

MARKET COMMENTARY

Q4 2018 in Perspective

Loring Ward's Asset Class Investing portfolios are strategically invested with a focus on long-term performance objectives. Portfolio allocations and investments are not adjusted in response to market news or economic events; however, we evaluate and report on market and economic conditions to provide our investors with perspective and to put portfolio performance in proper context.

Despite robust corporate profits and a solid global economy, global stocks experienced a correction (i.e., a decline in prices of 10% or more from a recent high) during the quarter. Fortunately, U.S. and global bonds offered some protection from the volatility. While we never know for sure what triggers a correction like this, rising interest rates, fears of slowing economic growth, continued trade negotiations, and a U.S. government shut down all added to investor uncertainty.

For the quarter, U.S. stocks (as measured by the S&P 500 Index) declined -13.5%, and non-U.S. developed market stocks (as measured by the MSCI World Ex U.S.) declined -12.8%. Emerging market stocks (as measured by the MSCI Emerging Markets Index) declined -7.5%.

The trend of short-term interest rates rising faster than long-term interest rates continued as the Federal Reserve increased its key policy rate by 0.25% in December. The new benchmark target rate is 2.25-2.50%, and that is the ninth rate-hike since December 2015. The Federal Reserve indicated that they are considering two interest rate increases in 2019. However, with short-term interest rates approaching the same level as long-term interest rates, investors are concerned the yield curve may become inverted in the near future which may cause U.S. growth to slow.

The U.S. Dollar Index, a measure of the value of the United States dollar relative to a basket of foreign currencies, advanced in the fourth quarter – with the U.S. dollar appreciating by 1.9% compared to foreign currencies. The U.S. dollar is now 4.9% higher than it was 12 months ago.

U.S. Economic Review

Positive economic growth in the U.S. continued in the third quarter. The final reading for third quarter GDP showed an increase in economic growth of 3.4%. The November 2018 reading of the unemployment rate remained at a four decade low of 3.7%. Domestic inflation remains tame as the Fed's preferred gauge of overall inflation, the core Personal Consumption Expenditures (PCE) index, fell back below the Fed's target of 2.0% with a reading of 1.8% in October 2018.

Financial Markets Review

Global stocks all fell in the fourth quarter with both U.S. and international stocks posting double digit declines. Emerging Markets Value stocks fared better, but still posted losses for the quarter of -6.7%. In diversified portfolios, U.S. Short-Term Bonds and Global Bonds both advanced slightly which helped offset some of the stock market declines. Price declines like these are a normal part of investing. Investors that seek the higher expected returns offered by stocks understand that there will likely be periods of downside volatility. This is an inevitable part of investing.



Source: Morningstar 2018. Market segment (Index representation) as follows: U.S. Large-Cap Stocks (S&P 500 Index), U.S. Value Stocks (Russell 1000 Value Index), U.S. Small-Cap Stocks (Russell 2000 Index), U.S. REIT Stocks (Dow Jones U.S. Select REIT Index), International Value Stocks (MSCI World Ex USA Value Index (net div.)), International Small-Cap Stocks (MSCI World Ex USA Small Index (net div.)), Emerging Markets Value Stocks (MSCI Emerging Markets Value Index (net div.)), U.S. Short-Term Bonds (BofA ML Corp&Govt 1-3 Yr TR), Global Bonds (FTSE WGBI 1-5 Yr Hdg USD).

In the U.S., large-cap stocks outperformed mid- and small-cap stocks in all style categories. Among the nine style boxes, Large Value performed the best and posted a -11.7% decline, and Small Growth posted with worst decline of -21.7%.

Source: Morningstar Direct 2018. U.S. markets represented by respective Russell indexes for each category (Large: Russell 1000, Value, and Growth, Mid: Russell Mid Cap, Value, and Growth, Small: Russell 2000, Value, and Growth).

U.S. Stocks Q4 2018

	Value	Core	Growth
Large	-11.7%	-13.8%	-15.9%
Mid	-15.0%	-15.4%	-16.0%
Small	-18.7%	-20.2%	-21.7%

In developed international markets, the results were similar to the U.S. with all stock categories posting declines for the quarter. Large-cap stocks outperformed small-cap stocks, and value stocks performed better than growth in all size categories.

Source: Morningstar Direct 2018. International markets represented by respective MSCI World EX USA index series (Large: MSCI World EX USA Large, Value and Growth, Mid: MSCI World Ex USA Mid, Value, and Growth, Small: MSCI World Ex USA Small, Value, and Growth).

International Stocks Q4 2018

	Value	Core	Growth
Large	-11.9%	-12.1%	-12.2%
Mid	-12.7%	-15.4%	-16.6%
Small	-14.8%	-16.2%	-17.5%

With stocks declining globally, a diversified index mix of 65% stocks and 35% bonds would have declined -8.2% during the fourth quarter. Bond diversification helped buffer the stock market volatility.

65/35 Index Mix: 2% Cash (BofA ML 3M US Treasury Note TR), 16% ST U.S. Fixed Income (BofA ML Corp&Govt 1-3 Yr TR), 17% Global Bonds (FTSE WGBI 1-5 Yr Hdg USD), 15% U.S. Large (S&P 500 Index), 12% U.S. Value (Russell 1000 Value Index), 8% U.S. Small (Russell 2000 Index), 4% U.S. REITs (Dow Jones U.S. Select REIT Index), 14% Intl Large Value (MSCI World Ex USA Value Index (net div.)), 7% Intl Small (MSCI World Ex USA Small Index (net div.)), 5% Emerging Markets Value (MSCI Emerging Markets Value Index (net div.)).

Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Foreign securities involve additional risks, including foreign currency changes, political risks, foreign taxes, and different methods of accounting and financial reporting. Emerging markets involve additional risks, including, but not limited to, currency fluctuation, political instability, foreign taxes, and different methods of accounting and financial reporting. All investments involve risk, including the loss of principal, and cannot be guaranteed against loss by a bank, custodian, or any other financial institution.

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