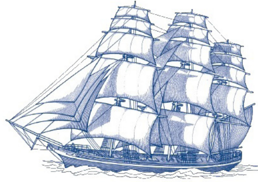


Martha's Vineyard
FINANCIAL GROUP

Monthly Investment Report

December 2018

***SUMMARY*: Federal Reserve chair Jerome Powell singlehandedly lifted U.S. stocks into positive territory for November after hinting that the Fed may be done raising interest rates for a while, or at least may not be as aggressive going forward. The reason: low inflation and weakening economic growth. Foreign stocks also got an upward bounce, particularly in Asia, where prices had been particularly depressed. U.S. government bonds also had positive returns as the yield on the 10-year Treasury note fell below 3.0% for the first time in more than two months.**

After suffering through their worst month in years in October, stocks were headed for more losses in November until Powell appeared to indicate that interest rates were now about as high as the Fed wanted them to be. That prompted a huge month-end rally, boosting the monthly returns on the Dow Jones Industrial Average and the S&P 500 to about 2.0% while pushing NASDAQ into the green by 0.5%. While the three major indexes remain in the red for the fourth quarter so far, they are still positive for the year to date, with the Dow up 5.6%, the S&P 500 up 5.1%, and NASDAQ leading the way with a 7.2% return.

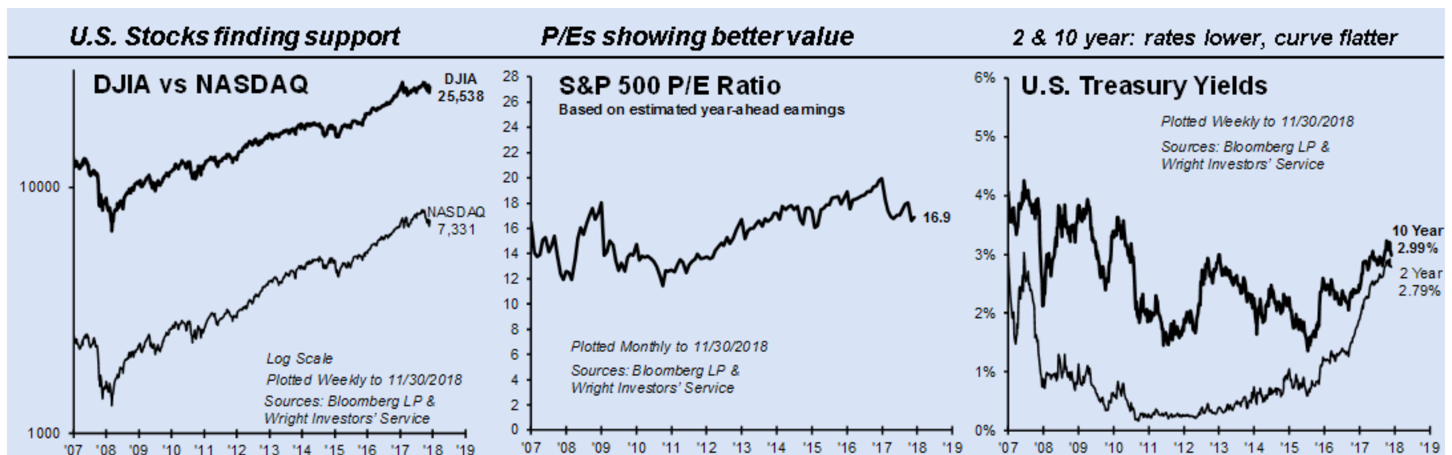
Health care stocks were the best-performing stocks in the S&P 500, rising 7.1% to boost their YTD return to 16.5%, which also leads the market. They were followed by real estate stocks, which gained 5.6%. Information technology stocks, which had been the best performers so far this year, came in last in November following a 1.9% loss, pushing their YTD return down to 8.9%, which still makes them the second-best performing category. Materials stocks are the worst performers year-to-date, down 8.4% despite a 4.0% rebound last month.

Foreign stocks had a mixed performance, with Asian and emerging markets rebounding in November, but they lag far behind their American counterparts on a YTD basis. Chinese stocks, which have been depressed this year, jumped 7.3% last month as trade tensions with the U.S. eased. However, they're still down by 13.6% so far this year, made worse by the U.S. dollar's 7.0% gain against the renminbi. Emerging markets also rebounded, gaining 4.1%, although they remain down 12.2% YTD. Japanese stocks had a slight gain last month. Euro zone stocks remained in the red, losing 0.6% for the month and down 10.7% year to date.

Bonds also had a mixed performance, with U.S. Treasury bonds posting positive returns as long-term bond yields fell following Powell's comments. The Bloomberg Barclays U.S. Aggregate, which is heavily weighted with government securities, returned 0.6% as the yield on the benchmark 10-year Treasury note slid below 3.0% for the first time since mid-September. Still, the index is down 1.8% so far this year. Outside the U.S., the Bloomberg Barclays Global Aggregate ex U.S. index gained 0.1%, although it's down 4.3% YTD. But U.S. corporate bonds lost 0.1% for the month while high-yield bonds and bank loans both lost 0.9%.

U.S. ECONOMY

The economy is showing signs of slowing down. While GDP grew at a 3.5% annualized pace in the third quarter, fourth-quarter growth is expected to weaken by a full percentage point, to about 2.5%, according to recent forecasts by the Atlanta and New York Feds. Leading economic indicators rose by 0.1% in October, down from September's upwardly revised 0.6%. "The index still points to robust economic growth in early 2019, but the rapid pace of growth may already have peaked,"



the Conference Board said. Industrial production rose 0.1% in October, slightly under expectations. Durable goods orders ex transportation rose 0.1%, well below forecasts but up from the prior month's downwardly revised 0.6% decline, while core capital goods, a proxy for business investment, were unchanged after falling 0.5% in September.

Consumer spending remained strong, although confidence appears to be slipping. Retail sales jumped a better-than-expected 0.8% in October after falling 0.1% the prior month, partly driven by higher gasoline prices; excluding auto and gas, the gain was only 0.3%. Consumer spending, a broader category, rose 0.6% as personal incomes rose 0.5%, the biggest gain since January. But the Conference Board's consumer confidence fell more than two points to 135.7 in November, although that is coming off its highest level since 2000. The University of Michigan's consumer sentiment index ended November at 97.5, down from 98.6 a month earlier.

But housing fell even deeper into the doldrums as higher interest rates pushed more buyers out of the market. Sales of existing homes rose 1.4% in October compared to the previous month, although that was down 5.1% compared to the year-earlier level, the biggest drop in four years. "There is some feeling that the market could actually go even lower than what it is now in terms of sales," said Lawrence Yun, the National Association of Realtors' chief economist. Indeed, pending home sales, a forward indicator, fell 2.6% compared to the prior month and 6.7% versus a year earlier, the 10th straight decline by that measure. But the market for new homes was even worse. Sales dropped 8.9% an annual rate of 544,000 in October, the steepest one-month decline in nearly a year and down 12% compared to a year earlier.

INVESTMENT OUTLOOK

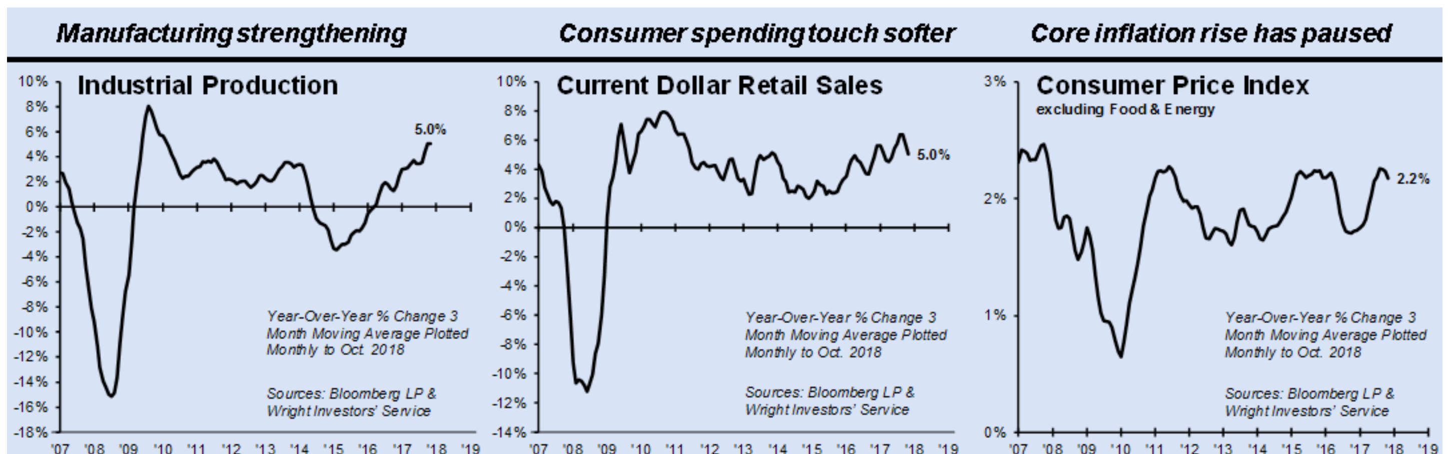
The Fed appears to be doing a serious rethink of its monetary tightening posture, which could be positive for both stocks and bonds. While the Fed is likely to raise the federal funds rate by another 25 basis points at its December 18-19 meeting, to 2.5%, its fourth rate hike this year, it now appears that it may not be as hawkish next year, as inflation remains under control and the economy is showing signs of easing. Powell told the Economic Club of New York on November 28 that interest rates are "just below" the so-called neutral rate, a retreat from his comments less than two months earlier that the fed funds rate was a "long way" from neutral. Those comments were echoed, both before and after, by other Fed members calling for the central bank to slow or halt its rate-hike strategy. Indeed, despite a robust jobs market, inflation still doesn't appear to be heating up, which might justify higher rates. The core personal-consumption expenditures (PCE) index, the Fed's preferred inflation indicator, rose just 1.8% on a year-on-year basis in October, below the Fed's 2% target. The recent sharp drop in oil prices – to about $50 a barrel at the end of November, the lowest level in more than a year – and a weakening in economic growth might also reduce inflationary pressures going forward. Combined with the recent announcement of a 90-day truce in the U.S.-China tariff war, which lifts a cloud over the global economy, at least in the short term, the investment outlook now appears brighter than it did just a month ago, we believe. The recent correction has also made stocks more attractively priced on a price-to-earnings basis than they have been in months.

December 2018

Total Investment Returns – 11/30/2018

	November	Last 12 Mos.
Dow Jones Industrial Average	2.1%	7.6%
Nasdaq Composite	0.5%	7.8%
S&P 500 Composite	2.0%	6.3%
S&P MidCap 400	3.1%	0.5%
S&P Small Cap 600	1.5%	3.5%
MSCI World ($)	1.1%	0.1%
MSCI World ex U.S. ($)	-0.1%	-7.8%
Bloomberg Barclays U.S. Aggregate	0.6%	-1.3%
90-Day Treasury Bills	0.2%	1.8%
Consumer Price Index NSA* (Oct. 2018)	0.2%	2.5%

*NSA: Not Seasonally Adjusted



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