2018 Recap

- After a fairly strong first three quarters 2018 experienced a sharp bout of selling not seen since the financial crisis.
- By year-end the major U.S. equity indexes had declined near 20% from their recent highs and non-U.S. equity indexes were down 10%+ for the year.
- While nothing compared to the stock market's year-end volatility, the bond market experienced a turbulent 2018 in its own right.
- The broad-based Barclays Aggregate Bond Index declined a few percent through mid-year as interest rates trended higher, but rallied as investors sought stability later in the year. Ultimately, the index was unchanged on the year while short maturity bond indexes experienced a slow and steady grind returning close to 1.5%.
- By the end of the year, the Bull Market in stocks had been declared dead by the media and everyone "knew" we were headed for a recession… potentially setting the markets up for a better than expected 2019.

Equity Outlook

- Earnings growth has slowed from last year's frantic pace but 6% consensus S&P earnings growth is still quite strong. Assuming valuations remain constant, earnings growth is 6% and dividends come in around 2%, investors might expect an 8% total return in the coming year.
- RiverGlades analysis points to Small and Mid-Cap stocks having similar return profiles yet with a historically higher market Beta. Market expectations have come down so much that U.S. equities face a situation where simply "less negative" results may prompt positive upside surprises for the markets.
- Developed international markets continue to look relatively attractive on a valuation basis but the generally lethargic growth and various region-specific issues, such as the ongoing "Brexit" drama in the U.K. leave the outlook somewhat less bullish.
- Emerging markets look poised to post gains in 2019 as many of the issues that weighed on the markets last year appear to have been resolved. Furthermore, the correction has left valuations that much more compelling. While these markets likely represent the greatest growth potential longer term, we also believe these investments carry potentially greater short-term volatility.

Fixed Income Outlook

- Federal Reserve Chairman Powell appears to have shifted his tone from quite "hawkish" in October to fairly "dovish" at year-end. RiverGlades' base case is for one rate hike in 2019 and likely no sooner than June.
- Ongoing analysis continues to favor short-to-intermediate bonds over those with notably longer duration. Longer-term bonds are facing various factors that might be keeping rates unduly low. As such, there is currently little justification to move into longer bonds as the pick up in yield is generally small in relation to the potential duration risk an investor would take on
- With growth prospects moderating and the general economic cycle moving into year eleven of the recovery, high yield bonds are a segment of the fixed income market that needs to be monitored more closely.
- Emerging market bonds have become more attractive following a pullback in 2018. Similar to high yield bonds, emerging market debt might be considered for investors that are looking to add some yield but understand the different types of risk that come with this asset class.

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