WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

Monthly Market Comment

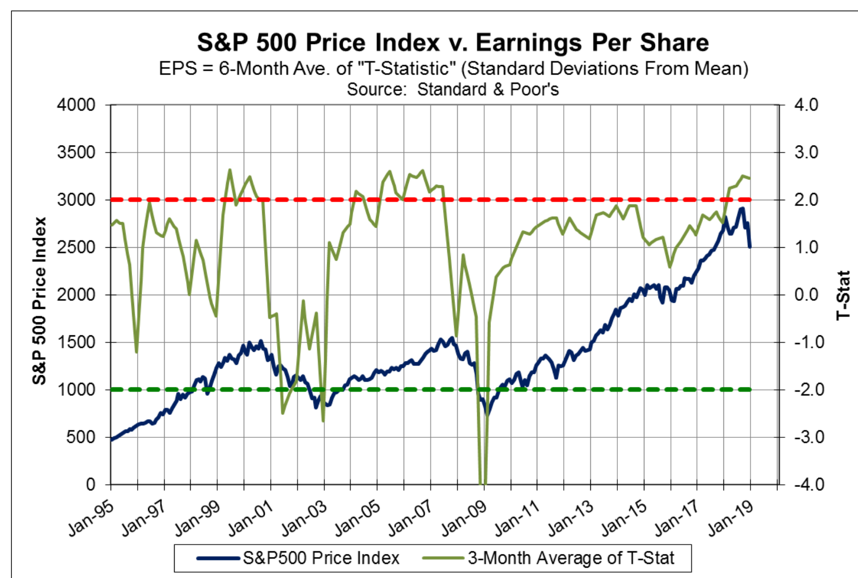
January 1, 2019

If you like red, December was the month for you. It was a veritable bloodbath for virtually all risk assets, with U.S. stocks falling to within a hair's breadth of a bear market. The only positive returns came from bonds, which investors bought up as a safe haven.

Stocks

U.S. stocks had posted a modest recovery in November, erasing part of their big October decline, but prices plunged again during December. The nadir came on Christmas Eve, when the S&P 500 price index dropped to a closing level of 2,351.10. That was the lowest reading since April 2017, and it left the index down 19.8% from its last record close in late September (the accepted definition of a bear market is a drop of 20.0% from a previous high). Fortunately, the selling subsided in the final days of December, and stocks embarked on a furious rebound. The S&P 500 ended the month down "just" 9.2% from the end of November and down 6.2% from the end of December 2017. Taking into account dividends, the total return on the S&P 500 was a negative 9.0% in December and a negative 4.4% over all of 2018.

Based on the available evidence, it seems the fourth-quarter correction stemmed mostly from investor panic about slowing economic growth. Even though most projections merely call for a moderation in growth at home and abroad, investors seemed to fear things could turn out much worse than that. We agree that headwinds are gathering force – higher inflation, rising interest rates, and protectionist trade policies are of particular concern – but we think the near-term momentum in the economy and in the financial markets should keep things from falling off a cliff. Since the late-2018 selling was apparently excessive, we think stocks should be able to rebound from here, especially if there are no surprises in the latest round of U.S.-China trade negotiations or in the political sphere. We even think stock prices could rise to at least one more round of record highs before the increasing headwinds produce a more significant downturn later in 2019. The problem is that automatic, computer-driven trading seemed to account for a lot of the fourth-quarter selling. It's not clear to outsiders how those computer algorithms work, so it's hard to predict whether or when a new wave of selling might hit.



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We think the various technical indicators support the case for a continued rebound in the stock market. At the end of December, the S&P 500 index remained below all its key simple moving averages (SMAs), but it had drastically narrowed its gap with the 20-day SMA. Perhaps more important, 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. It's true that the Dow Jones Transportation Index has recently performed even worse than the overall market, which has historically been a negative sign for stocks. It's also true that the share of S&P 500 stocks trading above their 200-day SMA is only about 20%, which suggests market breadth is exceedingly narrow. All the same, we think the recent price action has been much more positive than it was in the last few months. If the S&P 500 continues to rise from here, we think its next significant resistance levels will come at approximately 2,632 and 2,736. If stock prices instead start to fall again, we think the next significant support levels would be at approximately 2,448 and 2,351.

S&P 500 Stock Price Index + "MACD" Momentum Indicator

Source: BigCharts.com

Bonds

The extreme volatility in the stock market spurred an intense interest in safe-haven assets during the fourth quarter, while expectations for slower economic growth suggested the Federal Reserve might not hike interest rates much further. Both factors led investors to bid up bond prices, so yields fell. The yield on the benchmark 10-Year Treasury Note declined to a nearly one-year low of 2.69% at the end of December, versus 3.01% at the end of November. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was 1.5% in December and a slight 0.1% over the course of 2018.

Since we think the economy remains healthier than most investors believe, we fear that bonds may have been bid up too early. If we're right that the economy will continue to grow well for a while yet, 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. Bond prices could give up a lot of the gains they enjoyed in late 2018. Still, it's clear that investors are now much more cognizant

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of the economic slowdown that will eventually come, and they seem to the "the light at the end of the tunnel" for the Fed's rate hikes. We think that will provide more support for longer-term bonds than has been the case for at least the last year.

Real Estate and Commodities

Publicly-traded real estate investment trusts (REITs) performed slightly better than stocks in December, as they often do when bond yields are falling. At the end of December, the FTSE NAREIT Price Index stood 8.5% below its level at the end of November and 7.9% below its level at the end of December 2017. Reflecting their relatively high dividends, the total return on publicly-traded REITs was a negative 7.9% in December and a negative 4.0% in all of 2018. 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. However, if bond yields rise again, REITs could suffer.

For physical commodities, December was another big negative month, in large part because of continued weakness in energy prices. Rising U.S. production, increasing inventories, and worries about faltering economic growth all discouraged purchases of crude oil. Prices for natural gas also declined, in spite of their relatively stronger performance in the autumn. Growth fears also drove down industrial metals prices, but lower bond yields and a weakening dollar allowed precious metals prices to strengthen significantly. Agricultural prices were flat-to-down. In total, the S&P GSCI Total Return Index dropped 7.8% during December, leaving it down 13.8% 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, but as long as most other investors remain focused on the likely moderation in future growth, we think commodity prices could remain challenged.

Patrick Fearon, CFA
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	2,506.85	-9.2%	-14.0%	-6.2%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	255.40	-4.7%	-11.8%	-16.4%
REITs	FTSE NAREIT All-Equity Price Index	628.75	-8.5%	-7.1%	-7.9%
Commodities	S&P GSCI Total Return Index	2,203.47	-7.8%	-22.9%	-13.8%
Bonds	S&P U.S. Aggregate Bond Index	193.69	1.5%	1.4%	0.1%