QUARTERLY NEWSLETTER [4Q 2018]

Positives:

US Economy Remains Strong. The US, the world's largest economy, most likely set a record in 2018, passing $20 trillion of goods and services produced. GDP growth for the year will be close to 3%; if it does exceed 3%, it would be the first year in over a decade that growth has been this high. Unemployment is very low at 3.7% and corporate earnings, while likely to slow in 2019, should still post double-digit growth.

Cash Showed Gains In 2018. With interest rates continuing to rise, cash holdings have actually started to earn money. Short-term US Treasury-Bills gained 1.7% in 2018, more than double the rate of the prior year and a welcome relief for savers after seven years of virtually no gains. Overall US Treasuries, seen in the Bloomberg Barclays US Government Bond Index, rallied in December on safe-haven buying as stocks slumped and ended the year up +0.9%. Investment grade bonds of all types, measured by the Bloomberg Barclays US Aggregate Bond Index, also rallied at year-end to end 2018 flat with a +0.01% return.

Negatives:

US Stocks Hit Hard in Fourth Quarter. After setting another all-time record high in late September, the S&P 500 slumped almost -20% before a post-Christmas rally helped the index recover to lose “only” -13.5% in 4Q. Even with this rebound, the index still had its worst December in 87 years as trade tariff talk and interest rate hikes led investors to worry about slowing economic and profit growth. This worry caused the S&P 500 to post its first annual loss (-4.4%) since 2008. The NASDAQ composite had an even worse 4Q, off -17.3%, as many large technology firms provided disappointing future earnings guidance and was down -2.8% for the year.

International Stocks Again Trailed US Markets. While international stocks outperformed US equities in December, losses earlier in the year were hard to overcome. Developed markets, seen in the MSCI EAFE index, fell -4.9% in December but ended the year -13.8%, well behind US results; concerns include weak economic growth and political instability in Europe. Emerging markets, measured by the MSCI Emerging Markets index, did fairly well in 4Q (-7.5%) but overall in 2018, these stocks suffered from US dollar gains and the potential for tariffs to hurt Chinese companies. This index ended the year down -14.6%.

Little Place To Hide From Losses in 2018. No major stock indices had gains last year, and most bond types posted losses. We noted above that cash and some bonds were slightly positive, but many bonds also lost money in 2018, which is unusual when stocks are declining. Investment grade bonds saw some safe haven buying but high yield bonds were down in 4Q and the year (Barclays US Corporate High Yield index -2.1% YTD). Real estate, measured by the Dow Jones US REIT index, fell -4.2% for the year and commodity prices, seen in Barclays Commodity index, slumped -9.4% in 4Q on plunging oil prices, to end 2018 down -11.2%.

What We Are Doing For You:

Hanging On Tight While Adjusting Portfolios. Volatility may be high, and there are certainly political and economic issues to get our attention, but this leads us to careful analysis of your account holdings, not to bail out. We are studying portfolio allocations (and specific fund managers) to reposition client accounts for expected 2019 market conditions and may reduce your exposure to certain areas, like European stocks. We do not know what the market will bring in the short term, but history shows that hanging on tight to the market roller coaster eventually leads to a better outcome than jumping off in the middle of the ride.

On a personal note

Bernie Bernie and Jody celebrated Jenny's graduation from Cal Poly in December. The weekend long festivities included several fun events. Jenny is currently traveling in Southeast Asia while her grad school applications are pending. The family is looking forward to a ski vacation in late March.

Damien Damien and his family enjoyed the holiday season with some family visiting from out of town. It was great having Natalie home from college for an entire month during the winter break. They were able to get three days of skiing in during the first week of January. Natalie likes to ski pretty fast and unfortunately took a big fall. She hurt her hand but toughed it out and skied the rest of the day. (X-rays were negative!) She also smacked her head really hard, but thankfully was unharmed. The good news is this prompted her admit to Damien that she now knows why he insists they all wear a helmet.

Debbie In November, Debbie successfully completed her first trail "Ultra Marathon" (a race greater than 26.2 miles) called the "Quad Dipsea" in Marin county. She and Dave are looking forward to skiing at Heavenly Tahoe in April with her sister and her family.

Zack Zack enjoyed his Holiday Season close with family and friends. During this Winter season, Zack has been looking for every opportunity to get outdoors when the weather is pleasant. He has been able to fish occasionally, but has not had any success, Zack is hoping that fishing conditions will improve as spring rolls around. Another way Zack has stayed active is through exercise. Being inspired by Debbie's amazing feats, which includes her back to back run from the Pacific Ocean to the top of Mt. Tamalpais. Zack has been running a 4 mile loop that includes a climb of nearly 1000 ft. in elevation without stopping! Maybe one day he will be able to hang with Debbie!

We appreciate your continued trust and confidence. Do you have any questions or concerns?
Please feel free to contact us any time.

Bernard Damien Debbie Zack

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S&P 500 - A capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. MSCI EAFE - Designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted. MSCI Emerging Markets - Designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index. Barclays U.S. Corporate High Yield: The U.S. Corporate High-Yield Index measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt. BarCap U.S. Aggregate Bond - The Capital U.S. Aggregate Bond Index, which used to be called the 'Lehman Aggregate Bond Index', is a broad based index, maintained by Barclays Capital, and it often used to represent investment grade bonds being traded in the US. Barclays Capital (BarCap) U.S. Aggregate Bond Index is made up of the Barclays Capital U.S. Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Based Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million.

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