ROUND TABLE
WEALTH MANAGEMENT

QUARTERLY REVIEW

FOURTH QUARTER 2018

Seven words describe the 2018 equity markets: An escalator up and an elevator down! The fourth quarter of 2018 proved to be challenging with the S&P 500 retracing more than it gained during the first nine months of the year. It is perhaps this fact that makes the fourth quarter so emotional for investors as the psychological impact of the quarter greatly overshadows the actual full year negative return—it hurts more because it happened relatively quickly. Aside from municipal bonds that generated a positive return of 1.3% during 2018, all other asset classes shown in the chart below generated performances ranging from zero percent in the case of the Barclays U.S. Aggregate Bond Index, to a negative 14.2% in the case of emerging markets. During markets like those in the fourth quarter, it becomes tempting to "sell and go to cash". For long-term investors, however, such actions can create a negative feedback loop of buying high and selling low…exactly the opposite of how the most successful investors deploy capital. As shown in the chart below, all listed asset classes posted positive returns over the prior three-, five- and ten-year time periods. The message is clear: despite short-term negative performance in the capital markets, staying invested has been the winning strategy over the longer-term.

Staying invested in the markets does not mean taking no action. The "market" is comprised of thousands of stocks and fixed income securities, each with its own unique set of risks, cash flow characteristics, growth prospects and many other variables. Long-term investors have the ability to remain invested by changing the level of portfolio risk through security selection to better align with what is deemed an acceptable risk within available opportunities. For example, in the current market environment a growth-oriented equity portfolio may be rebalanced towards a value-style portfolio, and a fixed income portfolio may be transitioned from one of a lower credit rating to one of a high-grade rating, all while remaining invested in the "market."

Over the long term, staying invested matters. The facts show that staying fully invested is key to long-term investing success. For example, between January 1999 and December 2018 (20 years that included the Tech Crash and the Financial Crisis) the S&P 500 generated an annualized return of 5.6%. If an investor missed just *five* of the best trading days during that period (out of 5,030 total days), their annualized return would have dropped to 3.5% – a reduction of 38%. If an investor missed the 40 best days, their annualized return would have been a negative 4.2%.[1]

For 2019, Round Table is maintaining a cautiously optimistic outlook. The global economy and corporate earnings are decelerating, but are not projected to be negative. In the context of slower growth, valuation and credit quality take on increasing importance. As such, we believe a portfolio management shift from "risk taking" to "risk management" is appropriate.

Benchmark Returns through December 31, 2018

	QTD	2018	2 Years	3 Years	5 Years	10 Years
S&P 500	-13.5%	-4.4%	7.9%	9.3%	8.5%	13.1%
Russell 2000	-20.2%	-11.0%	1.0%	7.4%	4.4%	12.0%
MSCI World Ex. US Index	-12.7%	-13.6%	3.8%	3.6%	0.8%	6.8%
MSCI Emerging Markets	-7.4%	-14.2%	8.7%	9.7%	2.0%	8.4%
Bloomberg Barclays U.S. Aggregate	1.6%	0.0%	1.8%	2.1%	2.5%	3.5%
Bloomberg Barclays Municipal Bond	1.7%	1.3%	3.3%	2.3%	3.8%	4.9%
Bloomberg Barclays U.S. High Yield	-4.5%	-2.1%	2.6%	7.2%	3.8%	11.1%
FTSE Nareit All REITs	-6.1%	-4.1%	2.4%	4.6%	8.3%	12.4%

Source: Bloomberg *Periods greater than one year are annualized.

The Big Picture (click here for full article)

U.S. real gross domestic product increased 3.4% in the third quarter of 2018, which, when combined with fourth quarter estimates, suggests the U.S. economy will grow 2.9% for the full year of 2018. Economic growth in 2019 is expected to slow from 2018 levels, but not turn negative. Recession concerns are being raised more frequently in light of the market environment, yet most strategists do not foresee an economic downturn over the next twelve months. Much attention was paid to Federal Reserve Chairman Powell taking a more "dovish" approach in describing potential Fed Funds rate increases in 2019. As recent as this past summer, the market widely expected up to four interest rate increases in 2019; however, now the market is implying through Fed futures that only one to two rate increases may occur. While lower projected interest rates are generally good for fixed income and lower discount rates applied to equity cash flows help to increase share net present values, the development also implies that the Federal Reserve is less optimistic about the economic health of the U.S. economy and therefore warrants caution. Fixed income markets appear to be illustrating caution as well with the U.S. Treasury 10-Year Note yield falling from 3.2% at its 2018 peak to about 2.7% today...not much above the Fed Funds rate of 2.5%.

The New Year brought with it a change of power in Washington, with the House of Representatives moving to a Democratic majority and the Senate becoming more Republican controlled. Any hopes of the parties working together appear dashed at present due to a budget stalemate that has shut down the U.S. Government. The U.S. has (unfortunately) gone through this before and while such developments can have an impact on markets, the effect has generally been short-term.

International markets are trading at historically attractive valuations, but this may be justified due to deteriorating fundamental data. During the third quarter, Germany experienced negative economic growth and the United Kingdom appears to be summoning the spirits of the band The Clash as to whether "should it Stay or should it Go." Combining these issues with the ongoing trade dispute between the U.S. and China raises the risk premium for investing in non-U.S. markets, which at current valuations appears to be factored into current prices. Currency effects may also play a role as many expect the U.S. dollar to decline, which would be a tailwind for U.S. investors.

Summary of Allocation Recommendations

Asset Class	Recommendation	Comment	Asset Class Summary Link
U.S. Large Cap	Neutral/Overweight	Lower valuations offer improved return outlook; rotation to value from growth	U.S. Large Cap Review
U.S. Small & Mid Cap	Neutral	Favor higher weight to mid cap over small cap within this allocation	U.S. Small Cap Review
Non-U.S. Developed	Neutral	G-7 economic growth decelerating; valuations favorable but risk higher	International Equity Review
Emerging Markets	Neutral	Strong economic growth yet tariff, trade and currency concerns impacting asset class; valuations appear attractive	International Equity Review
Fixed Income	Neutral/Overweight	Short-term bonds capture large percentage of longer-term yields; emphasize higher-rated, quality bonds as safe haven asset	Fixed Income Market Review
Tactical	Neutral	Robotics and cybersecurity	Tactical Investments Review
Alternative	Hedge Funds & Private Equity	For appropriate allocations	Contact your Wealth Advisor

The Outlook

We raised our large cap recommended allocation to neutral/overweight due to the recent sell-off. In our third quarter 2018 letter we cited our concern that "the market may experience valuation contraction in light of lower, albeit positive, growth rates." This has played out and our rotation to value-style investing should bode well in the New Year if earnings projections are revised (historically EPS growth rates tend to decline over the year) for growth-oriented stocks. The S&P 500's forward price-to-earnings valuation is now below its 10-year average, suggesting the market may have accounted for future earnings risk. We are not projecting any tax-induced earnings growth as the benefit of tax reform is largely complete within the large cap asset class. Anecdotally, according to Factset, the effective tax rate for the S&P 500 for the first nine months of 2018 was 19% as compared to 25.7% over the corresponding prior year period.

Similar to last quarter, we are recommending a neutral allocation to U.S. SMID Cap Equities. We continue to favor midcap equities over small cap equities. Small caps remain most sensitive to economic growth and if we continue to see weakness in economic data and downward revisions of earnings, this may continue to hinder small cap performance. As such, we maintain our underweight to small caps in favor of mid and large cap equities.

We recommend a neutral allocation to non-U.S. developed markets. Valuations in developed markets remain attractive and likely reflect the ongoing Brexit concerns and deteriorating economic data out of Germany. Japan may remain challenged as the country is a large exporter to China, which remains muddled in a trade dispute with the U.S. Currency markets suggest the Euro will appreciate versus the U.S. Dollar and thus provide a tailwind for U.S. investors. Emerging markets, after a very weak year, trade at historically low valuations relative to developed markets and to themselves. Asian emerging markets continue to maintain higher projected economic growth within the asset class. Currency, which has been a detractor from EM investments this year, is expected to provide support if the U.S. Dollar retreats during 2019. We remain cautious within EM absent any sentiment changing catalyst and thus are recommending a neutral allocation to the asset class.

We are raising our fixed income allocation to neutral, primarily for risk management. For some time now we have recommended shorter duration fixed income portfolios, which was achieved in part through the use of senior loans and short-term bonds. Due to decelerating economic growth and the impact such a development can have on lower-rated fixed income securities, we are recommending increasing the percentage of highly rated bonds within fixed income portfolios. For taxable accounts we are recommending municipal bonds and within tax- deferred accounts we are recommending highly rated corporate bonds.

Our Tactical recommendations continue to include investments in a robotics ETF and a cybersecurity ETF. We remain committed to these investments for the intermediate term as the longer-term trends within these sectors have not changed.

Tax and Financial Planning News

Whether you're already one of the 33% of Americans who have set a financial resolution for 2019, according to Fidelity's Financial Resolutions Study, or one who has not yet, the new year presents a fresh start for those looking to improve their financial position. These are a few recommendations for starting the new year off right.

About 50% of Americans want to save more in 2019. A surefire way to save more is to increase your contribution to a 401(k) or IRA. By increasing your automatic paycheck contribution, you won't ever see the funds hit your checking account, avoiding the temptation to overspend. Another way to save more is to spend less. Consider tracking your budgets through an app like Mint and setting a goal to monitor your spending weekly.

In addition to saving more, about 30% of Americans would like to pay down existing debt. Whether it is a credit card, student loan, or other debt, every dollar spent paying down debt saves you in future interest payments due. Consider paying down the highest interest rate bearing debt (typically credit card) first and consolidate when you can. You can use Credit Karma to track the impact on your credit score!

2019 is a great year to establish a financial resolution. Consider reaching out to a Round Table Wealth Advisor for any recommendations for your personal situation.

Firm News

Lauren Gooding said "Yes!" to her longtime boyfriend Matt and the two were married in December! A heartfelt congratulations and best wishes to the new couple!

Please join us in congratulating Eric Thompson and Theodore Schneider for their respective promotions to Director.

Respectfully submitted,
Round Table Wealth Management

[1] Bloomberg, RTWM