The Cobblestone Advisor

Investment Brief

January 2019

COBBLESTONE
CAPITAL ADVISORS

Stocks End 2018 with a Whimper

Developments in the fourth quarter of 2018 stood in stark contrast to the first nine months of the year. Heading into October, risk assets, with the exception of international equities, generally stood in positive territory. Conversely, safer assets—such as US government bonds—lagged. As the fourth quarter progressed, growing concerns regarding trade relations, global economic growth, and the future path of Federal Reserve policy led to a marked shift in investor risk appetite. The whipsawing in sentiment brought on a sharp increase in market volatility as investors shunned risk in preference of safety. From its September peak to its Christmas Eve close, the S&P 500 was down 19.8%. It was the worst December for US equities (-9.0%) since the depths of the Great Depression, the worst year (-4.4%) since the Global Financial Crisis (GFC), and the first year ever that the S&P 500 experienced negative returns after rising for the first three quarters.

We understand that sharp sell-offs can be unnerving, especially following the relative tranquility and solid returns of 2017. So we think it may be helpful to consider last year's volatility in the context of what has transpired historically. As seen in the chart below, the S&P 500's average intra-year decline over the last 39 years was 13.9%. Though the sell-off in 2018 was above average, it was not an outlier by any means. It was, instead, more in line with the norm.

Naturally, investors never want to experience losses. Consequently, despite 2018's volatility appearing normal in the context of history, it is likely a year most investors would rather soon forget.

Should Investors Expect the Market Decline to Persist?

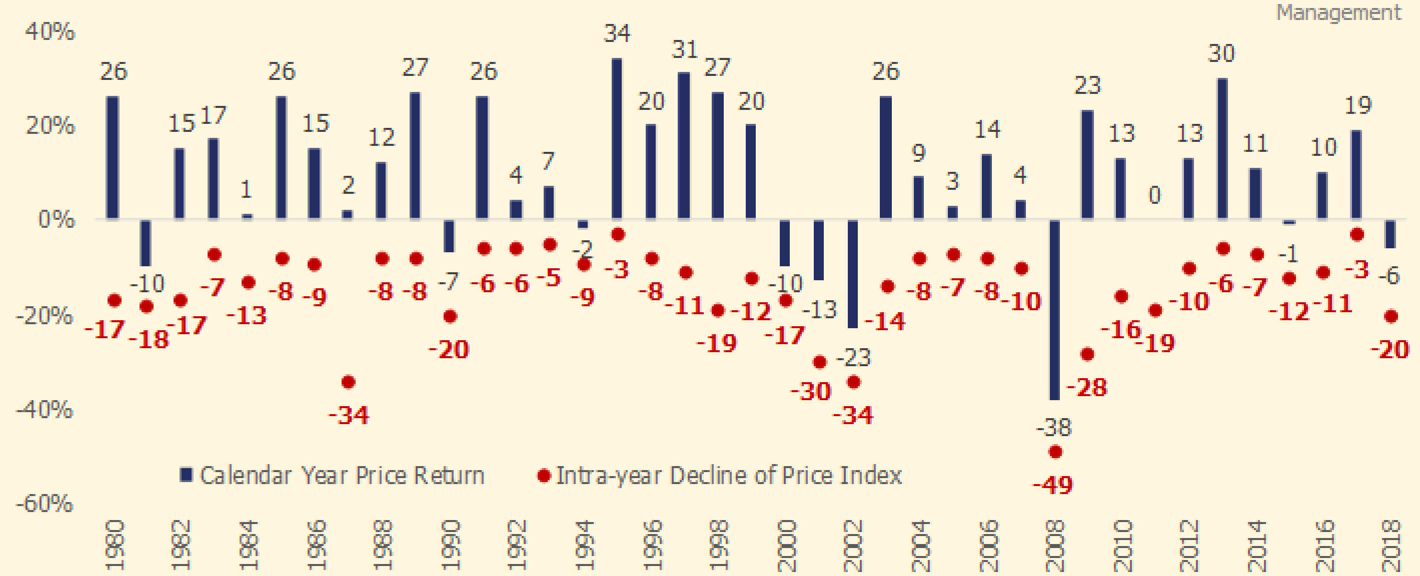
Recent data suggest that economic activity has moderated in the US and internationally. Domestically, consumer spending—which accounts for nearly 70% of GDP—is decelerating and business investment has slowed. A recent survey shows that small business owners expect their capital expenditures to soften

(Continued on page 2)

S&P 500 Intra-year Declines vs. Calendar Year Returns

Despite average intra-year drops of 13.9%, annual returns were positive in 29 of 39 years

Source: JPMorgan Asset Management



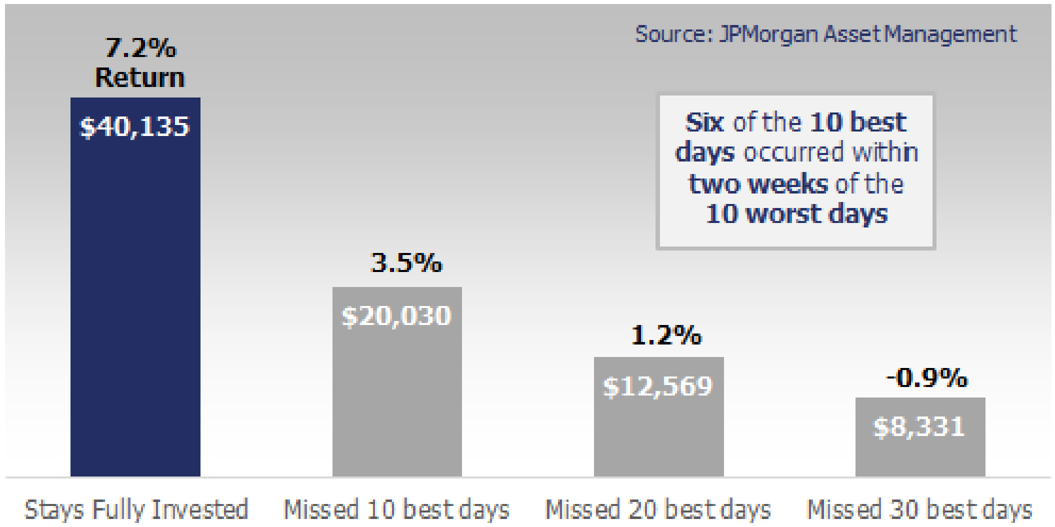
Tel. 585-473-3333 500 Linden Oaks, Suite 210, Rochester NY 14625 cobblestonecap.com

further. To the extent this softening occurs, aggregate demand could be negatively affected.

Looking overseas, several key economic indicators in China have also deteriorated: manufacturing activity contracted in December for the first time since 2016, industrial production and retail sales have decelerated, and inflation has softened. More broadly, the global manufacturing sector registered its most subdued expansion in more than two years in December, according to J.P. Morgan's Global Manufacturing Purchasing Managers' Index. It appears that the global synchronized expansion that began in 2017 has turned into a global synchronized deceleration.

Benefits of Staying Invested: S&P 500 Returns

Performance of $10,000 investment between January 1, 1998 and December 31, 2017



To get back to our question regarding whether investors should expect the market decline to persist, we point to economic and market fundamentals, which suggest December's selling frenzy may have been overdone. Though certain areas of the economy have moderated, labor market activity remains at its healthiest levels post-GFC, with unemployment near 50-year lows and wages rising at their fastest pace in more than a decade. Corporate profit growth, which underpins stock market valuations, also remains strong. More broadly, economic indicators including the Conference Board's Leading Economic Index and the Federal Reserve's recession probability model suggest continued economic expansion and relatively low risk of recession in the 12 months ahead. Considering this in aggregate leads us to believe that the market's recent slump may be transitory, as opposed to a definitive end to the current bull market. Indeed, over the first 10 trading days since Christmas, the S&P 500 posted its biggest 10-day rally since 2009 (+9.5%).

Understandably, fighting the urge to "do something," like sell stocks, during periods of heightened volatility can be a challenge. Yet the consequences of sitting on the sidelines when the market rallies can be pronounced (see above chart) since many of the market's best days are clustered around some of its worst. When market fundamentals remain supportive, and asset prices move lower, the more prudent move is to assess your asset allocation and, if necessary, adjust it to be in line with your long-term objectives. In that vein, we view the recent sell-off in the equity and corporate bond markets not as a time to let emotions take over, but as an opportunity to exercise discipline by maintaining or, if necessary, boosting exposure to these markets.

Total Return (%), Ending 12/31/2018				Annualized		
	Qtr	YTD	1 Year	3 Years	5 Years	10 Years
S&P 500 Stock Index	-13.52	-4.37	-4.37	9.23	8.47	13.08
Russell 2000 (Small Cap Stocks)	-20.20	-10.97	-10.97	7.34	4.40	11.93
MSCI EAFE (International Stocks)	-12.54	-13.74	-13.74	2.87	0.53	6.30
MSCI EMF (Emerging Markets)	-7.47	-14.53	-14.53	9.22	1.64	7.99
Barclays US Aggregate Index	1.64	0.01	0.01	2.05	2.51	3.47
FTSE NAREIT All Equity REITs	-6.06	-4.03	-4.03	4.23	8.29	12.49
Consumer Price Index (% Chg over Period)	0.29	1.95	1.95	2.05	1.49	1.80