Map To The Markets
2018 Review & 2019 Outlook

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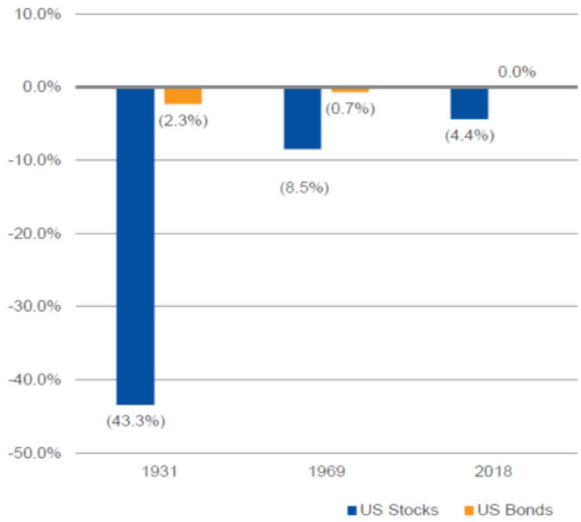
2018 Review & 2019 Outlook

2018 was a year full of ups, downs, and everything in between. Various headlines dominated the media's coverage of the markets ranging from continued trade war rhetoric, to the U.S. Federal Reserve raising rates then becoming significantly dovish, to the fear of a global economic slowdown or recession. This past year tested investors' mettle, patience, and ability to withstand market fluctuations in the face of significant market declines, most notably in the last three months of the year. While our investment philosophy refrains from trying to time the markets based on economic, market, or geopolitical predictions and focuses solely on purpose driven investing, those individuals who did attempt to trade in and out of the market during 2018 were both financially and psychologically whipsawed as volatility returned significantly over the course of the year. Additionally, it is important to remember that a market correction, as defined by a 10% decline in the S&P 500 Index, occurs, on average, as frequently as your birthday, and a bear market, as defined by a 20% decline in the S&P 500 Index, occurs, on average, as frequently as a leap year or the World Cup. As such, it's worth noting that many investors who initially entered the market over the past ten years have never experienced a prolonged bear market, a significantly bad year, or even dips that didn't correct quickly. 2018 is more than likely the first calendar year of negative portfolio performance for many of these investors, providing an opportunity to better understand their aversion to risk and whether their underlying portfolio is correctly aligned with the goals and purpose of those assets.

Hide & Seek?

In 2018, there was no place for investors to hide as only two asset classes provided positive returns for the calendar year[1] – Cash (+1.87%) and U.S. Fixed Income (+0.01%). All other asset classes, whether they be Large Cap Domestic Equities (-4.38%), Real Estate (-5.63%), International Equities (-14.09%), or Emerging Market Equities (-14.58%), finished 2018 on the negative side of the ledger. To put this past calendar year's returns in perspective, there have only been two calendar years since 1925 – 1931 and 1969 – in which U.S. Stocks and U.S. Fixed Income were both negative. Calendar year 2018 was only 2 basis points, or 0.02%, away from becoming the third calendar year in the past 93 years to have negative returns for both of those asset classes. Given the recent results, and extrapolating what is most recent into the future, many investors may be tempted to be reactionary and reduce weightings to underperforming areas of the portfolio, or selling low, and chase relative outperformance in other areas, or buying high. However, through implementing a disciplined rebalancing strategy, we recommend doing the exact opposite – re-allocating capital to the most underperforming asset classes in our portfolio while trimming those that performed relatively well. In essence, the benefit of this rebalancing is to de-risk the portfolio in periods of significant outperformance and then re-risk it in periods of underperformance.

The 2 previous negative calendar years for US stocks and US bonds

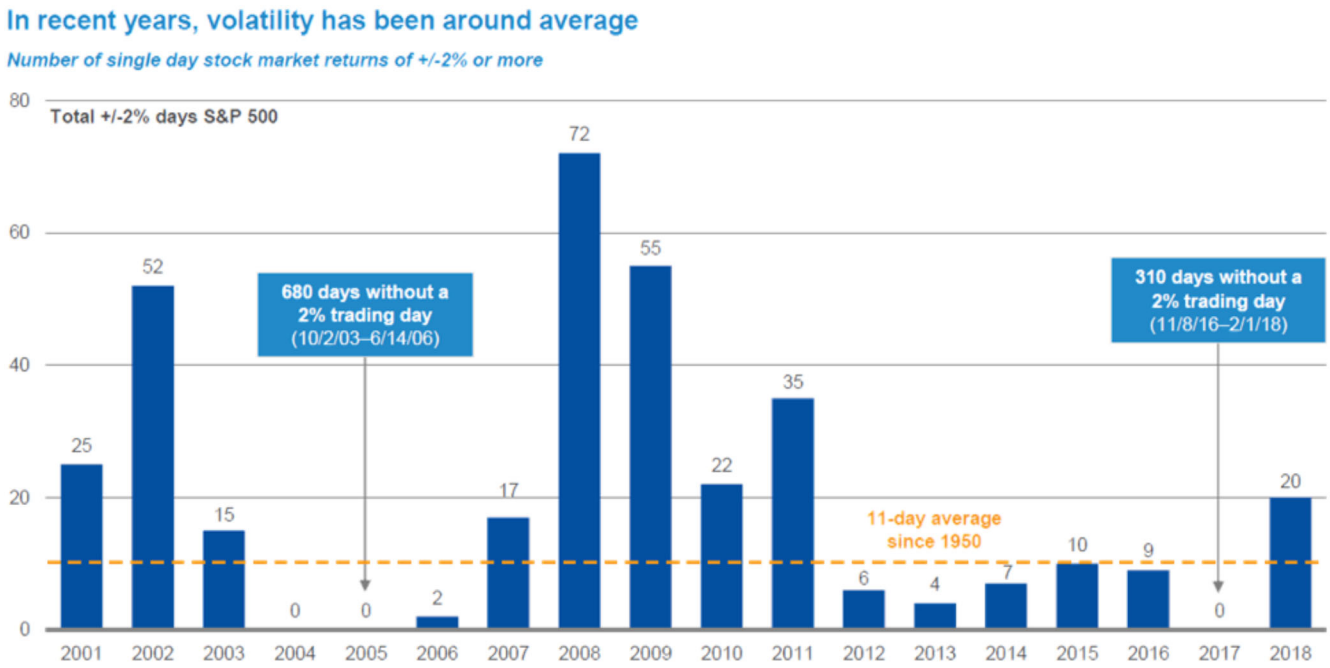


		1932	1970	2019
Returns the following year	US stocks	(8.2%)	3.9%	?
	US bonds	8.8%	16.9%	?
Returns the following 3 years	US stocks	11.7%	10.1%	?
	US bonds	6.5%	12.2%	?

Source: Morningstar as of 12/31/18. US Stocks represented by S&P 500 2018 and the IA SBBI US Lrg Cap Index 1931 and 1969. US bonds represented by the Bbgbarc US Agg Bond Index 2018 and the IA SBBI US IT Gov Index 1931 and 1969. Index performance is for illustrative purposes only. Past performance is no guarantee of future results. You cannot invest directly in the index.

The Return of Volatility

As noted above, investors were taken for a wild ride in 2018, especially following a rather sanguine 2017. In 2018[2], the S&P 500 had twenty, single-day trading sessions that were +/- 2%. Fifteen of those trading days were -2% or greater and the remaining five trading days were +2% or greater. Since 1950, the long-term average is only 11 trading days that were +/- 2%, and for comparison's sake, 2017 had zero +/- 2% trading days. Yes, you read that correctly – zero. In fact, 2018 included more volatile trading days (20) than the past three calendar years, 2015-2017, combined (19), and was the most volatile year since 2011 (35). The lack of volatility preceding 2018 coupled with the significant moves during the year more than likely exacerbated and compounded investor fears that the end was near, a recession is all but guaranteed, and potentially became a self-fulfilling prophecy that caused a 20% decline in the S&P 500 during the fourth quarter as many investors headed for the exits. However, volatility is nothing new in equity markets. The increase in volatility only further emphasizes the importance of maintaining a long-term investment horizon congruent with the purpose of your assets regardless of short-term price fluctuations and we believe this further highlights the need to remain properly diversified even though it may feel as though this strategy never wins.



1. Average since 1950.
Morningstar as of 12/31/18. Stock market represented by S&P 500. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.

Market Envy and the Case for Diversification

Many investors become frustrated when comparing their portfolio returns to the returns of the U.S. Stock Market and most of this angst is short-sided in nature. Per Blackrock, a diversified, global portfolio[3] has outperformed the S&P 500 Index over the past 18 years by roughly 0.45% annualized or 19.5% cumulatively[4]. However, owning this diversified portfolio can be emotionally difficult at times for many investors when comparing their returns solely to the S&P 500. In up markets, the diversified portfolio lags the S&P 500 as it is unable to overcome the large weighting to traditional fixed income. In down markets, the diversified portfolio will still typically lose money, albeit less than the S&P 500[5]. In both scenarios, many investors psychologically and emotionally feel like they are losing; however, diversification coupled with annual rebalancing has the ability to provide significant value to those investors who are patient enough to allow the process to come to fruition. Within our portfolios, we are committed to maintaining proper investment diversification, even in the face of prolonged periods of underperformance by one or more asset classes, as we understand our own limitations and are unable to consistently and accurately predict when those asset classes will return to favor while others may fall out of favor.

To Infinity & Beyond

Many bulge-bracket Wall Street firms, such as JP Morgan and Goldman Sachs, and brokerage houses, such as UBS and Merrill Lynch, promulgate and espouse market and asset class predictions every month, quarter, and calendar year almost ad nauseum. In the face of all of these forecasts and armed with what they feel is certain advice, investors parse through this data, surmising what they believe to be an area of opportunity and ultimately attempt to time when and to what degree to enter into the new, hot asset class for the next calendar year even though this decision is sub-optimal for their long-term wealth accumulation.

However, in what may seem controversial or blasphemous in our industry, we can tell you with 100% certainty that we do not know what will transpire over the next 12-18 months let alone the next 3-5 years. Asset classes, market capitalizations, and investment styles are cyclical – coming into and going out of favor without informing market participants when, to what degree, or for how long they intend on remaining dislocated from their long-term averages. Therefore, we do not try to time when to enter and exit the market – as time in the market is more important than timing it – nor do we portend to have some divine knowledge about the short-term direction of markets – markets that are completely out of our control. Instead of diverting our attention to the items that we are unable to influence, we focus all of our energy on the areas of a client portfolio we do have control over – purpose driven investing through aligning the underlying investment strategy to the needs of the client assets, thorough and exhaustive investment research to potentially maximize long-term wealth accumulation through portfolio positioning, consistent and unwavering diversification within the portfolio in an attempt to ensure against the risk of total loss, and disciplined rebalancing of client assets allowing for an objective reallocation of capital and risk. These four tenants do not guarantee the road won't be bumpy at times; however, they do provide the necessary guardrails to ensure our clients stay on the road to meeting their long-term goals.

[1] *Source: Bloomberg*

[2] *Source: Blackrock, Inc.*

[3] *40% S&P 500 Index, 15% MSCI EAFE Index, 5% Russell 2000 Index, 30% Bloomberg Barclays U.S. Aggregate Bond Index, and 10% Bloomberg Barclays U.S. Corporate High Yield Index*

[4] *Source: Blackrock, Inc.*

[5] *Source: Blackrock, Inc.*