~ Prevailing Winds ~

A Quarterly Market Update ***December 31, 2018***

Quarterly Recap:

In our last edition of Prevailing Winds, we described a market environment which was "fruitful" despite a deluge of troubling news stories. The challenging news flow continued in the fourth quarter. What did change dramatically was investors' willingness to overlook uncertainty. Volatility spiked as securities were repriced to reflect a more pessimistic outlook. Simply put, 2018 did not have a storybook ending that the markets were beginning to anticipate during the summer. Goldilocks came eye-to-eye with the Big, Bad, Wolf.

Quarter Ending December 31, 2019

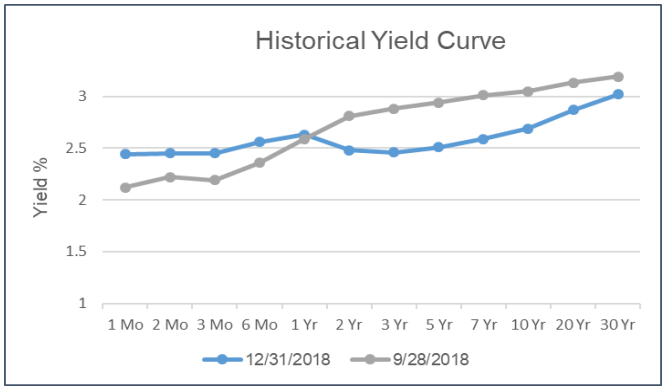
Equity Indexes	Close	% Change
DJIA	23327.46	-11.8%
S&P 500	2506.85	-14.0%
NASDAQ	6635.28	-17.5%
Treasuries	**Close**	**Change**
10-Year Yield	2.69%	-0.36
2-Year Yield	2.48%	-0.33

The Stock Market:

For much of 2018, the domestic stock market rallied to reflect strong earnings growth. It became increasingly clear during the summer that a relatively few companies (technology stocks) represented the bulk of the market's advance. The market leaders finally succumbed to negative sentiment beginning in October. While technology stocks faired the worst in the fourth quarter, almost every market segment weakened as fears loomed that global earnings and economic growth will slow precipitously in 2019. The market gains melted just as fast as snow in November.

The Bond Market:

The bond market and Federal Reserve took center stage in recent months. While earlier hikes were not controversial, the latest increase in December became an extreme irritant. Some investors came to believe that the Fed was ignoring signs of global weakness, pushing the economy into a future recession. What resulted is a yield curve which became even flatter, teetering on the brink of "inversion". What seems clear is that interest rate policy is at an inflection point. Investors will need to decide what "normal" rates are and how current rates differ from this yet to be determined metric.



Looking Ahead:

Was 2018 a bad year?. We would argue not entirely. While 2018 was disappointing, we are far more concerned about long term market fundamentals. The recent spike in volatility may prove to be an important factor in preventing future undue speculation and investor complacency. In the long term, valuation does matter and risk needs to be priced appropriately. The selloff tempered overly-bullish sentiment and hopefully will prevent a speculative bubble. Markets may be volatile as we enter 2019, but in a sense, they may be healthier.