



First Advisors

Happy New Year!

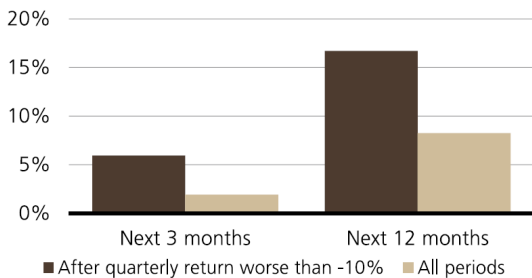
We hope you had an enjoyable holiday season! Wow, what a difference a year makes! Twelve months ago it was difficult to find any faults with 2017's asset class performance. 2018 was an entirely different story. The S&P 500 fell 14% in the fourth quarter, and cash was the only major asset class with a positive return in 2018. However, perhaps there is a silver lining hiding behind the recent market carnage.

I thought I would share a bit of research from our partners at the United Bank of Switzerland (UBS). Here at First Advisors, we compile and dissect macro research from several sources, and UBS has been consistently dependable in terms of calling the beginning or the end of many macros trends. In fact, our mutual fund clients benefitted from our call to lower our exposure to equities from overweight to neutral in March. For instance, our clients with a 'Growth with Income' allocation saw their equity exposure reduced from 64% to 60%. As a result, many of our clients may notice long term gains on 2018 tax forms despite a negative year for all equity markets.

So where do we go in 2019? As I've mentioned in the past, making predictions on short term market movements is a fool's game, however, our partners at UBS recently shared this history lesson on market rebounds:

"History suggests that after a quarterly decline of more than 10%, stocks tend to rebound fairly strongly in the subsequent quarter and gains continue to build over the following year. Since 1960, on the rare occurrence when stocks fell more than 10% in a quarter, the market rebounded quite nicely – with an average 6% return over the next three months and 17% over the next year. And the odds of generating a positive return have also been good – 82% over the next three months and 76% over the next year. Only during the financial crisis of 2008, the tech meltdown of 2000, and the oil crisis of 1973 were forward returns negative. "

Fig. 1: Stocks tend to rebound after a very weak quarter
Average forward S&P 500 return



Source: Bloomberg, UBS, as of 2 January 2019

Again, we remind our clients of the importance of sticking with a long term investment objective and avoid trying to time the markets. Our investment professionals do realize, however, that as your needs change, your allocation may also need to be adjusted. Please contact us if you would like to discuss your account. As noted in the past, we sincerely appreciate your business and trust in what we do. Here's to a more profitable 2019!

Sincerely,

Matthew J. Weaver CTFA | Vice President & Chief Investment Officer



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Annual Market Review 2018



Overview

Trade wars, midterm elections, and market volatility highlighted 2018 for investors. In an attempt to reduce the trade deficit, President Trump pushed to rewrite trade agreements with several long-time trade partners of the United States. Trump amended the trade agreement with South Korea, imposed tariffs on steel and aluminum, and renegotiated the North American Free Trade Agreement (now called the United States-Mexico-Canada Agreement). But the trade war with China has been the most compelling and impactful, not only to the countries directly involved, but to much of the global economy. Reciprocal tariffs were imposed by each economic giant throughout the year. There was a temporary truce achieved following the Group of 20 summit, but there was no definitive agreement reached.

Elections in November showed how politically divided the nation is. Democrats picked up 40 congressional seats to win control of the House of Representatives for the first time since 2011. On the other hand, Republicans maintained control of the Senate. The end result is a Congress that has become more divided, at least politically. Oh, and the federal government shut down in late December due to a budgetary stalemate between President Trump and Congress, principally over funding for a border wall.

For the year, the stock market reached new highs and gave it all back by the end of December. "Volatility" is the word that best describes the market in 2018. Despite the economy expanding at a rate not seen in many years, favorable corporate earnings reports, strong consumer spending, tepid inflation, and plenty of jobs to be had, stocks floundered. Trade wars continued, the Federal Reserve hiked interest rates, oil prices bottomed out, and long-term bond prices rose. The Chicago Board Options Exchange (CBOE) Volatility Index (VIX), which provides a measure of market risk and investors' sentiments, spiked in February, then was relatively stable through much of the summer. However, by the end of December, the VIX jumped again. Stocks were sold, bought, and sold again in rapid order, causing benchmark indexes to post noteworthy gains and losses on an almost daily basis. As a result, investors rode a roller coaster of stock prices throughout the year.

The year saw some positive highlights as well. The economy expanded at an annual rate exceeding 3.0% for the first time in several years. The unemployment rate hit the lowest mark since 1969. In November, 1.7 million persons were marginally attached to the labor force, an increase of 197,000 from a year earlier. The Federal Reserve, based on the strength of the economy and labor market, raised interest rates four times during the year. Consumer income rose and purchases increased, and inflation exceeded 2.0% midyear, only to fall back below that target by the end of 2018.

Key Dates/Data Releases

1/2: PMI Manufacturing Index

1/3: ISM Manufacturing Index

1/4: Employment situation

1/8: International trade, JOLTS

1/11: Consumer Price Index, Treasury budget

1/15: Producer Price Index

1/16: Retail sales, import and export prices

1/17: Housing starts

1/18: Industrial production

1/22: Existing home sales

1/25: Durable goods orders, new home sales

1/29: International trade in goods

1/30: GDP, FOMC meeting report

1/31: Personal income and outlays

Market/Index	2017 Close	As of 9/28	2018 Close	Month Change	Q4 Change	2018 Change
DJIA	24719.22	26458.31	23327.46	-8.66%	-11.83%	-5.63%
Nasdaq	6903.39	8046.35	6635.28	-9.48%	-17.54%	-3.88%
S&P 500	2673.61	2913.98	2506.85	-9.18%	-13.97%	-6.24%
Russell 2000	1535.51	1696.57	1348.56	-12.05%	-20.51%	-12.18%
Global Dow	3085.41	3121.54	2736.74	-6.81%	-12.33%	-11.30%
Fed. Funds	1.25%-1.50%	2.00%-2.25%	2.25%-2.50%	25 bps	25 bps	100 bps
10-year Treasuries	2.41%	3.06%	2.68	-31 bps	-38 bps	27 bps

Chart reflects price changes, not total return. Because it does not include dividends or splits, it should not be used to benchmark performance of specific investments.

Snapshot 2018

The Markets

- **Equities:** The year 2018 may ultimately mark the end of what was nearly a 10-year bull run. At the start of the year, January was a good month; February and March were not. However, as spring approached, growth in equities began to pick up steam, leading to record highs in several of the benchmark indexes during the summer months. But by October, volatility began to increase, as investor concerns about the impact of a trade war between the world's largest economies was enough to prompt sell-offs, sending stock prices lower. November was a little better, but December proved to be tumultuous. Ultimately, the benchmark indexes listed here could not match their 2017 year-end values. In fact, several of the benchmark indexes suffered their worst annual losses in many years.
- Each of the benchmark indexes listed above fell well below their respective 2017 year-end closing values. Compared to 2017, the Russell 2000, which had eclipsed its 2017 closing mark by over 13% in September, ended the year down over 12%. The Global Dow was not far behind, falling more than 11% by the end of December. The large caps of the Dow and S&P 500 ended the year down 5.6% and 6.2%, respectively. The Nasdaq, which led the way for much of the year on the strength of tech stocks, gave all of the gains back, dropping almost 4% below where it started the year.
- **Bonds:** As stock prices soared during the first half of 2018 and interest rates moved incrementally higher, the demand for long-term bonds was marginal. Yields on 10-year Treasuries rose almost 30 basis points in January as bond prices fell. Long-term bond yields continued to climb, reaching 3.0% in July. However, as volatility increased for stocks, the yield on long-term bonds began to fall as demand drove prices higher. Ultimately, the yield on the benchmark 10-year Treasuries closed 2018 at 2.68%, up from the 2017 closing yield of 2.41%.
- **Oil:** Oil prices began 2018 at over \$60 per barrel and continued pushing higher through January, reaching almost \$70 per barrel in May. Oil prices remained in the \$60 range for most of the fall, spiking to almost \$76 in early October. But fears of overproduction began pushing oil prices lower in November. Prices continued to fall, hitting a low of nearly \$42 per barrel in mid-December. Ultimately, oil prices closed 2018 at \$45.81 per barrel — their first annual loss since 2015. As oil prices rose and fell, so did prices at the pump. Retail regular gasoline prices closed the year around \$2.321 per gallon on December 24, about \$0.151 less than a year ago.
- **FOMC/interest rates:** The Federal Open Market Committee raised interest rates four times during 2018. Each time the target range increased by 25 basis points. The first increase occurred in March, followed by a rate increase in June, an increase in September, and a final bump occurring in December. For the year, the target range has increased 100 basis points, from 1.25%-1.50% to 2.25%-2.50%. Following each rate increase, the Committee expressed the expectation that the labor market would remain strong and the economy would continue to expand, while noting that private business investment had slowed. The Committee changed its stance by the end of the year and reduced its forecasts from four rate increases in 2019 to two 25-basis-point rate increases in 2019.
- **Currencies:** The dollar maintained a relatively strong position throughout much of 2018. The Wall Street Journal Dollar Index, which measures the U.S. dollar against the currencies of 16 other countries, closed 2018 at \$89.67, up from its 2017 year-end mark of \$85.98. Another currency index, the ICE U.S. Dollar Index, which measures the dollar relative to a basket of six foreign currencies, closed 2018 about 4.5% higher — its best annual gain in several years.
- **Gold:** Through the first quarter of 2018, gold hovered around \$1,350 a troy ounce. Rising interest rates,



favorable stock market returns, and a strong dollar helped to push gold prices lower during the summer months. However, as stock prices faltered, gold prices pushed closer to their early-year values, finally closing 2018 at \$1,284.70.

The Economy (through November 2018)

- **Employment:** The U.S. labor market was solid throughout 2018. Employment growth averaged 209,000 new jobs per month in 2018, compared with an average monthly increase of 174,000 new jobs in 2017. The unemployment rate ended the year (as of November 2018) at 3.7% — lower than the 4.1% rate at the close of 2017. Over the year, the unemployment rate and the number of unemployed persons declined by 0.4 percentage point and 641,000, respectively. According to the Bureau of Labor Statistics, there were 6.0 million unemployed persons in November 2018, down from 6.6 million unemployed in November 2017. The labor force participation rate was 62.9% in 2018, up slightly from last year's rate of 62.7%. The employment to population ratio was 60.6% (slightly better than 60.1% in 2017). In 2018, the average workweek was 34.4 hours (34.5 hours in 2017). Average hourly earnings in 2018 were \$27.35, an increase of 3.0%, or \$0.80, over \$26.55 in 2017.
- **GDP/budget:** Economic growth, as measured by the gross domestic product, expanded throughout the year, increasing at an annual rate of 3.4% in the third quarter of 2018. The first-quarter GDP rose 2.2%, followed by a 4.2% gain in the second quarter. Gross domestic product essentially measures what the economy produces, such as goods and services. On the other hand, gross domestic income measures all income earned from the production of goods and services, such as wages, profits, and taxes. GDI rose 4.3% in the third quarter of 2018, compared to a 1.3% increase in the third quarter of 2017. The average of gross domestic product and gross domestic income, a supplemental measure of U.S. economic activity that equally weights GDP and GDI, increased 3.8% in the third quarter, compared with an average annual increase of 1.9% in 2017. The federal deficit was roughly \$779 billion for fiscal year 2018, an increase of \$113 billion over the 2017 fiscal year deficit of \$666 billion. The government fiscal year runs from October through September.
- **Inflation/consumer spending:** Inflation, as it relates to consumers, had reached the Federal Reserve's stated target rate of 2.0%, only to fall below that level in November. The personal consumption expenditures (PCE) price index, the measure of the increase in the prices of goods and services purchased by consumers, was 1.8% higher in November 2018 compared to November 2017. Core PCE, which excludes the volatile food and energy components, expanded at an annual rate of 1.9% in 2018. Personal (pre-tax) income increased 4.1% in the third quarter of 2018 compared to an annual rate of 4.4% in 2017. After-tax income (disposable personal income) increased 4.0% in the third quarter of 2018 after expanding at an annual rate of 4.4% in 2017. Another measure of inflation, the Consumer Price Index, measures the price level of a basket of consumer goods and services purchased by individuals. Over the 12 months ended November 2018, the CPI rose 2.2% (2.1% in 2017).
- **Housing:** A lack of inventory, coupled with rising mortgage interest rates, contributed to a rather lackluster performance in the housing sector. Through November, existing home sales are down 7.0% from a year ago. The November annual sales rate of 5.32 million was notably lower than the 5.72 million rate for November 2017. The median existing-home price for all housing types in November was \$257,700, up 4.2% from November 2017 (\$247,200). November's price increase marks the 81st consecutive month of year-over-year gains. Total inventory of existing homes for sale in November was 1.74 million — 4.2% greater than last November (1.67 million).
- **Manufacturing:** Manufacturing and industrial production performed better in 2018 than the prior year. The Federal Reserve's index of industrial production revealed that total industrial production rose 3.9% over the 12 months ended in November 2018. Over the same period, the output of consumer goods increased 1.5% and production of business equipment expanded 4.1%. Capacity utilization for manufacturing increased 2.0% over the past year. New orders for manufactured durable goods (expected to last at least three years) increased by 8.4% from 2017. Shipments were up 7.2%. Capital goods — tangible assets used by manufacturers to produce consumer goods — also expanded in 2018. New orders for capital goods increased by 8.5%, and shipments of capital goods expanded by 7.3%.
- **Imports and exports:** From January through October, the international trade deficit for goods and services was \$503 billion, or 11.5% greater than the deficit over the same period in 2017. The goods deficit totaled \$729 billion, while services had a surplus of \$226 billion. Exports increased from \$1.944 billion in 2017 to \$2.093 billion. Imports increased from \$2.400 billion to \$2.600 billion. Import prices increased 0.7% over the past 12 months ended in November. Export prices expanded by 1.8% over the 12 months ended November 2018.
- **International markets:** International equities did not enjoy the same upward momentum in 2018 compared to the prior year. Economic expansion stalled for many international economies as heightened trade tensions between the United States and several of its trade partners and tighter monetary policies cast a shadow over economic expansion. Following demands for more favorable trade



terms, the United States imposed tariffs on imports from several of its trade partners. While negotiations ultimately resolved trade wars with some countries, notably Mexico and Canada, a major impasse still exists between the United States and China. The impact on both countries has been palpable, particularly in China, where fixed-asset investment, retail sales, and industrial output have each decreased in 2018 compared to 2017. In Europe, Great Britain is scheduled to leave the European Union soon, yet it remains unclear under what terms Brexit will take place. Also, several countries tightened their respective monetary policies in 2018 on the heels of economic growth in 2017. The lower interest rates in 2017 that helped propel consumer spending and business investment began to rise in 2018, hindering equity and economic expansion.

Eye on the Year Ahead

The economy grew at a respectable rate in 2018. Will it continue along the same path in 2019? Fears of an economic slowdown lingered at the end of last year and may be realized in 2019. The housing market hasn't picked up the pace and is generally lagging behind other economic mainstreams. Also, with inflation inching ahead, economic stimulus may be easing, which could lead to tighter financial conditions moving ahead. Certainly if the global trade wars between the United States and China continue, not only will the impact be felt domestically, but a rift between the world's two largest economies is sure to affect global economies and markets as well. And, as 2018 closes and 2019 begins, the federal government remains shut down.

Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). News items are based on reports from multiple commonly available international news sources (i.e. wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations. All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Past performance is no guarantee of future results. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful.

The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. The U.S. Dollar Index is a geometrically weighted index of the value of the U.S. dollar relative to six foreign currencies. Market indices listed are unmanaged and are not available for direct investment.

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