Investment Advisors, Inc.
Integrity • Independence • Insight

4th Quarter, 2018

Markets At A Glance

Period	S&P 500	DJIA	INT'L (EAFE)	Emerging Markets	Barclays Intermediate Govt/Credit	Barclays 1-15 Yr Muni	INFLATION (CPI)
4th Quarter	-13.5%	-11.3%	-12.5%	-7.5%	1.7%	1.7%	0.4%
12 Months	-4.4%	-3.5%	-13.8%	-14.6%	0.9%	1.6%	2.2%

Equity markets sold off sharply in the fourth quarter as all major indexes reported large losses. Volatility increased with large intra-day swings in both domestic and international markets. The full year S&P 500 decline of 4.4% snapped a string of nine consecutive years of positive returns. Intermediate and long-term interest rates fell while credit spreads widened, resulting in modest gains for most bond indexes over the fourth quarter and full year.

The U.S. economy wrapped up a solid year of economic growth, with many economists projecting full year 2018 real growth of around 3.0%. After a very strong first three quarters, the economy was clearly slowing heading into 2019. Although many economic indicators point to lower but still solid growth, fears of an impending recession have increased after one of the longest economic recoveries on record. A key question going forward is whether the economy slows to a growth rate more in line with recent years or actually stops growing. The global economy is more fragile, with significant concerns related to the outlook in Europe and China. The massive accumulation of debt in China would become much more problematic if their economic growth falters.

In December, the Federal Reserve raised rates but lowered expectations for future real GDP growth and inflation. Markets grew more concerned over a potential policy mistake where the Fed exacerbates already slowing growth by tightening monetary policy too much. The Fed is also continuing to withdraw liquidity by reducing its balance sheet. At the current pace, the Fed expects to reduce its balance sheet by another $600 billion in 2019. Other central banks are also expected to move to less accommodative monetary policies. We continue to believe that these changes in monetary policy represent a significant headwind for the markets.

We expect elevated volatility to continue in 2019. A bull case can be envisioned for this year that includes continued growth in the U.S. economy, slower but still healthy earnings growth, a fading headwind from Fed tightening, and reduced trade and geopolitical tensions. The bear case would reflect the potential for a full-blown trade war, increasing geopolitical tensions, a Fed policy error, continued political dysfunction and a contraction in corporate profits. We will be closely watching first quarter earnings releases as well as management commentary on the outlook going forward.