Year-End Review and Outlook

2018 – Trade Wars and Rising Interest Rates

After 2017's remarkable "synchronized" global growth, world economies diverged in 2018. While U.S. economic growth strengthened, many of the other major economies, including Europe and China, started to weaken. Escalating trade tensions and the continued rise of U.S. interest rates fueled fear of a global economic slowdown and led to two major market corrections.

The ongoing saga over trade was a big contributor to volatility in the markets. Throughout the year there were sell-offs over tariff discussions, implementations, and retaliations! On the other hand, each time there seemed to be progress on trade – conversations with the European Union, Canada, Mexico, etc. – the markets rebounded.

For the year, all major asset classes[1] around the world posted negative results, contrasting sharply with 2017:

	2018	2017
• U.S. large cap stocks (S&P 500 Index)	-4.4%	22%
• Global stocks (MSCI ACWI IN Index)	-10%	24%
• Emerging market stocks (MSCI EM Index)	-15%	37%
• U.S. corporate bonds (Citigroup U.S.BIG CORP. 3-7Y)	0%	4%

We started 2018 expecting U.S. GDP growth to accelerate. And accelerate it did! Fiscal stimulus provided by the *Tax Cut and Jobs Act of 2017* boosted business confidence and investment – and the economy grew at 3% in 2018 vs. 2.5% in 2017 (according to the Federal Open Market Committee projections).

However, we believed that the markets had already priced in the benefits of the fiscal reform and pull-backs were likely. With U.S. stocks trading at the upper range of historical price-to-earnings (P/E) ratios, we were wary of the reaction in the markets to faster-than-expected interest rate increases and negative developments in global trade negotiations.

We expected foreign markets would provide a better balance to any potential weakness in the U.S. markets last year. But foreign markets ended up detracting from returns in 2018. Factors, such as a weakening banking system in Europe, restructuring of China's economy, and a strong U.S. dollar created uncertainties and contributed to the market pull-back abroad.

[1] Returns calculated by Tamarac Inc. software

Looking Ahead to 2019

Trade wars with China continue to weigh on stocks. We continue to monitor the conversations with China as the February 28 deadline approaches. We believe the two sides will reach an agreement despite their diverging interests. China's efforts to restructure its economy are counter to the U.S. wanting to "even the playing field". But we believe that the U.S. has the upper hand for now. With U.S. exports to China accounting for only 8% of all goods and services exported in 2017 (vs. 18% of China's exports going to the U.S.), we believe China is motivated to reach a deal with the U.S.

Recession is on the minds of investors. Headlines of global uncertainty, which can be unsettling, are raising concerns of a recession. However, based on the fundamental factors that influence the U.S. economy, we believe it is unlikely we will enter a recession in 2019.

- **GDP growth.** Last year the U.S. economy maintained strong growth momentum, while operating at "full" employment. Going forward, we expect the pace will be more moderate due to tighter financial conditions and fading effects of the fiscal stimulus. We expect the U.S. economy will continue to grow at about 2%.

- **Employment.** As more jobs were created at a healthy pace throughout 2018, the unemployment rate continued to decline and ended the year at 3.9%, reports the Bureau of Labor Statistics. This should provide support to consumer confidence and the economy overall.

- **Consumer confidence** has weakened somewhat in the last couple of months but finished the year strong supported by the robust job market. With 2/3 of the economy relying on consumer spending, this is a strong positive and suggests the economy will continue to expand in the short-term.

- **Monetary Policy.** As the economy was doing well, Fed Chair Jerome Powell picked up the pace and increased rates by a full percentage point over 2018. The target rate is currently set at 2.25% - 2.50%, approaching the Federal Open Market Committee's long-run projection of 2.75%. Therefore, we believe that the majority of the hikes are now behind us.

Still, we expect continuing market volatility in 2019. We believe that trade tensions and uncertainty surrounding global economic growth will continue to shake the markets. And the as-yet unknown impact of the recent record-length U.S. government shut-down has added uncertainties.

As we always say, market volatility is an inherent part of investing – it reflects investors' opposing views of anticipated events.

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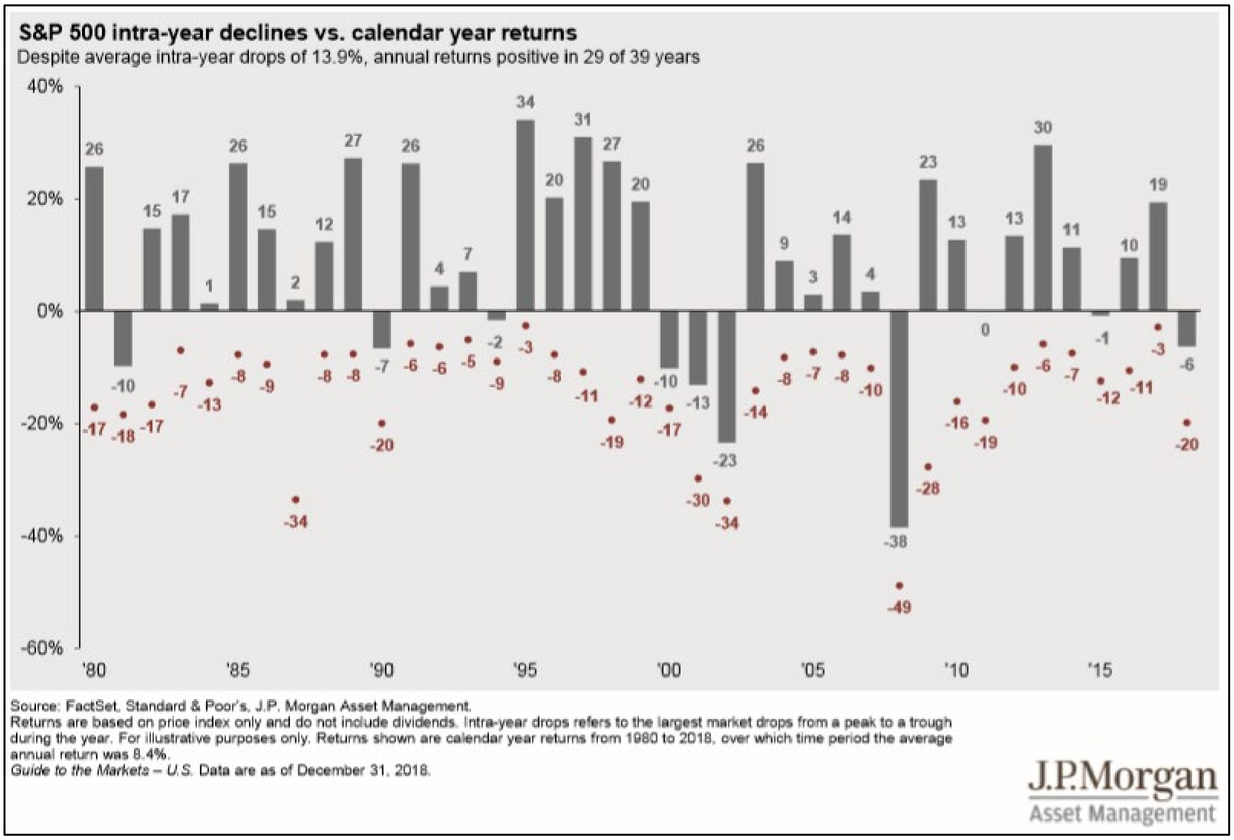
For some perspective, let's look at the S&P 500 over the last 39 years:

- Average intra-year drops were close to 14%.

- Over the course of the 10-year bull market, the S&P 500 retreated by:
  - 16% in July 2010,
  - 19% in October 2011,
  - 11% in February 2016, and
  - Nearly 20% this last December.

But despite these pull-backs, *in 29 of those 39 years the market ended the year positive* (as illustrated in the following chart).



Valuations are improved after the most recent pull-back in late 2018. At the end of December 2018, the S&P 500 Index (which represents the U.S. markets) was trading at 14.4x-forward-earnings vs. 16x historical average, while MSCI ACWI ex-U.S. (which represents the foreign markets) was trading at 11.5x vs. 14.2x historical average.

Foreign markets continue to provide an attractive opportunity. We maintain our view that international stocks, especially emerging markets, provide an attractive opportunity to diversify the uncertainty in the U.S. Emerging markets, besides having more attractive valuations and growth prospects, represent about one-eighth of global equity market capitalization and shouldn't be ignored.

Alternative strategies may become more profitable in a volatile market environment. As appropriate (based on each client's specific situation), we use several mutual funds based on "alternative" strategies to provide diversification and downside protection.

Summing It Up

We believe markets will remain volatile as trade tensions and fear of a global economic slowdown continue to pressure them. Despite the risks, based on our analysis we don't expect the economy will enter a recession in 2019. With attractive valuations providing further support, we expect the markets, overall, will either move sideways or produce low, single-digit, positive returns.

You have a well-diversified portfolio with many different asset classes (stocks, bonds, alternatives, and cash) – all based on your specific needs and risk tolerance. This allows you to stay invested while riding out the inevitable ups and downs of the markets in order to reach your long-term goals.

We will continue to closely monitor the economy and asset valuations, while anticipating the effects of any policy changes. And everyone at Neumann Capital Management is here to answer any questions you may have about our outlook or your portfolio – including, Katia Atanassov, CFA, CFP®, the newest addition to the Investment Committee.