	(15.37%)	(9.06%)
MSCI EAFE (Foreign Stocks)	(12.54%)	(13.79%)

Value stocks outperformed growth stocks (lost less) for the first time in two years in the fourth quarter. Large cap stocks lost less than small and mid cap stocks, with small cap stocks particularly hard hit. Hedge Fund returns had enormous variability this past quarter, even among funds with similar strategies. In general, distressed credit and merger arbitrage had the best results.

Interest rates on short term treasury securities (one year or less) rose during the quarter, while rates on other treasury maturities declined. The yield curve also flattened during the quarter. The interest rate spread between corporate bonds and treasuries widened during the quarter, especially for high yield bonds. The following are treasury yields for various maturities:

MATURITY	12/29/17	9/29/18	12/31/18
3 Month	1.39%	2.19%	2.45%
2 Year	1.88%	2.81%	2.50%
10 Year	2.41%	3.05%	2.68%
30 Year	2.74%	3.19%	3.01%

Our bond portfolios had positive quarterly returns and did exactly what they should have – provided income and a layer of stability to an overall portfolio. While owning high quality bonds is not exciting in a strong market they are most welcome during difficult times.

Many market observers and President Trump have blamed the Fed for the difficult quarter. We believe the initial decline in stocks in October was primarily driven by the Fed raising rates and the fear they would raise rates too much and slow economic growth. After stocks stabilized in November, the decline resumed in December. While the fear of higher interest rates was probably an initial reason, there were many other factors which created market uncertainty:

- The effects from the Fed unwinding its quantitative easing program are unknown - this has never been done before. We do know this reduces liquidity in the financial system;
- Slowing global growth, especially in Germany, Japan and China;
- The imposition of tariffs and the trade dispute with China;
- "Erratic" statements from President Trump denigrating the Fed and the continued turnover of key staff in the Administration;
- Slowing housing and auto sales in the U.S. partially because of higher interest rates;
- It appears U.S. economic growth peaked in the second quarter following the corporate tax cut;
- For the first time in ten years investors could earn a decent return (2%+) holding "cash";
- The European Central Bank (ECB) ended its bond buying program which also reduces liquidity in the financial system;
- The lack of an accepted deal on Brexit and economic problems in Italy;
- The perception that corporate profit growth and profit margins have peaked;
- The growth of automated trading and passive investing which tends to move markets in lock step and increases volatility, especially in a less liquid environment;
- The limited government shutdown over the funding of the border wall.

After ten years of a bull market and "excess" liquidity provided by the central banks, a serious market decline is not shocking. On the other hand, bear markets often signal a recession is likely in six-twelve months, which we believe is unlikely. All of the factors just mentioned are serious and concerning, but consider the following:

- U.S. economic growth may be slowing from early 2018, but it appears it will be about 2%+ in 2019, the same as it was in many years prior to 2018;
- The decline in the price of oil is positive for the consumer and many businesses and should help consumer spending;
- While the Fed has raised rates and short term rates have had a meaningful increase, rates on longer term maturities have recently declined. So, while mortgage rates are higher than a year ago, they are lower than three months ago and still very low by historical standards;
- Corporate profits still appear to be set to grow 5% - 8% in 2019, which is as good or better than a number of years over the past ten year bull market;
- Consumer confidence remains high and the Christmas shopping season appeared to be strong;
- Unemployment is low, wages are rising and inflation remains subdued;
- Stocks do not appear expensive. In fact small cap stocks are in a bear market and those companies are least dependent on exports, which is where economic weakness lies.

The negatives seem to outweigh the positives, but we believe the potential for a meaningful market rally from these levels is very possible in the coming months as many of these negatives are already priced into the market. If the Fed pauses on rate increases or unwinding the quantitative easing program during the first half of the year, progress is made or appears to be made on a trade deal with China, and economic statistics remain stable, a significant rally from these levels is likely.

We remain concerned about a recession or economic slowdown 18 to 36 months from now, but we are hesitant to rebalance portfolios (reducing stock allocations) at these levels and at this time. We are not market timers and believe the key to successful investing is to have the proper asset allocation which is appropriate for each investor's risk tolerance and objectives.

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