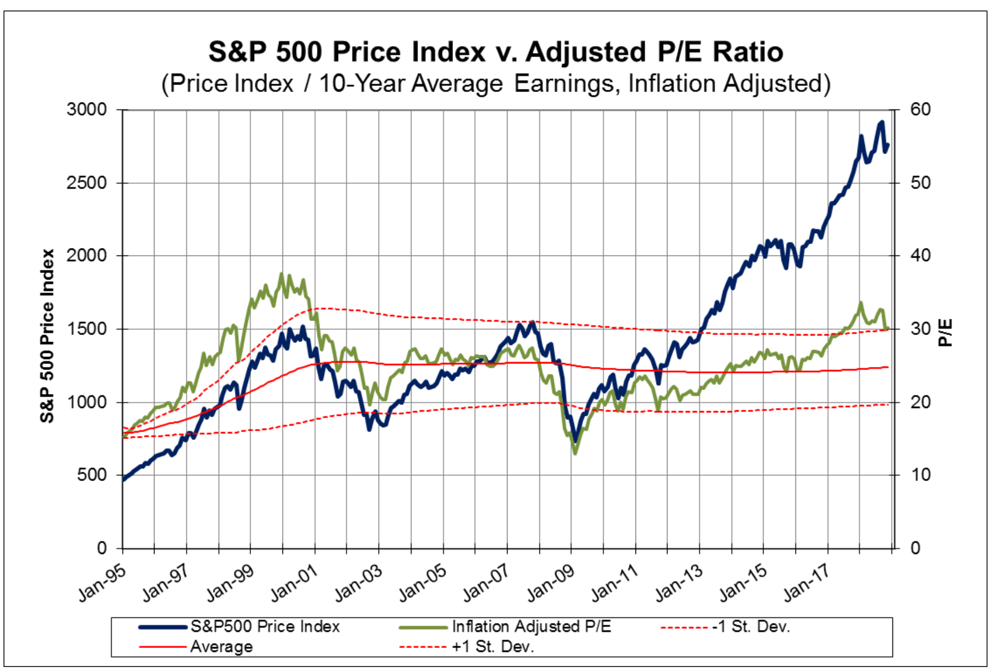
Monthly Market Comment
December 1, 2018

On balance, the financial markets provided positive returns over the course of November, but it was sure a wild ride in mid-month! Stock prices actually fell into a correction – defined as a drop of at least 10% from a recent high – before recovering in the last days of November. As investors sought safe havens, bonds and real estate also posted positive returns, but physical commodities plunged.

Stocks

U.S. stocks had nearly fallen into a correction in late October, but they rebounded strongly in early November before resuming their slide in mid-month. Their lowest close came on November 23, when the S&P 500 price index fell to 2,632.56, for a decline of 10.2% from their last record close in late September. With their rebound in the last week of November, the S&P 500 ended the month 1.8% higher than at the end of October and up 4.3% from the end of November 2017. Taking into account dividends, the total return on the S&P 500 was 2.0% in November and 6.3% over the last year.

We had thought the stock market's decline in October was enough to price in the various risks we've been talking about, such as rising inflation pressure and continued interest-rate hikes. We also see risks in the appreciating dollar, the waning stimulus from this year's tax cuts and government spending hikes, and the continued disruptions from the administration's trade war. It now looks like investors were still coming to terms with those threats in November and even into early December. All the same, we are holding out hope that investors will soon to focus again on the fact that, for the time being, the economy is still expanding and corporate profits are still rising. With the market's drop in recent months, we also think stock valuations have become more attractive. We even think stocks could rise to at least one more round of record highs before the increasing risks produce a prolonged downturn sometime in the coming months.



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Technical indicators are mixed at present. For example, the S&P 500 index at the end of November stood above its 20-day simple moving averages (SMA), but it was still slightly below the more important 50-day and 200-day SMAs. Similarly, the key short-term momentum indicators (such as the "moving average convergence/divergence," or MACD) suggest stocks are in a recovery mode after being massively over-sold, but that's counterbalanced by other negative signs. The Dow Jones Transportation Index has recently performed even worse than the overall market, and the share of S&P 500 stocks trading above their 200-day SMA is stuck below 50%, which suggests market breadth is narrow. If the S&P 500 rises from here, we believe its next significant resistance level will come at approximately 2,813. If stock prices instead start to fall again, we think the next significant support levels would be at approximately 2,690 and 2,632.

S&P 500 Stock Price Index + "MACD" Momentum Indicator
Source: BigCharts.com

Bonds

Now that investors have started to question whether economic growth can remain strong in the face of rising inflation and other issues, some have started to think the Fed might stop hiking interest rates in the near term. That rekindled the demand for fixed-income investments throughout November, boosting prices and pushing down yields. The yield on the benchmark 10-Year Treasury Note ended November at a two-and-a-half-month low of 3.01%, compared with 3.16% at the end of October. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was 0.5% in November, and a negative 1.0% over the last year.

Looking into the future, the risk we see for bonds is the possibility that they may have been bid up too early. If we're right that the economy will continue to grow well for a while yet, before hitting serious potholes in perhaps mid-2019, then inflation pressures could remain relatively high and the Fed could continue to hike rates at something like its current pace. In addition, the surge in government borrowing since the late-2017 tax cuts were implemented could become an ever more serious headwind for bonds. In other words, we think there's a significant chance that investors will start selling bonds again in the near term. In our view, bonds with longer maturities will be most at risk. We continue to think there will be less risk in bonds with shorter maturities and/or inflation protection provisions.

Real Estate and Commodities

Publicly-traded real estate investment trusts (REITs) often outperform when bond yields are falling, and that's exactly what they did in November. At the end of the month, the FTSE NAREIT Price Index stood 4.5% above its level at the end of October, although it was still a slight 0.3% lower than at the end of November 2017. Reflecting their relatively high dividends, the total return on publicly-traded REITs was 4.8% in November and 3.9% over the last year. Looking ahead, we believe the continued economic expansion should keep REITs' operational dynamics healthy, while falling or stable bond yields will continue to help their price performance.

For physical commodities, November's big problem was a plunge in energy prices. In particular, crude oil prices fell sharply in the face of rising U.S. production, increasing inventories, and worries about faltering economic growth, at least outside the United States. Just as important, after the U.S. government had spent months lobbying big foreign producers to ramp up their output in order to limit the damage from its November 1 sanctions against Iranian oil exports, the administration unexpectedly provided exemptions to several foreign exporters. With oil supplies rapidly moving into surplus, the only major energy product to have a good experience in November was natural gas. It rose strongly in response to an early cold snap. Precious metals and industrial metals alike showed relatively little price change from the beginning of the month to its end. Agricultural prices were mixed-to-down, in part because of new protectionist tariffs against U.S. farm goods. In total, the S&P GSCI Total Return Index dropped a sharp 11.3% during the month, although it was only down 2.5% over the last year. Looking forward, we still think continued good economic growth in the near term will limit the rise of excess supplies of crude oil and other physical goods. We're still holding out hope that commodity prices could well stabilize or even rebound in the coming months.

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Chief Investment Officer

Asset Class	Index	Ending Reading, Latest Month	1-Month Change	3-Month Change	12-Month Change
U.S. Stocks	S&P 500 Price Index	2,760.17	1.8%	-4.9%	4.3%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	267.94	0.8%	-7.3%	-10.5%
REITs	FTSE NAREIT All-Equity Price Index	687.30	4.5%	-1.5%	-0.3%
Commodities	S&P GSCI Total Return Index	2,388.63	-11.3%	-13.2%	-2.5%
Bonds	S&P U.S. Aggregate Bond Index	190.76	0.5%	-0.6%	-1.0%