CLEARPOINT

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ANOTHER YEAR DRAWS TO A CHOPPY CLOSE

BY BRIAN HRABAK, CFA, CHIEF INVESTMENT OFFICER AND SENIOR MANAGING DIRECTOR

2017 was a great year with accelerating and synchronized global growth, which led to exceptional returns and low volatility for investors across most asset classes. Anything but the same can be said for this year, with few areas of the capital markets in positive territory for the year, and with an accompanying return of volatility. We can point to three main drivers of volatility: economic growth divergence, Federal Reserve policy, and political risks, including trade.

The synchronized global growth of 2017 diverged in 2018 with U.S. growth leading the way versus other developed economies. U.S. GDP growth accelerated, aided by 2017 tax cuts, whereas China slowed. China was hampered by the trade spat with the U.S. and a government clampdown on credit. Growth in the Eurozone also eased due to political concerns, particularly in Italy and Brexit. The global growth divergence led to increased volatility and slowing growth overseas accompanied by weaker currencies, which led to poor international equity returns.

The shift from quantitative easing to quantitative tightening is underway in the U.S. When the Federal Reserve dropped its funds rate to zero during the global financial crisis, it also implemented an asset purchase program that swelled

CLEARSTEAD SPONSORS ROUNDTABLES ON DISCRETIONARY MANAGEMENT AND RESPONSIBLE INVESTING

In October Clearstead sponsored a roundtable entitled, *"Discretionary Management: Finding an Appropriate Balance."* We had eight subject-matter experts present their thoughts, which was immensely valuable. A link to the roundable summary can be found HERE.

In February, 2019 we are sponsoring a second rountable entitled, *"Responsible Investing: The Costs of Conscience."* We will explore investing according to environmental, social, and governance principles and how institutional trustees can fulfill their fiduciary responsibilities. Please call Jennifer Lucas (216-621-1090) if you would like more information.

the Fed's balance sheet from $870 billion to $4.5 trillion.[1] Lower interest rates encouraged investors to move into riskier asset classes to generate yield and return. Savers and those depending on fixed income yields were forced out on the risk spectrum to generate income, even if they did not want the associated risk. Volatility fell for several years after the global financial crisis with a benign economic environment, and remained low as investors took the Fed's cue that they would remain supportive of economic growth.

However, the story is changing. The Federal Reserve has hiked interest rates for the eighth time, with a ninth forecast for December, and has begun shrinking its balance sheet. As of December, the Fed's balance sheet is near $4.1 trillion and forecast to gradually shrink over many years. The Fed's balance sheet normalization program began in October, 2017 and is now at the stated maximum quarterly reduction rate of $50 billion of securities.[2] The uncertainty regarding Federal Reserve policy and its near-term effect on economic growth is likely to result in volatility.

Another driver of volatility was political risks, with the two largest being the trade war with China and Brexit. As we have written several articles on trade tensions earlier this year, I will not revisit those details other than to say not much progress has been made on either front, though sides continue to talk.

Quick market reversals late this year underlie investors' nervousness, with shifting narratives on interest rates and U.S. - China trade. With the Fed continuing to reduce its accommodative policies and the tense trade situation, elevated volatility may be here for the near-term. Higher yields in the bond market make fixed income instruments more appealing, and compete for investors' attention, which is part of the reason equity multiples have contracted. Investors also may be deciding to reallocate portfolios toward yield-generating securities. Cash and fixed income investments may be attractive safe havens for investors to wait out market volatility and get compensated with yield.

As we are further in this economic cycle, my advice, particularly for this year, although it holds for most years, is to maintain a proper balance between risk-seeking investments and safety. While we are mindful of the length of this cycle, valuations are reasonable based on strong earnings growth for the S&P 500 and a nearly-flat year-to-date return, and U.S. economic fundamentals appear in solid shape, though slowing. It is also important to note that significant gains can occur during the later portion of an economic cycle. Rather than timing markets, establish an approach appropriate for the level of risk you can accept (or return desired) and rebalance as market volatility presents opportunities.

Cheers to a safe and prosperous 2019!

Sources:

(1) www.federalreserve.gov

(2) www.federalreserve.gov

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MARKET BENCHMARK RETURNS

November 30, 2018		1M	3M	12M	YTD
US Large Cap	S&P 500	2.0%	-4.4%	6.3%	5.1%
US Small Cap	Russell 2000	1.6%	-11.6%	0.6%	1.0%
Developed Intl	MSCI EAFE	-0.1%	-7.3%	-7.9%	-9.4%
Emerging Intl	MSCI Em Mkt	4.1%	-5.5%	-9.1%	-12.2%
Real Estate	NAREIT	4.5%	-0.7%	3.5%	3.6%
Core Fixed	BarCap Agg	0.6%	-0.8%	-1.3%	-1.8%
Short Fixed	BarCap 1-3Yr	0.3%	0.3%	0.8%	0.8%
Long Fixed	BarCap LT G/C	0.6%	-4.3%	-6.3%	-8.1%
Corp Debt	BarCap Corp	-0.1%	-1.8%	-2.8%	-3.6%

Source: Bloomberg

The performance data shown represent past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.