MARBLE TRAIL ADVISORS

Financial Planning & Wealth Management

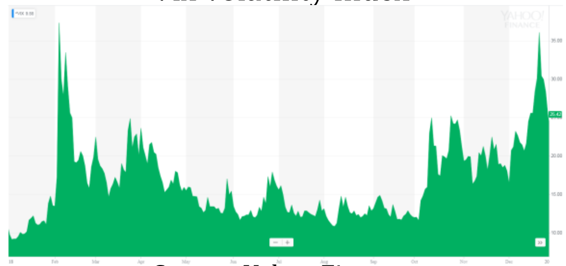
Market Update

4th Quarter 2018

Global Stock Market Highlights

- Financial markets suffered a dramatic reversal as investors fixated on slowing global growth and concluded that the U.S. economy may itself be headed for recession.
- The S&P 500 lost 14% for the quarter and 5% for the year. The carnage was widespread: most stock exchanges in Europe and Asia fell nearly as much as the U.S., leading to double-digit losses for 2018. With trade a key worry, Japanese stocks, dominated by large exporters, suffered some of the steepest declines, losing 17% in Q4 and nearly 15% for the year.
- Uncharacteristically for a “risk off” environment, emerging markets held up relatively well, led by a 15% rally in the Brazilian stocks, where investors cheered the ascension of a new conservative government to replace the socialists that had run the country for 15 years.
- US volatility surged to its highest levels since 2011, with massive gains and losses continuing into the new year.

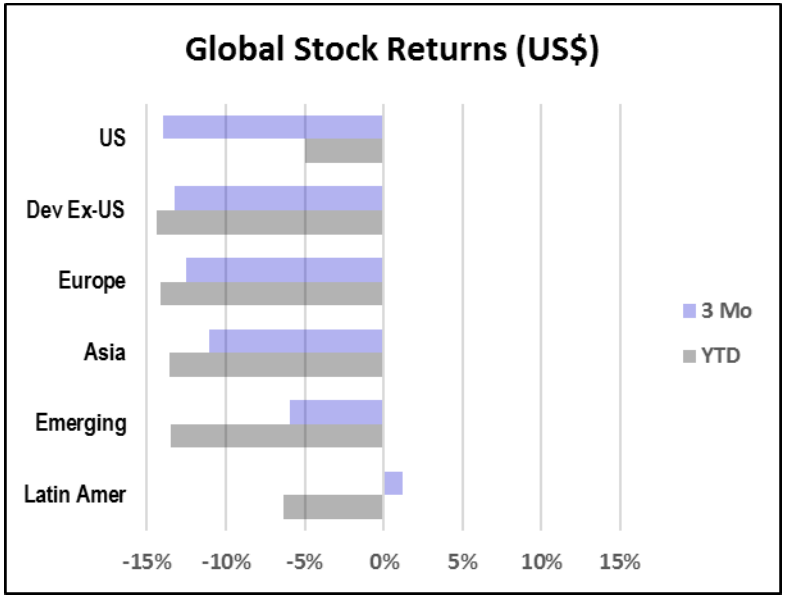
Vix Volatility Index



Source: Yahoo Finance

P/E Ratios	Current	1 Yr Ago	3 Years Ago
S&P 500	17.1	22.9	19.0
Russell 2000 (Small)	14.0	22.4	18.7
Europe	13.6	18.4	15.9
Emerging Markets	12.8	15.3	12.4

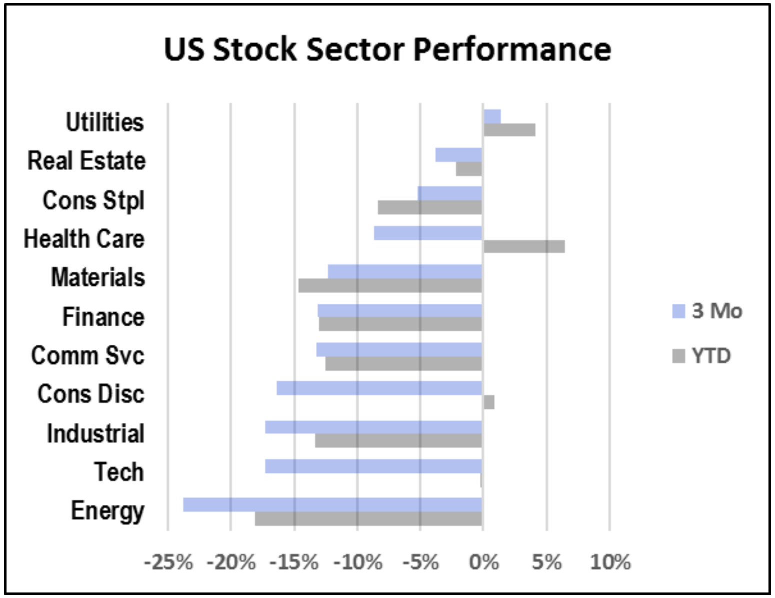
Source: Morningstar



Source: S&P Dow Jones

Stock Sector Highlights

- The stock market rout offered few safe havens, with only Utilities able to eke out a modest 1% gain.
- Energy shares were the biggest losers as the price of oil plunged 40% in the quarter amid softening global demand.
- Technology stocks were also hit hard in Q4, erasing the year's earlier gains.
- Besides Utilities, only health care and consumer discretionary (e.g., Amazon) held onto yearly gains, and these now represent two of the most expensive parts of the market.
- Financials are the cheapest sector, with investors concluding lower, not higher, interest rates are on the horizon, which could shrink bank profit margins.



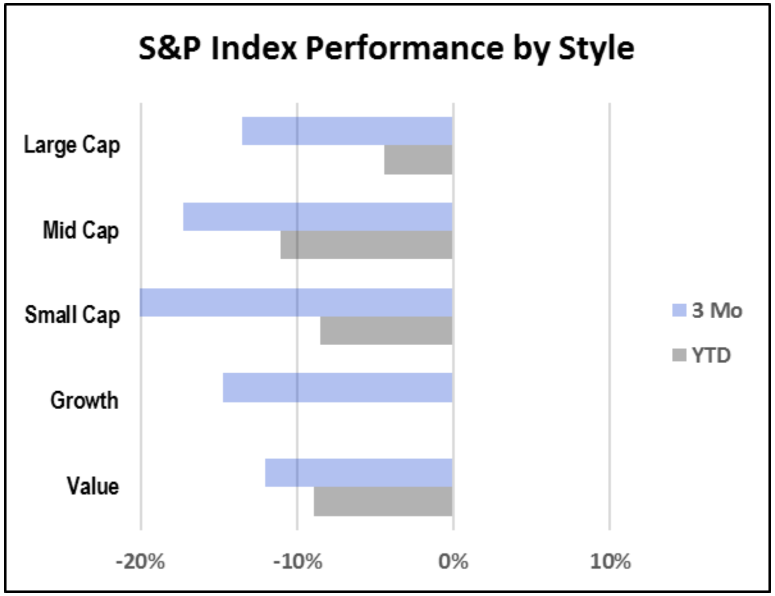
Source: S&P Dow Jones

	P/E Ratios			Yields	
Sector	Current	1 Yr Ago	3 Years Ago	Current	3 Years Ago
Consumer Discretionary	21.2	23.5	21.0	1.3%	1.5%
Consumer Staples	18.8	22.8	22.3	3.0%	2.7%
Energy	12.1	32.0	16.3	3.5%	3.2%
Financials	11.0	17.7	14.8	2.1%	1.9%
Health Care	27.4	23.8	22.5	1.6%	1.5%
Industrials	15.7	23.7	17.6	2.1%	2.3%
Technology	20.8	23.7	20.2	1.6%	1.9%
Utilities	16.0	20.8	17.0	3.3%	3.6%
S&P 500	*17.1*	*22.9*	*19.0*	*2.2%*	*2.3%*

Source: Morningstar

Stock Market Performance by Style

- Stocks of smaller companies were savaged in the fourth quarter, with investors becoming more concerned with the prospect of a recession. Previously those companies had done relatively well as it was assumed they would be more insulated than large companies in a trade war. The logic behind punishing them disproportionately now, when they were already relatively inexpensive, eludes us.
- Larger growth companies, on the other hand, remain expensive even after double-digit losses in Q4.
- We continue to await a rotation back to value based on fundamentals



Source: S&P Dow Jones

Style Box Valuation (P/E)

	Value	Blend	Growth
Large	16.0	18.7	23.0
Mid	13.7	18.1	25.9
Small	13.7	15.7	19.7

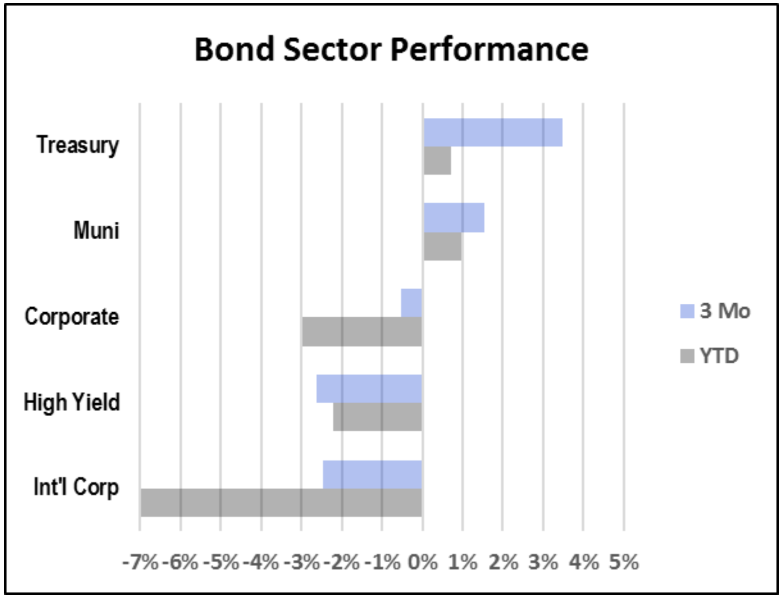
Source: Morningstar, Vanguard

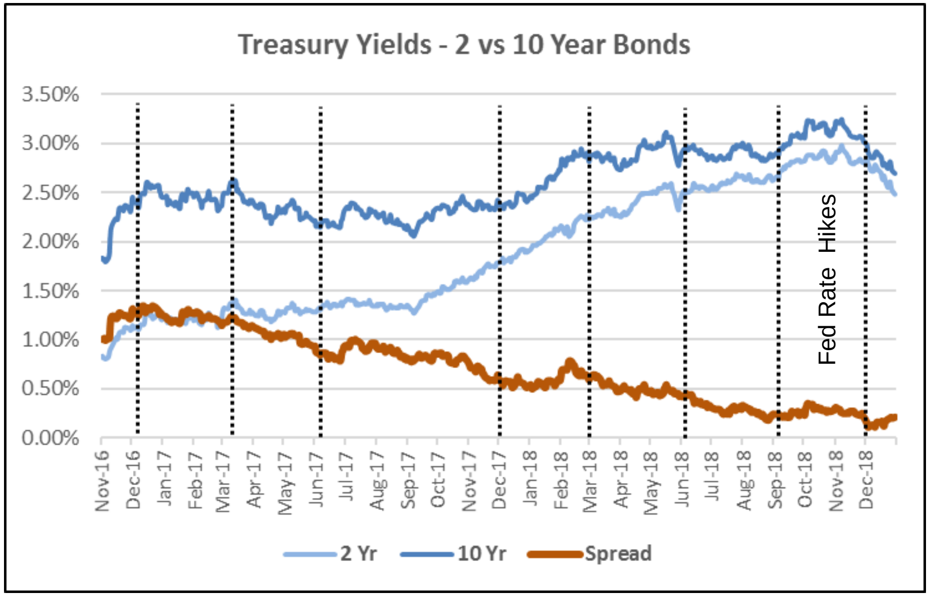
P/E Ratios	Current	1 Yr Ago	3 Years Ago
S&P 500	17.1	22.9	19.0
Russell 2000 (Small)	14.0	22.4	18.7
Large Growth	23.0	27.4	23.1
Large Value	13.4	20.4	17.0
Small Growth	19.7	29.3	26.1
Small Value	13.7	17.2	16.4

Source: Morningstar

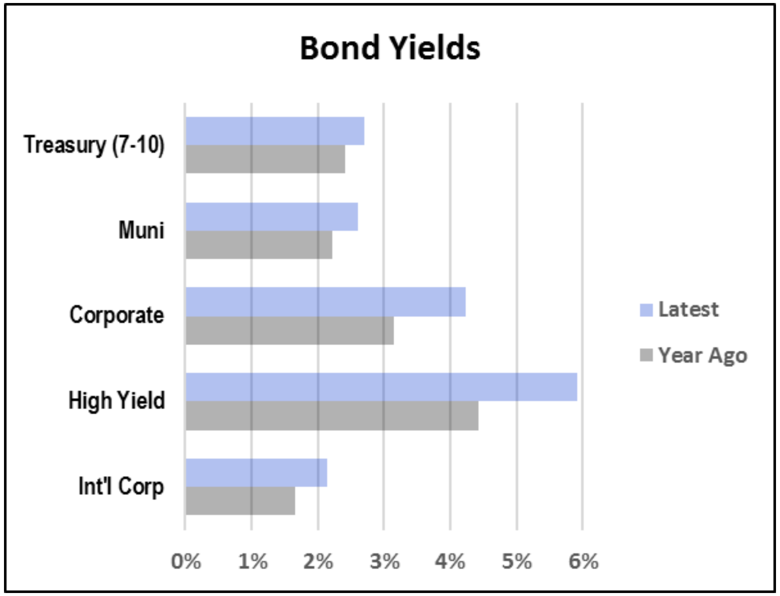
Bond Market Highlights

- Amid the darkening mood, investors fled to the relative safety of treasury and municipal bonds, sending them higher. Other bond sectors suffered quarterly and annual losses.
- Despite plunging stock markets, the aggregate bond market barely broke even for the year and underperformed even cash. This represents the first time since 1992 that cash outperformed both stocks and bonds.
- We had previously remarked that the tight spread between high yield and investment grade corporate bonds seemed to be sending a different signal about the near-term probability of a recession vis-à-vis the narrowing spread between short and long-term treasury bonds. That all change in Q4, with both indicators now signaling trouble ahead.





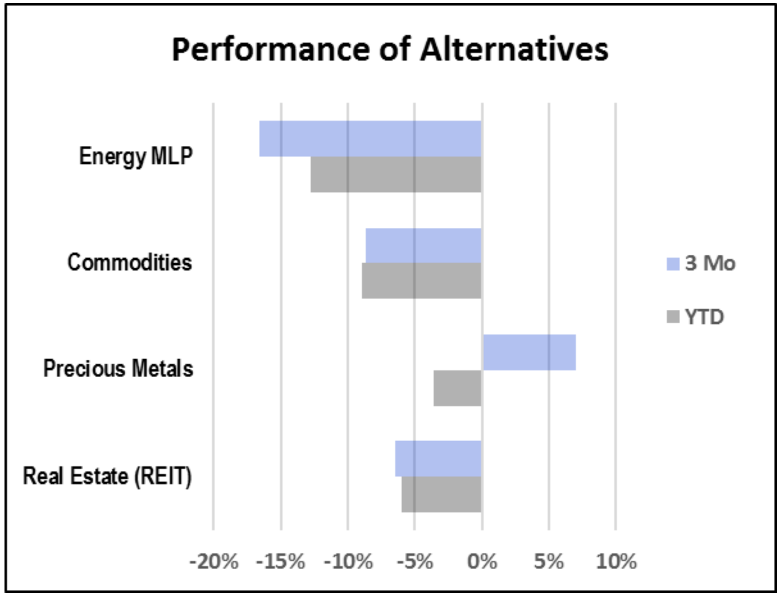
Source: St. Louis Fed



Source: S&P Dow Jones

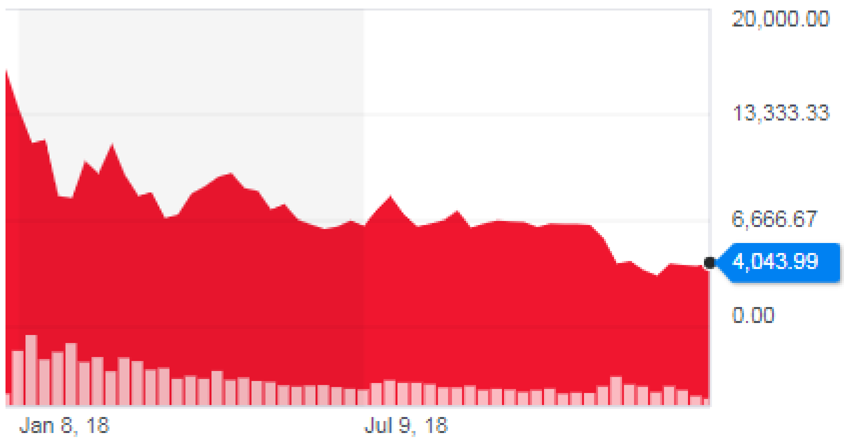
Alternative Investments

- Cash not only outperformed stocks and bonds in 2018 but most alternative investments as well.
- Gold proved a reliable safe haven in Q4 but still finished down 4% for the year.
- Oil prices collapsed 40% in the quarter to just $45 / barrel, pulling energy stocks into the red for the year.
- Lower interest rates usually underpin a rally in REITs, but the dour economic outlook weighed more heavily on shares.
- Bitcoin broke through its trading range – in a bad way, plunging more than 40% in Q4. Its successor to the speculators throne, Cannabis stocks, fared no better, with Canopy Growth down 42% and Tilray losing a whopping 51%.



Source: S&P Dow Jones, Morningstar

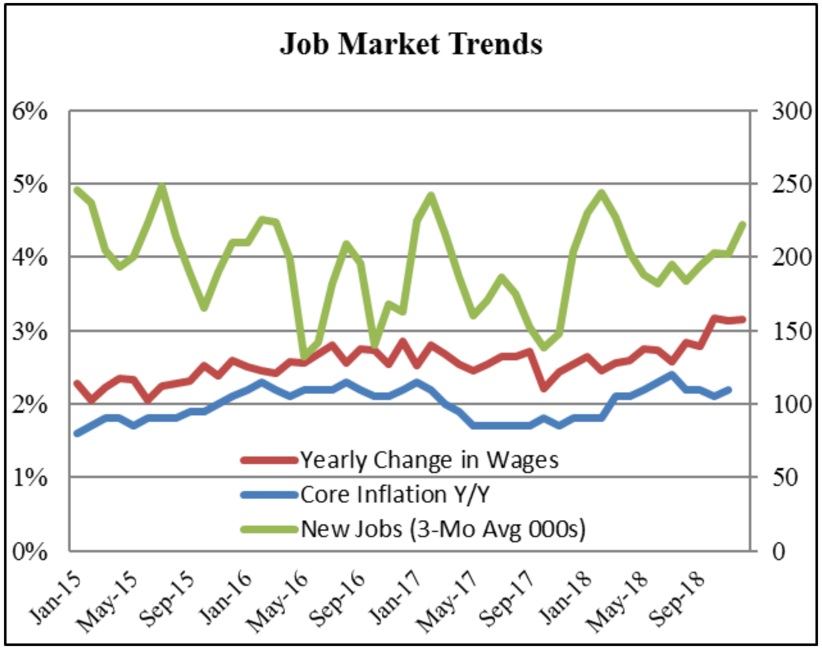
Bitcoin

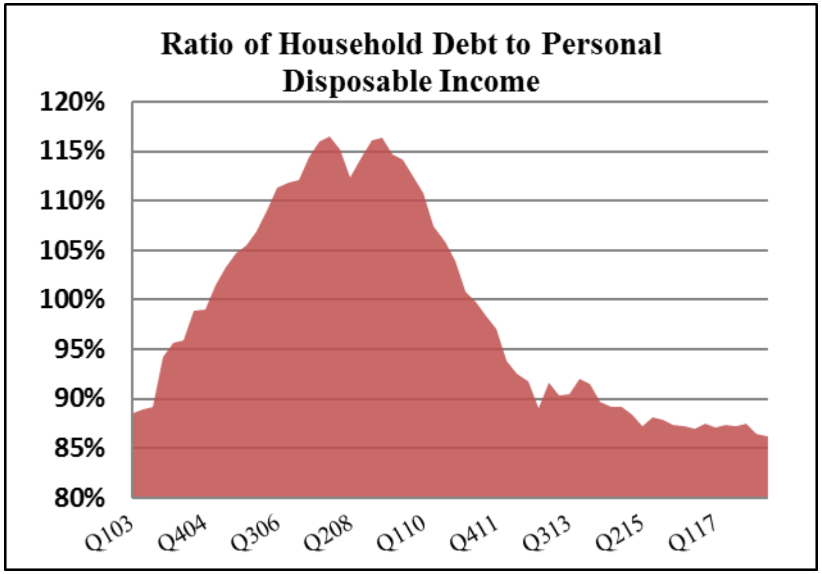


Source: Yahoo Finance

Economy

- Economic growth slowed from 4.2 to 3.4% in Q3 and early estimates of Q4 are in the neighborhood of 2%. Business investment, a key driver of growth in the first half of 2018, slowed notably in the second half. Sentiment has reversed sharply, with concern shifting from rising interest rates to the prospect of a recession in the next 12-24 months.
- In spite of the mood, job growth accelerated while the unemployment rate ticked up to 3.9% due to higher workforce participation. Annual wage growth jumped to 3.2%, the highest in 10 years, but inflation remained at just over 2%.
- Consumer debt continues to rise gradually, but tax cuts have increased disposable income and made this slightly less burdensome, helping to offset the effects of higher interest rates. Excessive consumer debt burden does not seem a proximate threat to the economy.
- We still consider an external shock to the system a more imminent threat to the nine-year expansion than a gradual build-up of excess.
- Elsewhere, growth in Europe and China is slowing, and the U.K. faces a highly uncertain future with the prospect of remaining in the European Union now about as likely as a Brexit with no deal.





Sources: ADP, US Depts. of Labor and Commerce, & the New York Fed

Our Macro View

Region	Current Conditions	Long-term Outlook	Investment Implications
USA	Moderating growth; labor market at or near full employment; early signs of excesses that typically precede recession, all clouded by trade policy.	Base: Trump backs down on trade war as effects become unpopular, leading to modest resurgence in business investment; rising debt and interest rates lead to next recession (1-3 years). Downside: Trade war triggers stagflation – higher inflation & lower growth; corporate profits suffer. Upside: Trade war averted; increased investment leads to extended rise in growth & productivity.	Stocks more fairly valued than at any time in past 18 months, but politics and conflicting economic signals likely to lead to continued short-term volatility. Nonetheless, a *slightly* less defensive posture is warranted.
Europe	Very slow growth; populist challenges throughout Euro zone; Brexit deal could go either way.	Base: Irreconcilable differences lead to slow dissolution of the EU in its current form. Downside: Nationalist sentiment (e.g., Italy) hastens the process beyond the point of prudence. Upside: Germany takes more enlightened view toward providing fiscal stimulus in South.	Market consensus not entirely in line with our base case. Brexit and Euro zone now equally in focus. Slightly lower than normal weightings with modest currency hedges.
Japan	Marginal gains in growth and inflation are fading; trade weighing on outlook; massive public debt.	Base/Downside: More of same until debt burden breaks view of Yen as safe haven asset, at which point inflation returns by way of devaluation. Upside: Nation implements structural reforms and immigration policy to inject dynamism.	After massive sell-off, stocks are generally cheap and more normal weightings with hedging of currency exposure is appropriate.
China	Tariffs clearly hurting industry; in response the State is allowing its currency to devalue and is relaxing credit, adding to already high public & private debt levels.	Base: Slowing of economy creates domestic issues absorbing central government resources, pressuring stocks and the currency. Conflict with US simmers without boiling over. Downside: Either government missteps or a trade war lead to rising unemployment & unrest; foreign investment moves to other emerging markets. Upside: Consumer economy grows fast enough to outweigh other problems.	Chinese stocks in bear market due to trade worries. Potentially more near-term upside than downside, but range of possible outcomes extremely wide. Selectivity remains key; avoid state-owned enterprises, heavy industry; favor consumer and smaller companies.

Our Fundamental View

Fundamental	Medium- to Long-term Outlook	Investment Implications
Stock Market Valuation	Many assets remain expensive relative to historical averages, which suggests that investment returns for everything from stocks to bonds and real estate will be below long-term averages. Tax cuts justify some of the appreciation since Nov 2016, but companies will have to deliver earnings growth from operations in 2019.	Achieving 5-7% annual returns over the next 5-10 years will require embracing stock market volatility to the extent afforded by your risk tolerance and portfolio withdrawal rate. Diversification will remain key to generating decent returns while managing risk.
Interest Rates	Recently, a worsening economic outlook has caused interest rates to fall, but U.S. government debt is rising quickly at the same time that central banks are purchasing fewer bonds. This is likely to create upward pressure on rates.	Continue to employ reasonable hedges against rising rates, including laddered bond portfolios, floating rate notes and cash. With short-term rates high relative to long-term, focus on the near-end of the yield curve for now.