JANUARY 2019

December saw added pressure on the broad stock market indices sending markets into correction territory. With volatility being a major theme for markets throughout the year, it was only fitting that following the worst-ever Christmas Eve trading day, the Dow Jones posted its largest single day point gain ever (1,086) on December 27th. Despite the month-end rally, the broad market Standard and Poor's 500 Index ended the year with a negative total return for the first time since 2008.

MARKETS AT ODDS WITH FUNDAMENTALS ENTERING 2019

In 2018, investors faced a year of heightened volatility (corrections in January and February, and again through the 4th quarter) in which fundamentals were at odds with general sentiment and overall market performance. During the year we saw markets reach record highs, the economy expand at rates not seen in many years, unemployment reach a 50-year low, wage growth continue to rise, and corporate profits surge. However, despite strong fundamentals, headlines drove the markets and stock prices fell into correction territory on uncertainties surrounding a trade war and the government shutdown--and on fears that a global growth slowdown may lead to a recession. As we enter 2019, we are not questioning whether or not equities can (and should) move higher based on solid underlying fundamentals, but rather whether growing uncertainty and fear are what will drive the markets.

Our internal investment committee met last week to take a look into our crystal ball for tips on navigating the markets this coming year. Just kidding, but wouldn't it be nice? We met to review the state of the markets and prepare our outlook and predictions for 2019. Overall, we believe volatility will persist, at least in the short term, but come year-end we believe the Standard and Poor's 500 Index should post a modest single-digit return after potentially presenting investors with a few attractive entry points throughout the year. Let's dive into what we are expecting to see in the year ahead.

Securities offered through HighTower Securities, LLC, Member FINRA/SIPC. Investment advice offered through HighTower Advisors, LLC, an SEC Registered Investment Advisor. Financial Principles, LLC, is under separate ownership than any other named entity. © 2018 Financial Principles, LLC. Reproduction of this material is prohibited without consent of Financial Principles, LLC.

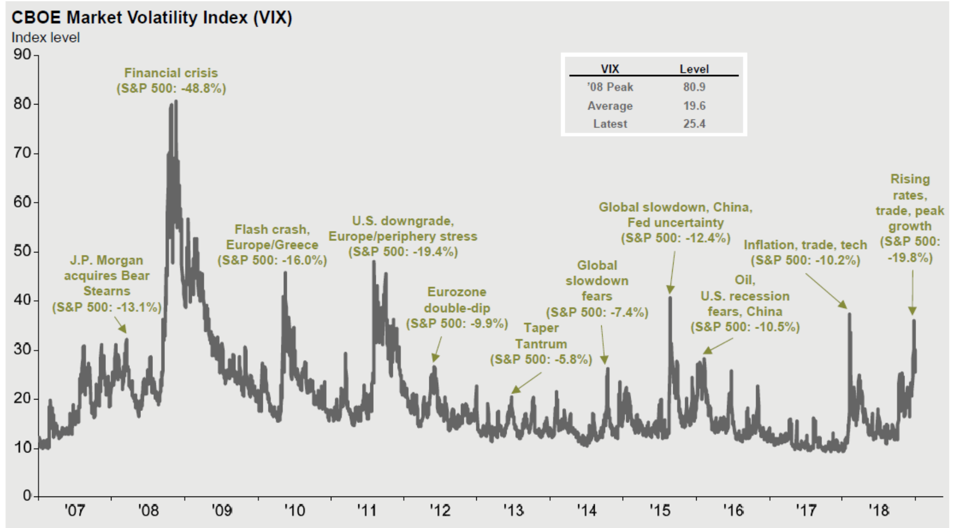
Our 2019 Market Predictions

1.	**Growth will slow in 2019, but we won't see a recession.** Absent an unforseen large scale market event we do not see any reasonable indication of a recession on the horizon for 2019. We do believe that growth of the domestic economy will slow in 2019 towards a 2% GDP growth rate, but that we will not realize a recession.
2.	**Earnings growth will slow in 2019.** Coming off a 2018 with record setting earnings growth (21% by current estimates as we await Fourth Quarter earnings), which were boosted by corporate tax cuts, we see pressure on revenue growth and margins leading to a slower earnings growth in 2019.
3.	**Wages will grow again in 2019, but unemployment will bottom out.** As of November, wage growth is at 3.2% year over year compared to the 50-year average 4.1% and unemployment has reached a 50-year low at 3.7% compared to the 50-year average 6.2%. We believe that wage growth will continue higher in 2019, but that the unemployment rate will bottom above 3% this year.
4.	**Consumer spending will rise in 2019.** Consumers are already spending, but we see spending rising again in 2019 as a function of sharply lower fuel prices and continued wage growth putting more dispsosable income in the pockets of consumers.
5.	**Inflation will slow in 2019.** The Personal Consumption Expediture (PCE) is essentially a mesaure of the goods and services targeted towards individuals and consumed by individuals. For 2018, inflation was largely in line with the Federal Reserve's 2% target. In 2019, we see the inflation rate dipping (largely on the sharp decline in oil prices).
6.	**The Federal Reserve will raise rates less than expected.** The Federal Reserve's four rate hikes in 2018 coupled with (politics aside) President Trump's harsh criticism of Fed policy drove a great deal of the market volatility in the 4th quarter. The Fed has set the tone that they expect to hike rates twice in 2019. They have also forecasted that 2.75% is more in line with a neutral long-term rate. Given the current target rate of 2.25% to 2.50%, one more hike of 0.25% would put rates laregly in line with that target. In addition, the low unemployment rate and our prediction for a lower inflation rate in 2019, we find it harder for the Fed to justify hikes in 2019. Not only do we not see a fundamental case for continued rate hikes in 2019, but there is currently only a 0.04% spread between the 1 year and 10 year Treasury yield and the Fed does not want to invert the yield curve (especially in light of the pressure of the public spot light that they are under thanks to President Trump and the media). When it comes to rate hikes for 2019, we are having a hard time seeing more than one, and believe there will potentially be none.
7.	**The Federal Deficit will rise.** In fiscal year 2018, the Federal budget had a deficit of $782 billion, or 3.9% of GDP. We expect that the deficit will rise in 2019, which coupled with a slowing GDP growth will raise the deficit as a percentage of GDP to 4.5%, or more. We see the only stop to this being a reversal of tax policy, which we believe is unlikely.
8.	**The United States and China will reach a trade agreement.** The United States and China have agreed to not impose any new tarrifs while trade negotations are ongoing. Both countries are likely to experience slowing growth in 2019 pressuring a deal in the ongoing trade war.
9.	**International markets could outperform domestic equities.** It seems this has been the prediction for years. However, we see that a number of headwinds in international markets, especially emerging markets, have resolved themselves paving the way for potentially stronger growth abroad on a weakening dollar. Valuations remain attractive in global, especially emerging, markets.
10.	**Volatility will persist, but domestic equities will push higher.** For the last few years volatility has been largely absent from equity markets. In 2018, volatility returned with two corrections and an intra-year decline of 20% in the Standard and Poor's 500 Index. Valuations for domestic equities are attractive with dividend yields above, and forward price-to-earnings ratios below, their respective 25-year averages. We see the Standard and Poor's 500 Index posting moderate single-digit returns for the year, albeit with a frustrating bumpy ride. For clients with cash on the sidelines, we do believe that stocks will push higher from here this year, but dollar cost averaging should be employed (with an eye to buy the dips) as we believe volatility may offer opportunitic entry points.

We will revisit these predictions mid-year, and again at year-end

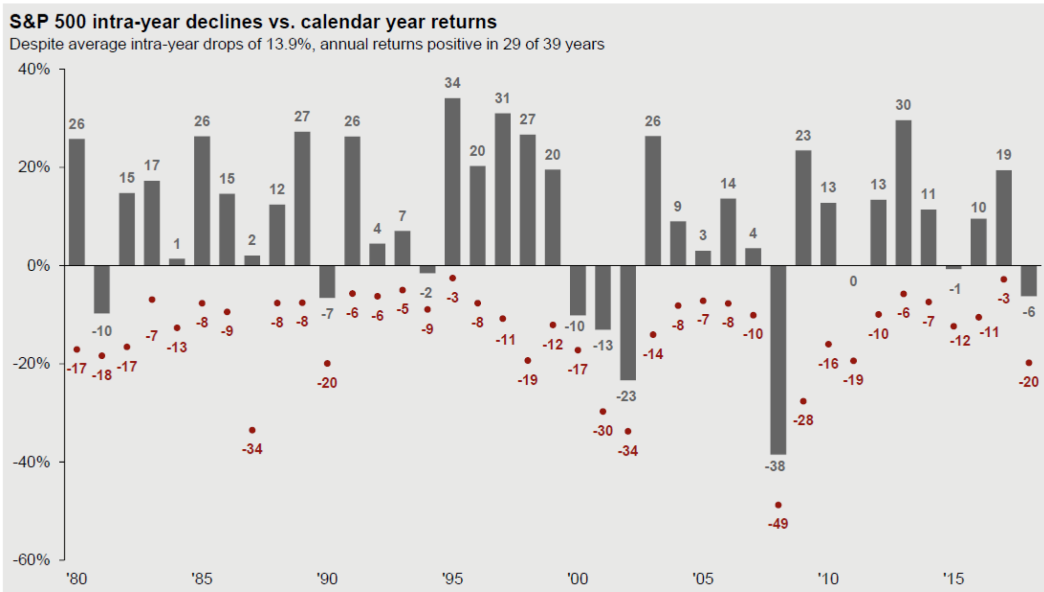
SO WHAT DOES THIS ALL MEAN FOR INVESTORS?

As volatility ticks higher, so does the risk of losing focus on a long-term financial and investment plan and making decisions out of fear. To the right, we outline the CBOE Market Volatility Index (VIX) since 2007 (just before the Great Recession of 2008). As you can see, volatility doesn't generally last. It typically peaks on headline risks and events, and then retreats. *When volatility settles down, markets typically settle up* as they move towards the higher values they retreated from. While we may see a second spike in the short term as budget negotiations, the shut down, and trade talks with China all come to a head, we encourage clients to remain focused on their long-term financial plan and investment strategy and try to not focus on the headlines.



Sources: CBOE, FactSet, J.P. Morgan Asset Management.
Stock market returns are based on calendar year peak to trough declines experienced during VIX spike, except for J.P. Morgan acquires Bear Stearns, which is based on the calendar year peak to the acquisition date. Average is based on the period shown from 12/31/2006 to 12/31/2018.
Guide to the Markets – U.S. Data are as of December 31, 2018.

As you can see below, since 1980 markets typically see an average 13.9% annual intra-year decline. We have not seen volatility that was in line with these long-term averages since 2011. We remind investors that, after a few years of volatility that was well below average, this year brought a return to more normal markets (except for December, which was admittedly above average) in terms of volatility. While we do expect markets to move higher in 2019, we are bracing for more normal volatility than we have experienced during the potentially soon-to-be longest bull market run in the markets. If you are feeling unsettled or nervous during these times, please do not hesitate to contact our office. It is a good time to revisit your financial plan and risk tolerance to ensure that your investment plan and portfolio are in line with your objectives.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2018, over which time period the average annual return was 8.4%.
Guide to the Markets – U.S. Data are as of December 31, 2018.

LAST YEAR'S KEY ECONOMIC DATA

Employment

Labor markets were solid in 2018, with employment growth averaging 209,000 new jobs per month (up from 174,000 in 2017). Unemployment rates fell to 3.7% from 4.1% to end 2017 and average hourly earnings were up 3.0%.

FOMC/Interest rates

The Federal Open Market Committee raised rates four times as forecasted, the target Fed Funds rates remains at 2.25% to 2.50%.

GDP

The economy continued to expand through 2018 increasing at an annual rate of 3.4% in the third quarter of 2018 (the first and second quarter saw 2.2% and 4.2% gains, respectively).

Inflation and consumer spending

Inflationary pressures are low and consumer spending remains strong.

The *Consumer Price Index,* which measures the increase in the price of goods and services, reached the Federal Reserve's stated target of 2.0% before falling to 1.8% in November.

Consumer Spending was strong throughout the year with the highest retail sales around the holidays in years and annual consumer spending hitting new highs.

Housing

A lack of inventory and rising interest rates contributed to lackluster performance for existing home sales. Sales were down 7.0% year over year, while prices were up 4.2%.

Manufacturing

Manufacturing and industrial production performed better this year than last. The Fed's index of industrial production showed total industrial production was up 3.9% while the output of consumer goods was up 1.5%.

Imports and exports

The trade deficit was up from 2017, as were prices on imports and exports on heating-up trade negotiations with China and rewritten agreements with Canada and Mexico.

International markets

International markets did not enjoy the same upward movement they saw in 2017 and heightened trade negotiations put pressure on international markets while the strong dollar and tariffs put even more pressure on the emerging markets. The US was able to resolve issues with Mexico and Canada, but negotiations and increased tariffs persist with China.

Consumer confidence

Consumer confidence remains high at 98.30, but off its all-time high 111.40.

Bradley H. Bofford, CLU®, ChFC®, CFP®
Managing Director, Partner
973-582-1002
bbofford@hightoweradvisors.com

Michael Flower, CFP®
Managing Director, Partner
973-582-1004
mflower@hightoweradvisors.com

Daniel Trout
Partner
973-582-1006
dtrout@hightoweradvisors.com

Steven Gelber, AIF®
Associate Wealth Advisor
973-582-1015
sgelber@hightoweradvisors.com

Andrew Olivier, CFP®
Associate Wealth Advisor
973-582-1005
aolivier@hightoweradvisors.com

HIGHTOWER
FINANCIAL PRINCIPLES, LLC

FINANCIAL PRINCIPLES, LLC
A HIGHTOWER WEALTH MANAGEMENT PRACTICE

310 PASSAIC AVENUE, SUITE 203, FAIRFIELD, NJ 07004
505 FIFTH AVENUE, 4TH FLOOR, NEW YORK, NY 10017
973-582-1000
WWW.FINANCIALPRINCIPLES.COM

FOCUSED ON YOUR FINANCIAL INDEPENDENCE

Securities and investment advice offered through HighTower Securities, LLC, Member FINRA/SIPC. HighTower Advisors, LLC, is an SEC Registered Investment Advisor. Financial Principles, LLC, is under separate ownership from any other named entity.
The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual.
The information contained herein has been obtained from sources considered to be reliable, but accuracy or completeness of any statement is not guaranteed.
No information contained herein is meant as tax or legal advice. Please consult the appropriate professionals to see how the laws apply to your situation.

©Financial Principles, LLC, 2019. Reproduction of this material is prohibited without consent of Financial Principles, LLC.

Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). News items are based on reports from multiple commonly available international news sources (i.e. wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations. JPMorgan Guide to the Markets, December 31, 2018