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Dear Valued Client,

After spending most of 2018 in positive territory, the US equity markets decreased 13.55% in the 4th quarter of 2018 and the S&P 500 ended the year down 4.52%. 2018 marks the first year of negative returns since the 2008 financial crisis. Unfortunately, there were very few places to hide amidst the volatility as US small cap, emerging markets, & developed international stocks were all down 20.29%, 7.64%, & 12.62% in the 4th quarter, respectively. For the calendar year 2018, US small cap stocks, emerging markets, and developed international stocks were down 11.11%, 15.31%, & 13.8%, respectively. In years when the equity markets perform poorly, bond markets historically move in the opposite direction, but this year was an anomaly since the Federal Reserve raised interest rates 4 times in 2018 to 2.5%. While bonds rallied late in the year as US economic growth concerns increased, the gains were not quite enough to offset the losses in bonds earlier in the year from higher interest rates and rising inflation expectations. As a result, the Vanguard Total Bond Market Index closed 2018 down 0.13%. International and emerging markets were lower for 2018 as well. This was due to slowing growth and rising uncertainty surrounding trade policy across China and Britain's planned exit from the European Union, both of which pushed the US Dollar higher in value versus foreign currencies. Another item of note was the continued performance divergence between growth and value stocks in 2018. The Russell 1000 large cap value index was down 8.42%, while the Russell 1000 large cap growth index was down 1.65%. The Russell 2000 small cap value index was down 12.99%, while the Russell 2000 small cap growth index was down 9.42%.

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This performance divergence amongst growth and value stocks was prevalent throughout most of 2018 when the S&P 500 was in positive territory, a dynamic that suggests more weakness occurring beneath the surface of the market indices. Part of the reason why markets were as volatile as they were in the 4th quarter was because the stocks that were helping the S&P 500 through most of 2018 finally began to move lower, along with declining momentum that forced many technical-oriented traders to the sidelines.

As most of our clients know, we implement investment selections across client portfolios that tend to exhibit greater price resiliency in more volatile market environments and this year was no exception. Downside price resiliency is less relevant for younger investors with long time horizons, but its value increases significantly once time horizons shrink and clients begin taking distributions for retirement. While all our model portfolios unfortunately posted negative returns, all 4 model portfolios exceeded the performance of their benchmarks, reflecting the benefits of active management and defensive investing in a late stage economic cycle with growing uncertainty. FMI Large Cap (FMIQX), FMI Common Stock (FMIUX), Morningstar Wide Moat (MOAT), FMI International (FMIYX), First Eagle Global (SGIIX), First Eagle Overseas (SGOIX), Matthews Asia Growth & Income (MICSX), and American New World (NFFFX) all exceeded their respective 2018 benchmark performance. The only active fund that did not perform as well as the benchmark in 2018 was the First Eagle US Value (FEVIX) fund, which lost 5.64% vs. S&P 500 loss of 4.52%. As some of you may have noticed, we did quite a bit of rebalancing toward the end of the year across taxable accounts. Despite negative performance in 2018, many of the taxable gain distributions from the mutual funds were much higher than anticipated, so we were very proactive in avoiding and/or minimizing these taxable gains to the best extent possible. We should not have tax efficiency challenges next year as we significantly decreased the aggregate amount of actively managed funds used within taxable accounts as a means of increasing tax efficiency moving forward.

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We like the Wisdomtree family of exchange traded funds and implemented them across many taxable client accounts, as their funds and strategy are a good representation of the types of investments we want to own long-term that should create superior risk-adjusted returns with the added benefit of improved tax efficiency. Additionally, Wisdomtree funds can now be purchased and sold without any transaction fees at TD Ameritrade.

While investment returns were negative for 2018, the US economy and corporate earnings performed well. Year-over-year economic growth accelerated in 2018 from 2.5% to near 3% as unemployment remained below 4%, inflation remained stable near 2%, and consumer spending remained high (Source: Bureau of Economic Analysis, Bureau of Labor Statistics). A notable soft spot in the economy for 2018 was in housing, as existing home sales were down 10.25% from year-ago levels in December, due in part to weather and affordability challenges from higher prices and higher interest rates (Source: National Association of Realtors). On a national scale, we haven't yet seen a dip in home prices, as the Case-Shiller Home Price Index continued to be up 5.5% over 2017, due in part to continued low levels of housing inventory. Current housing inventory will absorb 3.7 months of housing sales, reflecting the continued tightness in the housing market, which benefits sellers at the expense of buyers (Source: National Association of Realtors). For 2019, the Federal Reserve expects growth to slow to 2.3% and interest rates rising .50% to 3% (Source: Federal Reserve). Revenues and earnings from S&P 500 companies grew by 8.8% & 20% in 2018, respectively, helped in part by lower corporate tax rates (Source: FactSet Earnings Insight). For 2019, S&P 500 corporate revenues and earnings are expected to grow by 5.5% & 6.9% according to FactSet.

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As we look back at how the markets performed in 2018, I'm reminded of the quote from Warren Buffett that says, "the light can at any time can go from green to red without pausing at yellow." Investors don't react to the news insomuch as they react to how the news influences profit expectations for the coming year. While 2019 should be another year of growth for corporate profits and the economy, the trajectory of growth is clearly slowing, and investors price businesses based upon that trajectory of growth, which partly explains why volatility has recently increased. The good news is that lower, but stable growth might be a good thing for the financial markets if it stabilizes inflation pressures and keeps the Federal Reserve from making a policy mistake of raising interest rates too high. At this point, however, all eyes are on the government shutdown and pending trade negotiations with China, both of which are big issues with ramifications that need to be resolved quickly. Historically, government shutdowns don't last long and don't have a major economic impact, but the longer it lasts, the bigger it's impact will be on the economy and markets. Over the last 6 months, new job creation has averaged around 222,000 jobs per month, so if that pace continues into 2019, the economy would absorb the 800,000 in displaced federal workers in about 4 months (Source: Bureau of Economic Analysis). This is just to make the point that while the government shutdown is unfortunate and avoidable, the silver lining is that it's happening against the backdrop of a relatively strong economic environment.

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We invite you to join us for our January client roundtable on Friday, February 1st at 9:00 in our Oak Ridge office as we review 2018 & our outlook for 2019 in more detail. Seating is limited, so please RSVP if you plan on attending. We look forward serving you in 2019! Never hesitate to call us if you have any questions or concerns regarding your accounts. As always, thank you for the trust that you have placed in us.

Sincerely,

C&J Wealth Advisors

Cassandra Catlett, CPA CFP®
J. Mark King, CFP®
Jeff Loos, ChFC®, LUTCF
Scott Smith, CIMA®

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The S&P 500 consists of 500 stocks chosen for market size, liquidity and industry group representation. Each stock's weight in the index is proportionate to its market value. The S&P 500 is one of the most widely used benchmarks of US equity performance. The MSCI World Index is a market capitalization-weighted index designed to provide a broad measure of equity market performance throughout 23 countries in the developed world.

The opinions and forecasts expressed may not actually come to pass. This information is subject to change at any time, based on market and other conditions and should not be construed as a recommendation of any specific security or investment plan. The advisor does not guarantee the accuracy and completeness, nor assume liability for loss that may result from the reliance by any person upon such information or opinions. Past performance does not guarantee future results.

Diversification can be thought of as spreading your investment dollars into various asset classes to add balance to your portfolio. Although it doesn't guarantee a profit, it may be able to reduce the volatility of your portfolio.