FULLEN FINANCIAL GROUP

Quarterly Market Summary – Q4 2018

Market Results as of the Fourth Quarter of 2018
Selected Index Results for Q4 – 2018

Index(1)	**%Growth For FY 2017**	**%Growth For FY 2018**	**%Growth For Q4 2018**
DJIA	25.08%	-5.63%	-11.83%
Lehman Aggregate Bond Index (U.S. multi-sector bond)	1.18%	-2.60%	0.92%
S&P 500 (large cap)	19.42%	-6.24%	-13.97%
S&P 400 (mid cap)	14.45%	-12.50%	-17.65%
Russell 2000 (small cap)	13.14%	-12.18%	-20.51%
MSCI EAFE Index (developed international)	21.79%	-16.40%	-13.55%
iShares MSCI Emerging Market Index	34.59%	-17.11%	-8.99%
iShares Dow Jones US Home Construction	59.10%	-31.29%	-15.00%
MSCI US REIT Index	0.11%	-7.96%	-7.19%
Amex Oil Index	5.33%	-13.21%	-25.50%
Barclays Global Agg ex-US Corp Bond Index	14.44%	-6.79%	-1.94%

(1) These results do not include reinvestment of dividends.

Q4 Quick Summary

- The overdue U.S. equity correction finally emerged in Q4, as the S&P 500 Index fell by nearly 14%. Broad global indices also suffered, as the MCSI EAFE lost 13.5% and the MSCI Emerging Markets Index fell nearly 9%.
- During Q4, the core bond market recovered as a flight to less risky investments ensued. The Lehman Aggregate bond index rose by nearly 1% for the period. Long-term Treasury yields fell sharply, as did other benchmark, developed market government bond yields.
- Investor reaction was triggered in part by further signs of slowing among global economies and concerns the Federal Reserve's policy tightening cadence could usher in a recession. Global trade issues, along with U.S. and U.K. political dysfunction, added to the discontent.
- The Federal Reserve stuck to its tightening pace and pushed the Fed Funds target rate to an upper bound of 2.50% in December. However, the central bank offered some softer words to dispel the notion its policy course was on autopilot. The Fed also referenced the cooling across global economies and lingering policy uncertainties as variables that would affect future policy decisions.

Overdue...And Not Completely Overdone

The fourth quarter global equity drawdown was the worst quarterly performance we have seen since 2011. However, given the historic lows in volatility witnessed in 2017, a sustained equity setback in

2018 was likely in the cards. It took until the last quarter of the year before we got it. While some of the year-end weakness can be attributed to technical and program trading, we believe the fundamental concerns that helped trip up this market have some merit. That is, economies have indeed weakened, and there is broad data supporting that. The synchronized global growth noted just a few quarters ago has transformed into something quite different...synchronized economic deterioration. In addition, political risks across the globe (including developed market economies) are at notable levels. A U.S. government shutdown, Brexit, uprisings in France, and new political leadership in Italy and Brazil, all contribute to market uncertainty. Meanwhile, the directional change in monetary policy, as central banks reduced or markedly reversed prior easing of interest rates, was bound to cause some unease. In our view, the market was set for a correction, and the fourth-quarter result may remind investors of potential downside risks in their investment portfolios.

Interestingly, some relative bright spots did emerge in previously struggling emerging markets, as expectations for less Fed tightening in 2019 slowed the US dollar's ascension and gave emerging markets some life. China's long shadow of economic uncertainty, however, allowed for only sporadic gains in some markets.

Wringing Out Some Excesses

While we do not believe the Q4 market activity signals near-term U.S. or global recession, we do think the period was the start of a necessary adjustment in market risk-taking. This was most evident in U.S. markets where more cyclical, high-growth equity sectors lagged, and high-yield bond spreads widened. From here forward, we anticipate the value equity style may come back to the fore as the higher-beta (higher risk), growth style outperformance could wane. In what is expected to be a low-return equity environment, it's possible investors will focus more on total return, as opposed to capital appreciation.

S&P 500 Index Sector Returns – Q4 2018
Source: Bloomberg

Sector	Cyclical or Defensive	Total Return	Sector	Cyclical or Defensive	Total Return
Consumer Discr.	Cyclical	-16.4%	Info Tech	Cyclical	-17.3%
Consumer Stples	Defensive	-5.2%	Materials	Cyclical	-12.3%
Energy	Cyclical	-23.8%	Real Estate	Cyclical	-3.8%
Financials	Cyclical	-13.1%	Telecom	Defensive	-13.2%
Health Care	Defensive	-8.7%	Utilities	Defensive	1.4%
Industrials	Cyclical	-17.3%			

In the fourth quarter, Energy, Industrials, Technology, Consumer Discretionary, and Communication Services were the five worst performing U.S. equity sectors, in that order. With the exception of Communication Services, all are cyclical groups, where investors go to typically get "growth" or "beta" exposure. In contrast, the more defensive Utilities, Consumer Staples, and Health Care sectors led U.S. markets. Real Estate, a sector sensitive to changes in interest rates, also performed relatively well.

During the fourth quarter, we also saw some unwinding of perhaps extended risk-taking in the riskier segments of the global bond market. U.S. high-yield or "junk bond" spreads widened to levels not seen since early 2016, and emerging market spreads also continued to widen. For several quarters, U.S. monetary policy had made emerging market bonds less attractive, but U.S. high-yield largely remained unscathed, until Q4. This despite a higher volume of low-credit, high-yield issuance and easy covenant terms. Before the onset of Q4, volatility in high -yield was at lows for nearly a two-year period. Just like equities, we believe a correction in this market was long overdue.

Financial Stress Low, But Economic Data Deteriorates Further

Recent economic data perhaps further confirms that global economic growth may have already reached an apex in late 2017/early 2018. And while economic data continues to indicate lower economic growth rates going forward, there seems to be no broad economic unrest, as financial mechanisms remain sound. Indeed, global leading economic indicators and business conditions indicators are positive, yet the data's trend deterioration from recent highs has been notable. Economic forecasters have captured this condition in broadly lower GDP predictions over the next year, including outlooks from the Bloomberg consensus and such organizations as the International Monetary Fund.

The economic drawdown has perhaps been the most pronounced in developed international markets where, following the boost from the U.S. tax cuts, economies have quickly lost momentum. Emerging market growth has also slid, although cyclical peak activities in Purchasing Managers' Indices (PMIs) were not as robust, and they have not fallen as far.

Lacking a more direct benefit from U.S. tax policy, other developed markets have seen reported and forecasted GDP deteriorating faster than in the U.S. Emerging market GDP has sustained a sharp drop since mid-year, although growth rates are expected to be steady at or near current levels through 2019. Risks to global GDP forecasts may signal some additional weakness, given China's economic uncertainty and the potential lag of monetary policy impacts. More volatile financial markets, should they persist, could alter the behavior of market participants as well. The good news is global financial stress remains tame by historical standards. This may offer some argument that economic growth could stabilize, albeit at lower levels, and recessionary conditions may be not be on the near horizon.

Market Recalibrates Interest Rate Expectations

After reaching near-term peaks at the start of Q4, many developed market government debt yields fell sharply as investors became more risk-averse during the period. Investors exited risky asset positions in favor of the most solid government debt exposures, including German Bunds, U.K. Gilts, JGBs (Japan), and U.S. Treasuries. The U.S. Treasury 10-year yield twice attempted to pierce through 3.24% early in the period, before closing the year at 2.68%. The Bloomberg Barclays Treasury Bond Index closed Q4 with a 2.6% gain compared to the Bloomberg Barclays U.S. Aggregate Index gain of 1.6%. The U.S. Aggregate also includes mortgages and investment-grade corporates, as well as other asset-backed securities. By contrast, the Bloomberg Barclays U.S. High Yield Index, composed of more risky debt securities, lost 4.5% for the period. Meanwhile, investment grade credit spreads also widened slightly, as the Bloomberg Barclays Investment Grade Corporate Index fell 0.2%.

The risk aversion and gains in some core bonds (treasuries and mortgages) was prompted by weakening economies, an ease in recent inflation readings, and comments from the Federal Reserve suggesting its normalization of policy was near the end. The combination caused investors to rethink previous notions of a steady move higher in rates through 2019. Instead, the market seems faced with the potential "lower-for-longer" interest rate mantra.

Clearly this mantra was aided by an apparent about-face in the Federal Reserve's communication about interest rate policy. Many forecasters seem to place the normalized Fed policy at 2.5% to 3.0% in this environment, where previously the Fed was targeting policy at or above the high side of that range. But Fed Chairman Jerome Powell, late in Q4, messaged that Fed policy was not so predisposed, and that members would consider many of the fundamental variables that left investors uneasy during the quarter.

Outlook - Tempered Return Expectations

With the return of more normalized market volatility and the tapering of economic strength, we anticipate modest equity returns for the quarters ahead. Given rising political and economic risk and the potential for earnings growth expectations to be dialed-back globally, price-earnings (P/E) ratio expectations could be the primary drag on global equity markets.

We enter 2019 with notable caution and believe we could see only low-to-mid single digit equity returns for the year, with risks to the downside. In core fixed-income, our total return expectations for 2019 are positive as interest rates look range-bound through the period. Durations should be kept below benchmark, as with a flat yield curve, investors are not getting compensated to take duration risk. Longer-term interest rates (10-year and 30-year Treasury rates) have not kept pace with the Fed's increases in the benchmark rate. With modest overall expectations for economic growth, we expect long-term rates to remain relatively low.

Finally, with minimal to negative returns across most asset class segments forecasted, investors may have little incentive to take material risk with tactical asset class bets. As such, we believe 2019 may be an environment in which investors will want to maintain the long-term strategic allocation most closely associated with their personal risk tolerance.

Risks

Investors should be aware of the risks associated with all portfolio strategies and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance and the effectiveness of strategic and tactical portfolio approaches.

Conclusions

Although the market downturn in Q4 was significant, market performance thus far in 2019 has offset much of that decline. This is not normal, and we believe the possibility of further correction is certainly there. As mentioned earlier, there is convincing evidence that over the next few years, investment returns will be lower and volatility higher. A moderately rising interest rate environment is hoped for even though it will include some negatives such as lower fixed income yields (compared to what we have experienced over the last couple of decades). Adding to the anxiety associated with a lower yield environment will be higher volatility; unfortunately, investors that choose to sit-out to avoid volatility will likely lose what investment yields are available, even if reduced. While there will be periods of negative returns, history tells us that equity and fixed income yields should still be positive (over time) and are highly likely the best alternative for the vast majority of investors (even at reduced levels).

In periods of higher market volatility, maintaining investment discipline within a lower overall yield environment will be more difficult emotionally. However, we need to remember that market timing as an investment strategy has never worked consistently (and results in lower longer-term yields). Trying to time markets in a lower yield environment has a high probability of creating permanent loses. Avoid the temptation to act in an undisciplined and consequently damaging way–everyone is investing in the same lower yield environment. If someone appears to have found a way around it, be very wary – they are either not showing you all their "cards" or are taking very high investment risk.

Fullen Financial is always available to help sort out false claims so don't be concerned about asking us.

As always – stay with a consistent and disciplined investment strategy – it is the only course of action with any track record of success (in any investment environment). There is no reason to believe, even with the changing economic dynamics, that the disciplined approach to investments will be less effective than in the past at delivering the best possible relative returns.

At the most fundamental level, match your investment time horizon to your spending timeline – if you have short term cash needs then those funds should be in short term investments. These are simple asset/liability matching principles practiced by the most sophisticated investment managers every day (but far too complex to explain in sound bites and not conducive to selling products). Additionally, don't try to solve short-term financial problems with long-term equity exposure. If you try to chase returns, you may get lucky sometimes but, if pursued long enough, it always ends in extreme frustration and often with serious financial losses. The reality is that no one has ever consistently predicted investment markets and they never will - and there is always a consequence to continued unsound financial behavior.

As always, if your personal or family situation has changed (or is likely to) a discussion with us as to how this may impact your financial plan and your overall asset allocation is warranted. Or, if you simply feel a need to discuss any aspect of your portfolio and/or financial plan, or you haven't had a planning update within the last 12 months, please contact us to review your financial plan and investments.

Your financial plan is the most important financial document that you possess! Keep it updated and use it.

Please note that you are entitled to receive Fullen Financial's Form ADV whenever you would like to. This document outlines many details of who Fullen Financial is, their investment methodologies and their advisor's education and experience. You may do so by contacting Lisa Bushman at lisa@fullenfinancial.com and requesting such. Alternatively, you can go to the Fullen Financial website (www.fullenfinancial.com), click on "Resources" in the top menu bar, and then on "Client Forms."

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