Capital Markets Update - 4Q 2018

SOLARIS Advisors

Notable 4Q 2018 Market Performance

	S&P 500	MSCI EAFE	MSCI Emerging Markets	Barclays Aggregate	10-Year Treasury	HFRI Hedge Fund Composite	USD	WTI Crude Oil
4Q Return	-13.52%	-12.50%	-7.40%	1.64%	3.87%	-5.34%	1.09%	-37.49%
2018 Return	-4.38%	-13.36%	-14.25%	0.01%	0.00%	-4.08%	4.40%	-20.46%

4Q 2018 Market Commentary

Risk assets sold off sharply during the 4th Quarter, leading the domestic stock market down for its worst annual performance since 2008. Investors spurned healthy US economic data, as unemployment remained below 4%, inflation (as measured by CPI) held above 2% and corporate earnings continued to post impressive double-digit growth. Non-US stocks were weighted down by US-China trade war rhetoric, uncertainty surrounding the pathway and effects of Brexit and the unsustainably high level of non-performing loans on the books of Italian banks. In addition, the unrelenting strength of the US dollar resulted in big declines for emerging market equity markets. Bonds proved more resilient but still the Barclays Global Aggregate Bond Index lost -1.2% in 2018. Towards the end of the year, credit spreads began to widen, signaling concern for lower liquidity and the overall quality of corporate bonds. As a result, high yield bonds fell -4.5% in Q4.

What is spooking the market and do these fears justify the kind of negative market action we witnessed in 2018, particularly in the final quarter of the year? Could it be wrong-minded decisions by central bankers including the Fed? Is it an increase in operating leverage on the balance sheets of corporations and households? Perhaps it's the post-peak corporate earnings outlook? Or could it be the slowdown in China's growth? While these are valid concerns, we don't think they paint a sufficiently dire picture to account for the recent re-rating of global markets. Take for example the Fed's attempt to break the market's codependency on easy money/zero interest rates. Even if the Fed's policy moves were to invert the yield curve, the average time from inversion to bear market since 1965 has been 17 months. Yes, the market is a discounting mechanism, but this lead time suggests there may be upside this year.

So although fundamentals have begun to erode, they have not deteriorated *drastically* and are not the primary reason for most of the recent negative investor sentiment. Rather, markets are preoccupied with the capricious, unpredictable and impulsive nature of decisions that impact economic growth. Investors and corporations crave a steady, reliable hand — not inflammatory trade policy or inconsistent foreign policy. Concern over policy missteps become amplified when there is a lack of confidence in, or a clear understanding of, the direction we are heading. Exacerbating this is the deafening feedback loop of sensationalized and polarizing reportage. One can only hope that this troubling phase will play itself out and we will return to a more thoughtful discourse based on shared objectives that are fully and well articulated.

Notwithstanding the heightened level of political and geopolitical risk, we remain long-term, fundamental investors, and we are not abandoning equities especially now that their valuations have become more attractive. Equity exposure has already been taken down via market action. We would not take further steps in this direction other than for the few clients who find this inflated level of volatility too difficult to bear.

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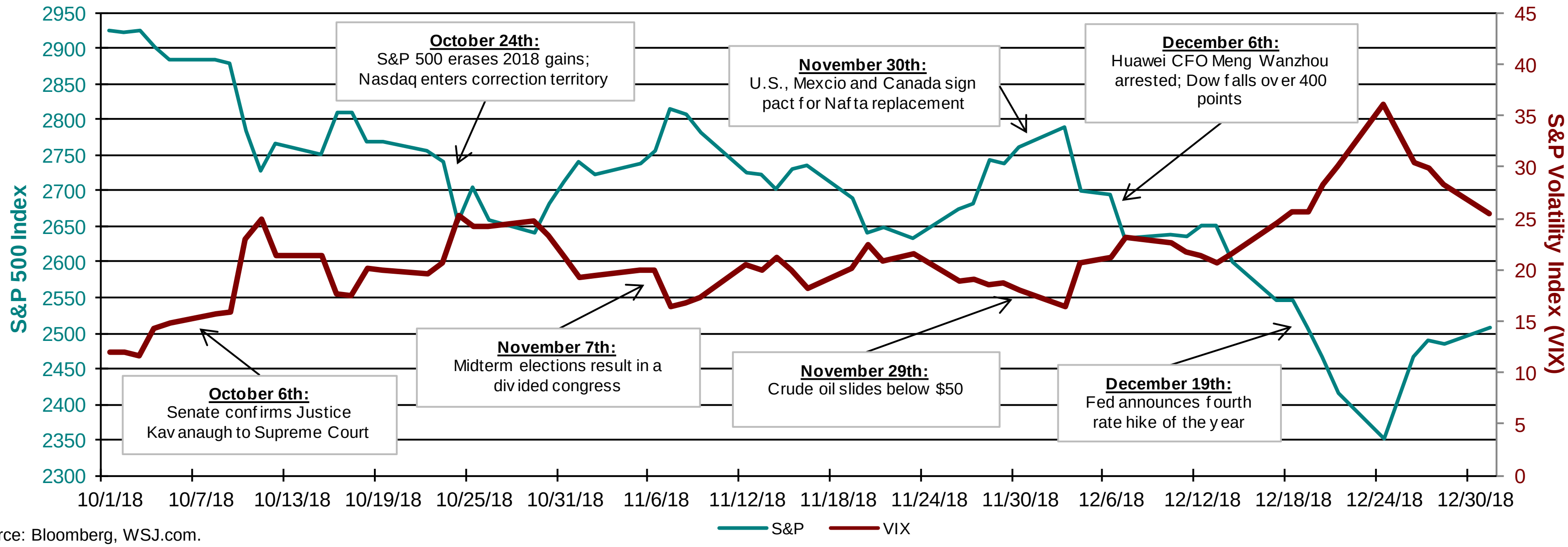
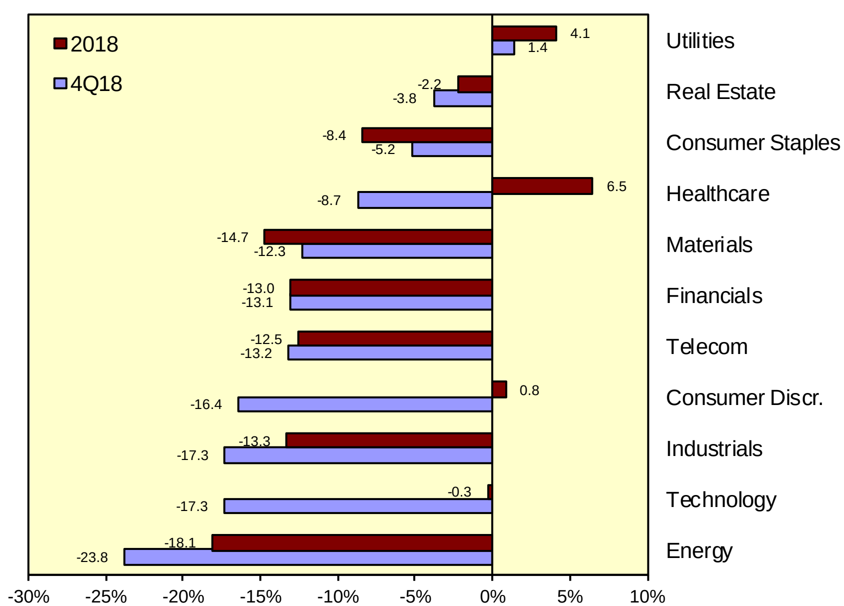
S&P 500 and VIX Performance – 4Q 2018



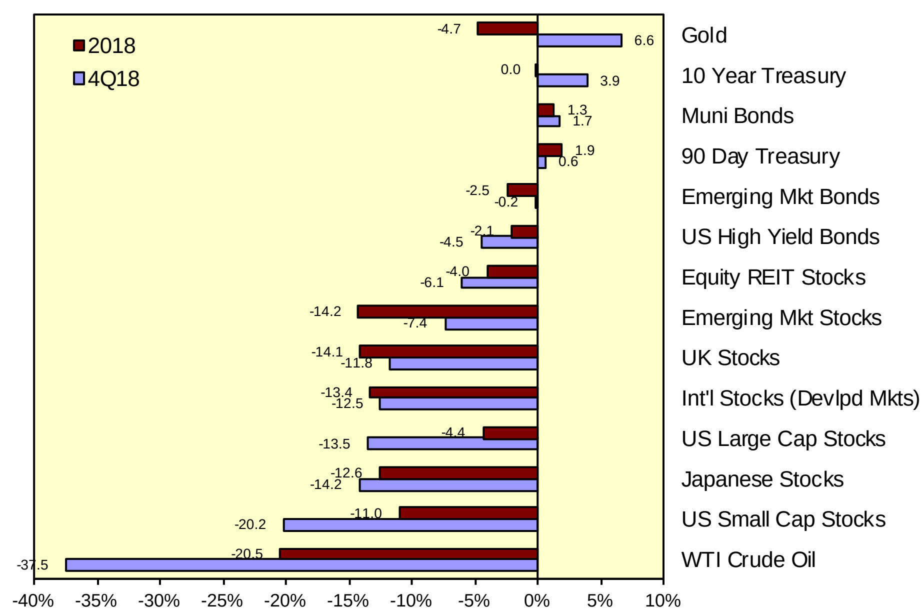
Source: Bloomberg, WSJ.com.

Global Capital Markets and Sector Performance – 4Q 2018 and Full Year

S&P Sector Performance



Global Capital Markets Performance



Source: Bloomberg.

Capital Markets Update - 4Q 2018

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Global Capital Markets Performance – 4Q 2018

Top Sectors | Bottom Sectors

U.S. Equity

	Value	Blend	Growth
Large Cap	(11.72)	(13.82)	(15.89)
Mid Cap	(14.95)	(15.37)	(15.99)
Small Cap	(18.67)	(20.20)	(21.65)

U.S. Fixed Income

	Short Term	Intermediate	Long Term
Treasuries	1.31	2.24	4.19
Corporate	0.89	0.75	(1.64)
High Yield	N/A	(4.36)	(7.79)

Global Equity

	Value	Blend	Growth
U.S.	(12.24)	(14.30)	(16.33)
EAFE	(11.65)	(12.50)	(13.30)
Emrg Mkt	(6.66)	(7.40)	(8.16)

Global Fixed Income

	Intermediate
Sovereign	(0.40)
Corporates	(0.81)
High Yield	(3.49)

Source: Bloomberg.

Global Capital Markets Performance – Full Year 2018

Top Sectors | Bottom Sectors

U.S. Equity

	Value	Blend	Growth
Large Cap	(8.27)	(4.78)	(1.51)
Mid Cap	(12.29)	(9.06)	(4.75)
Small Cap	(12.86)	(11.01)	(9.31)

U.S. Fixed Income

	Short Term	Intermediate	Long Term
Treasuries	1.56	1.41	(1.84)
Corporate	1.64	0.01	(6.76)
High Yield	N/A	(1.77)	(7.58)

Global Equity

	Value	Blend	Growth
U.S.	(8.58)	(5.24)	(2.12)
EAFE	(14.26)	(13.36)	(12.48)
Emrg Mkt	(10.28)	(14.25)	(18.04)

Global Fixed Income

	Intermediate
Sovereign	(2.35)
Corporates	(3.57)
High Yield	(4.06)

Source: Bloomberg.

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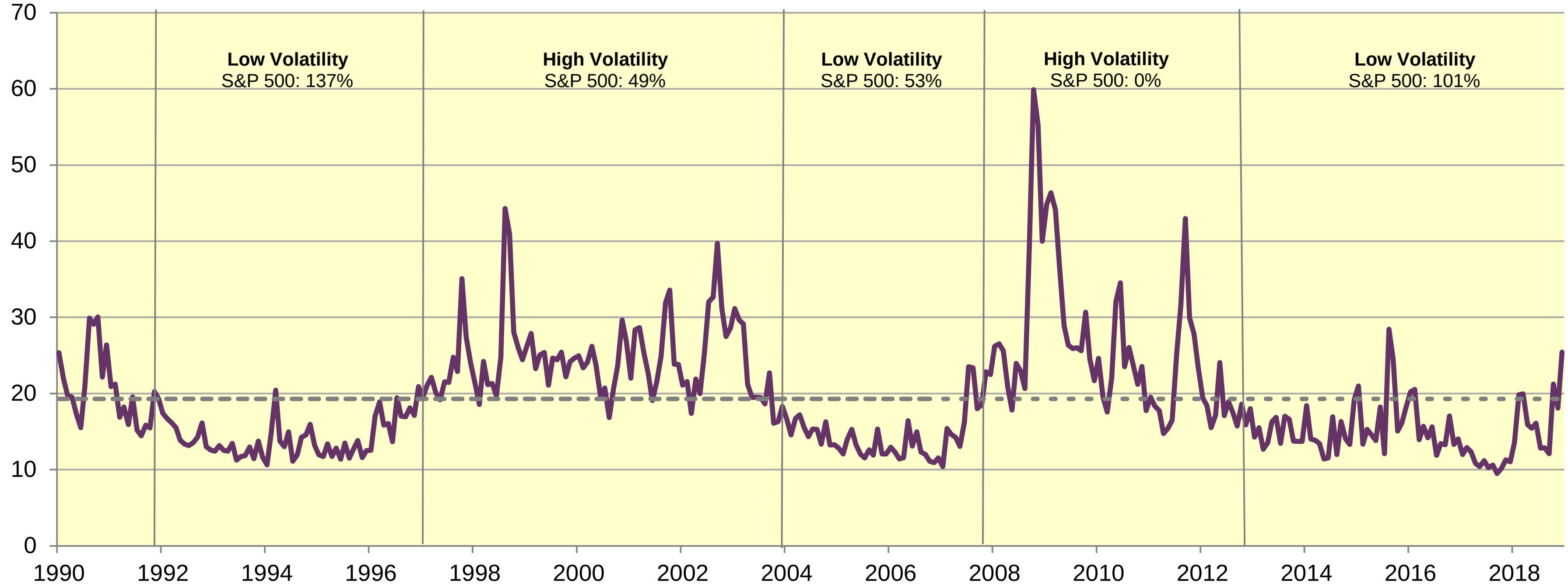
Persistence of Volatility Regimes



Source: Bloomberg.

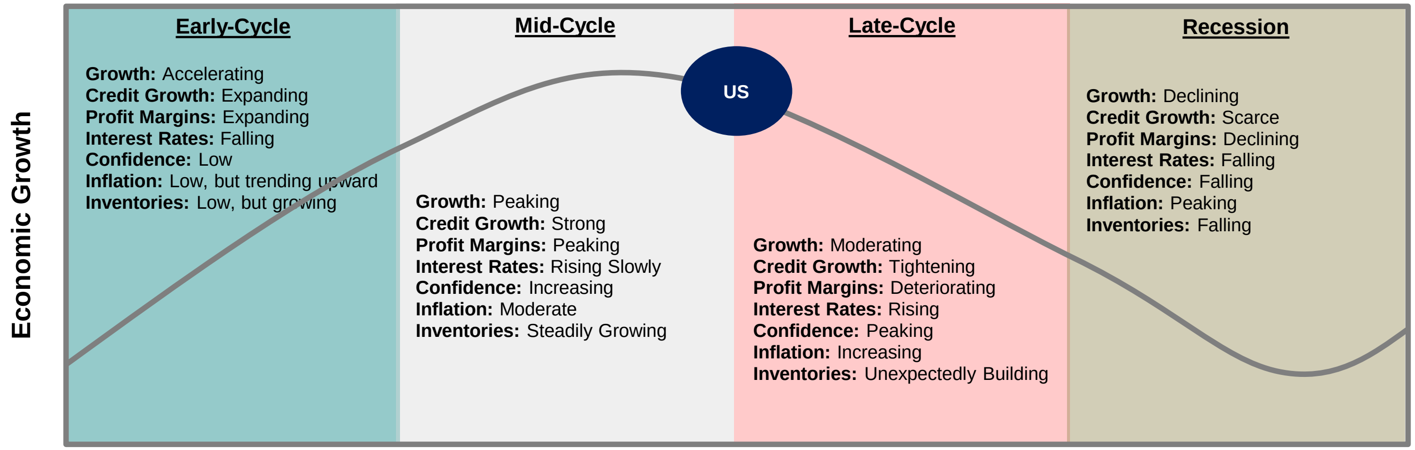
Key Market Themes

Late Cycle Dynamics
Tightening Global Liquidity
China Transitions
Globalization Backlash

Source for entire section: NEPC. Additional sources, if any, are listed at bottom of pages.

Late Cycle Dynamics

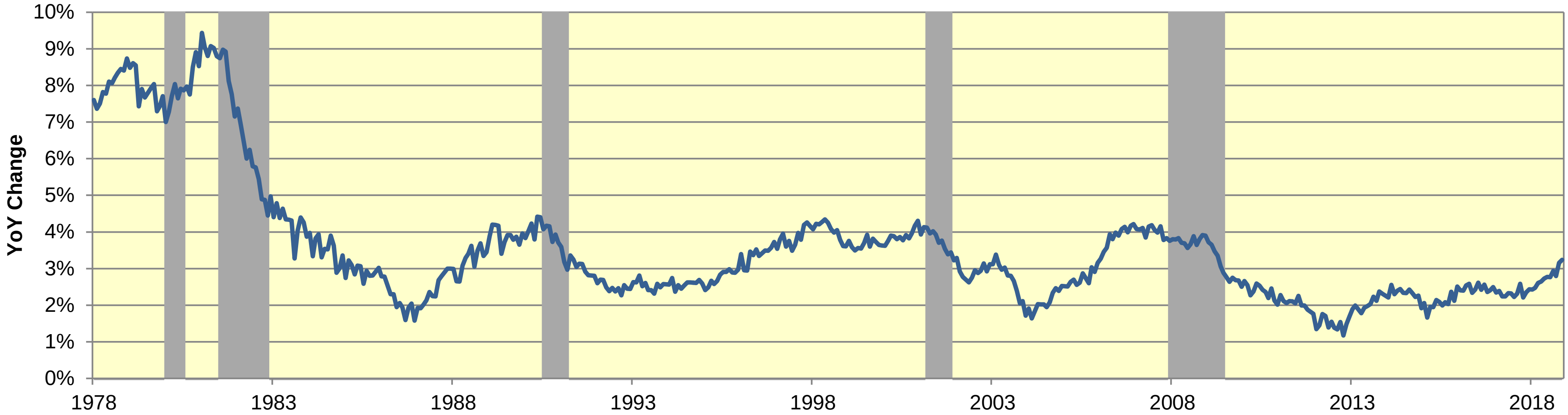
U.S. economy has transitioned to a late-cycle environment



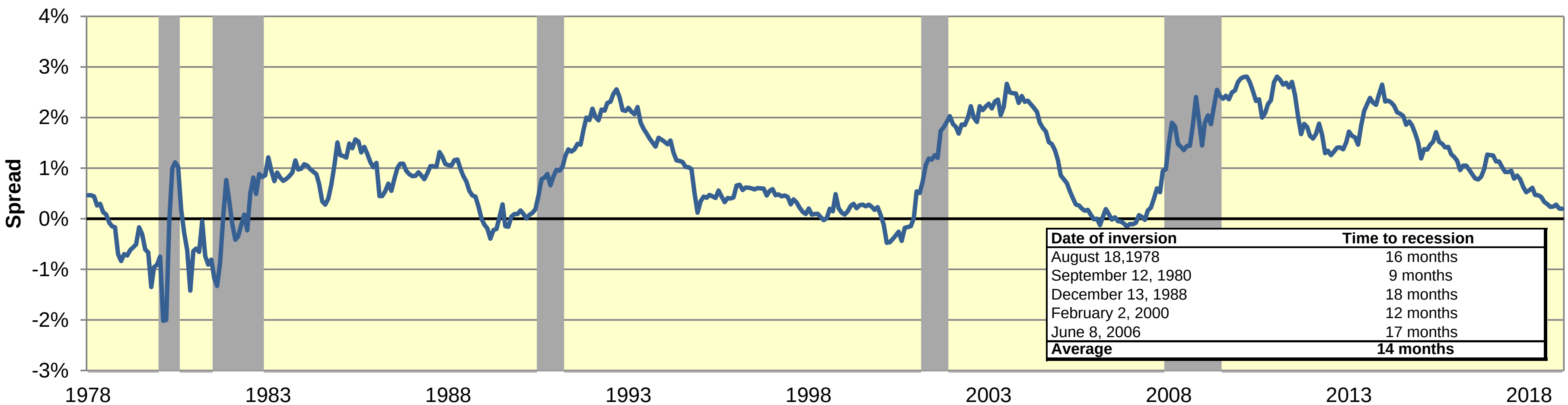
Indicator	Expected Late Cycle Behavior	Current State
Equities	Peaking/Rolling Over	Yes
Rates	Rising	Yes
Yield Curve	Inverting	Close
Inflation	Rising	Yes
Growth	Choppy, Dipping 12-24 months Ahead	Yes
Credit Spreads	Stable to Rising	Yes
Output	Near or Above Potential	Yes
Unemployment	Declining/Bottoming	Yes

Late Cycle Dynamics

U.S. Average Hourly Earnings



Spread Between 10 Year and 2 Year U.S. Treasuries



Date of inversion	Time to recession
August 18,1978	16 months
September 12, 1980	9 months
December 13, 1988	18 months
February 2, 2000	12 months
June 8, 2006	17 months
Average	**14 months**

Source: Bloomberg (Top); Bloomberg, JP Morgan (Bottom).

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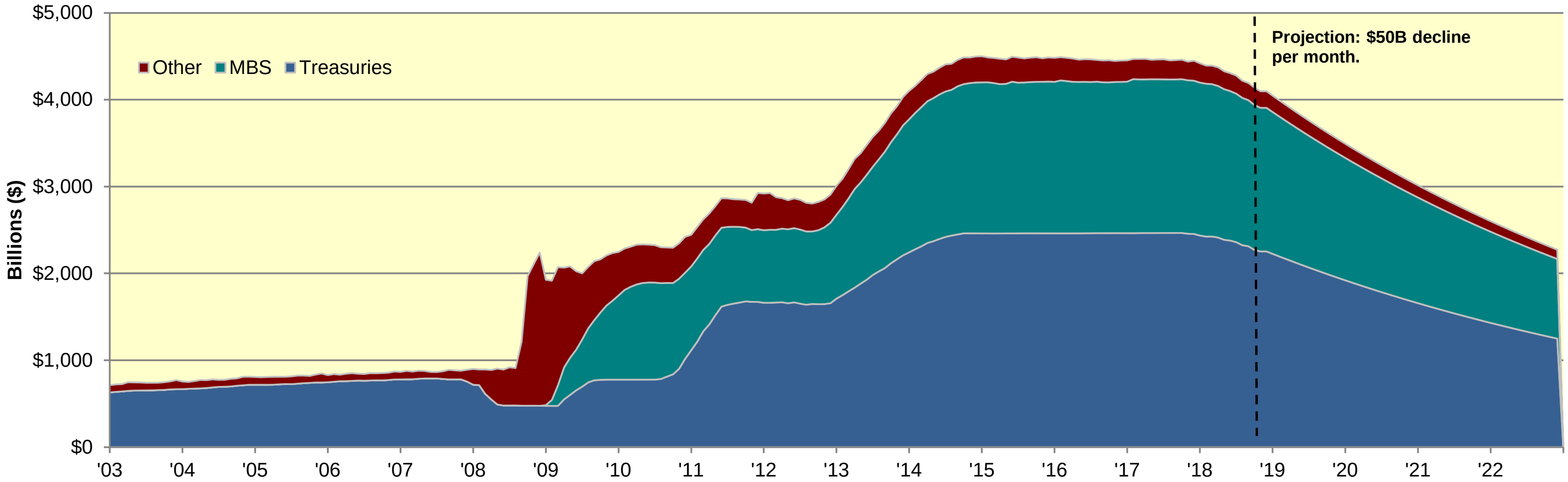
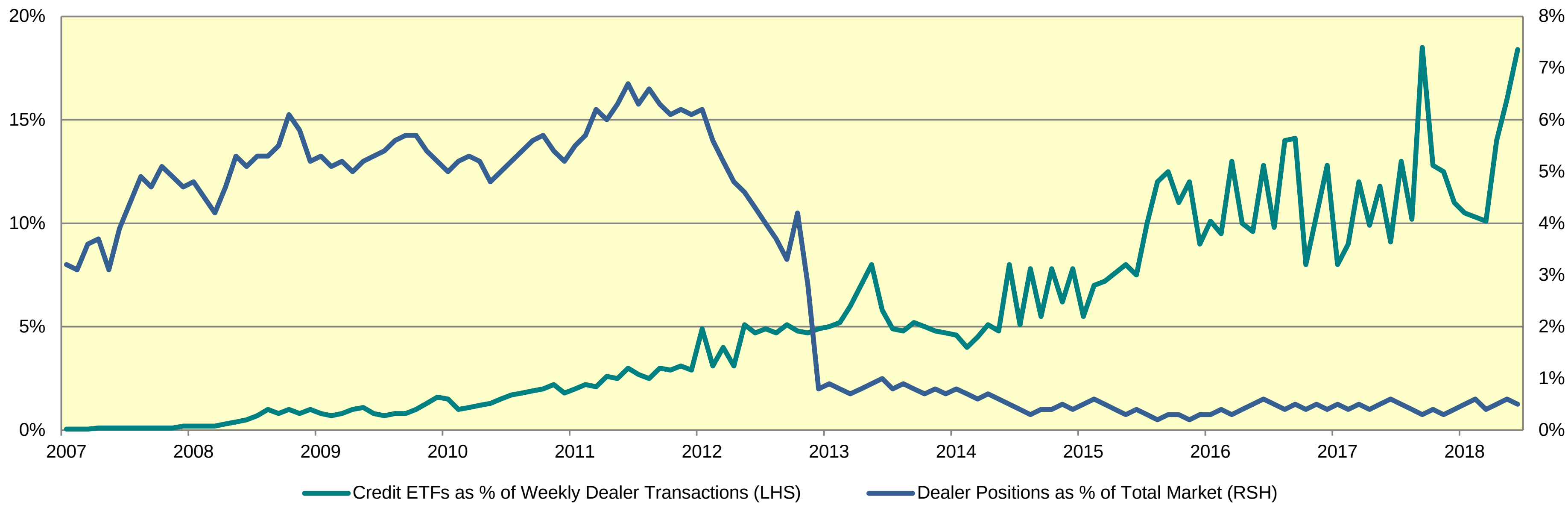
Tightening Global Liquidity

Federal Reserve Balance Sheet Assets



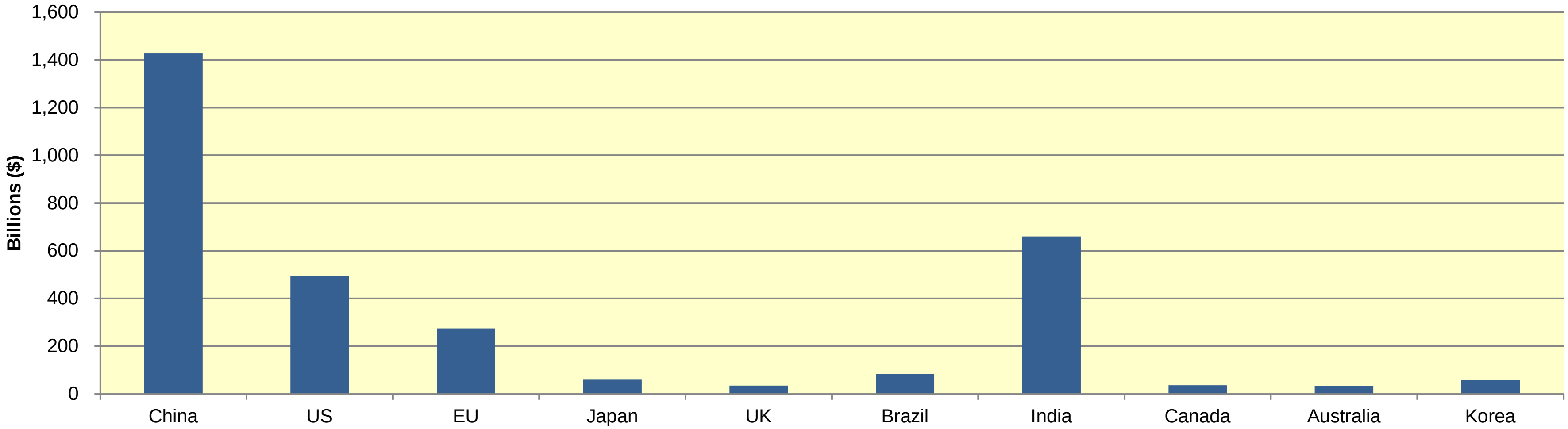
Credit Supply/Trading



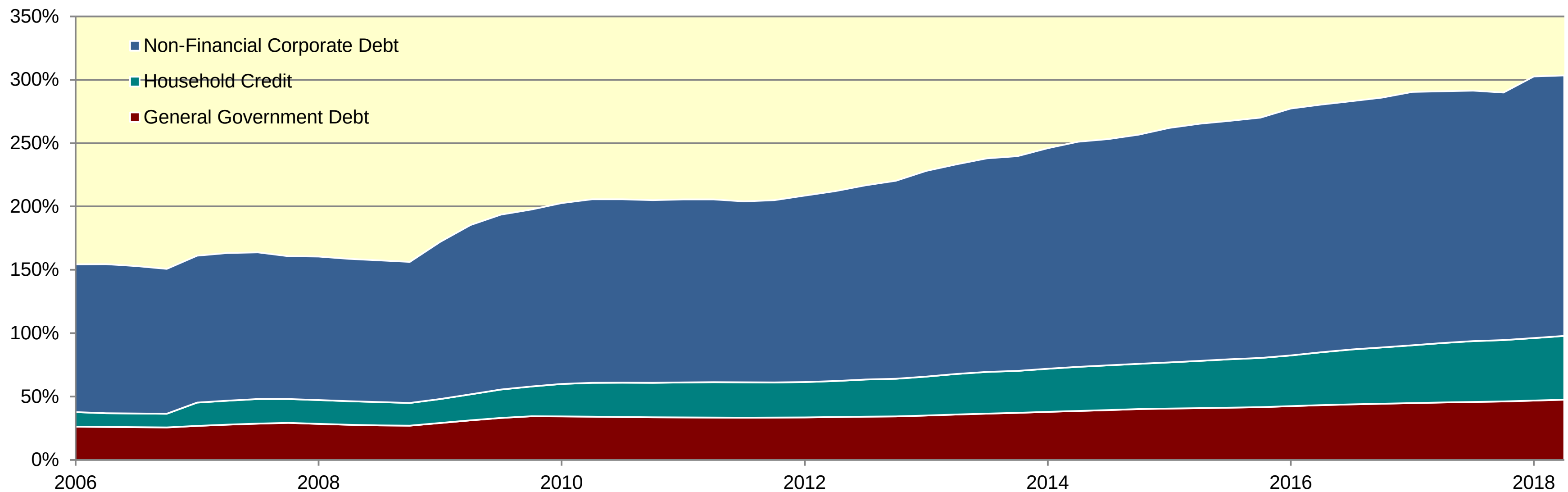
Source: Bloomberg (Top).

China Transitions

2019 Projected Real GDP Growth



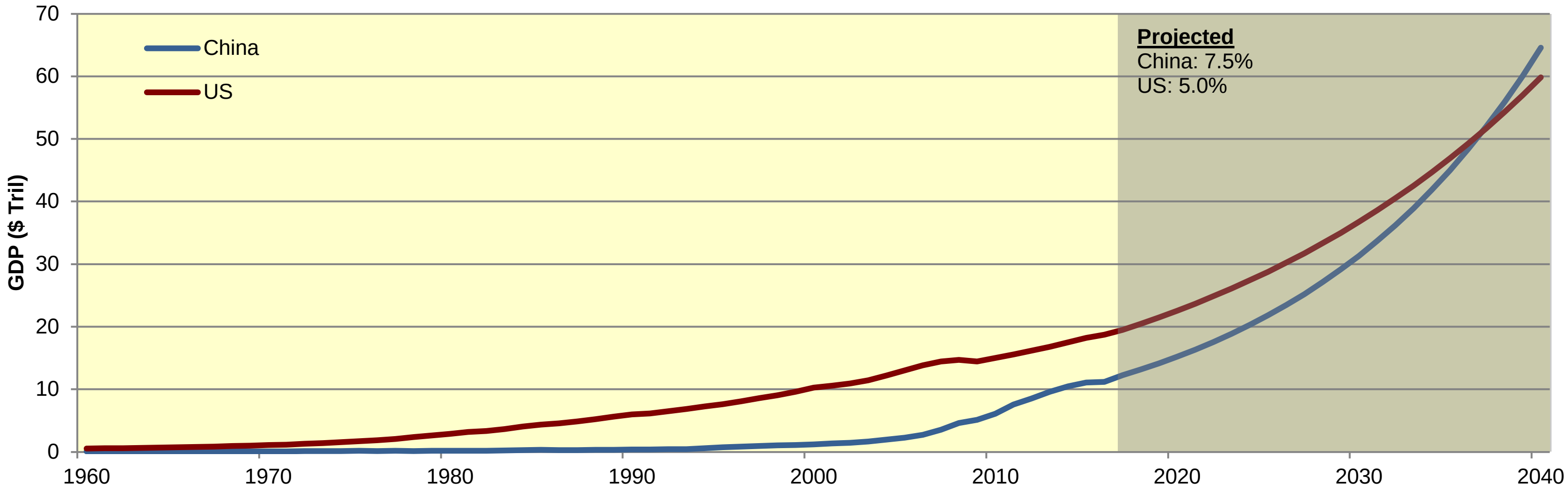
China Credit (as % of GDP)



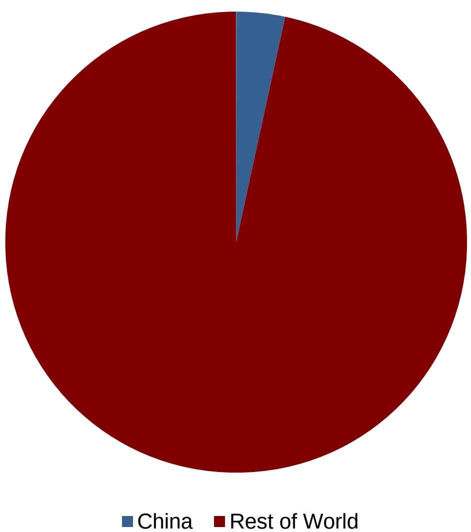
Source: OECD (Top); BIS (Bottom).

China Transitions

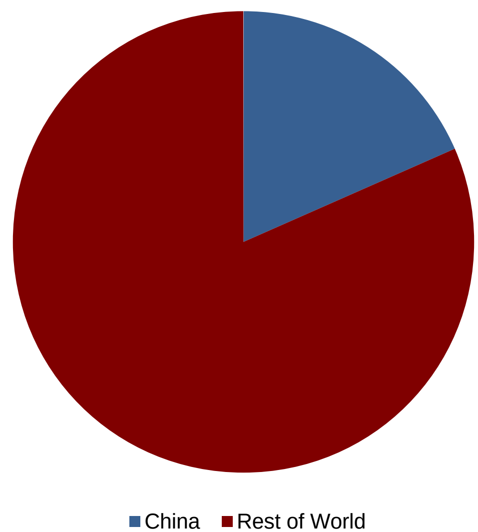
Nominal GDP Growth



Current ACWI Breakout



20-Year ACWI Projection



Source: Bloomberg (Top).

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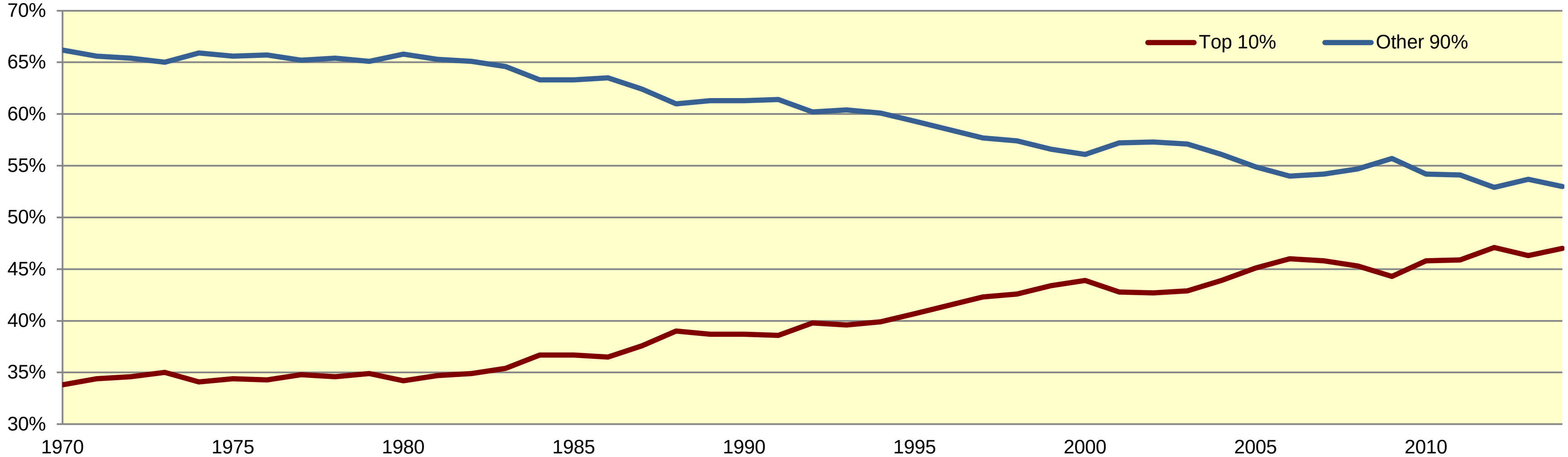
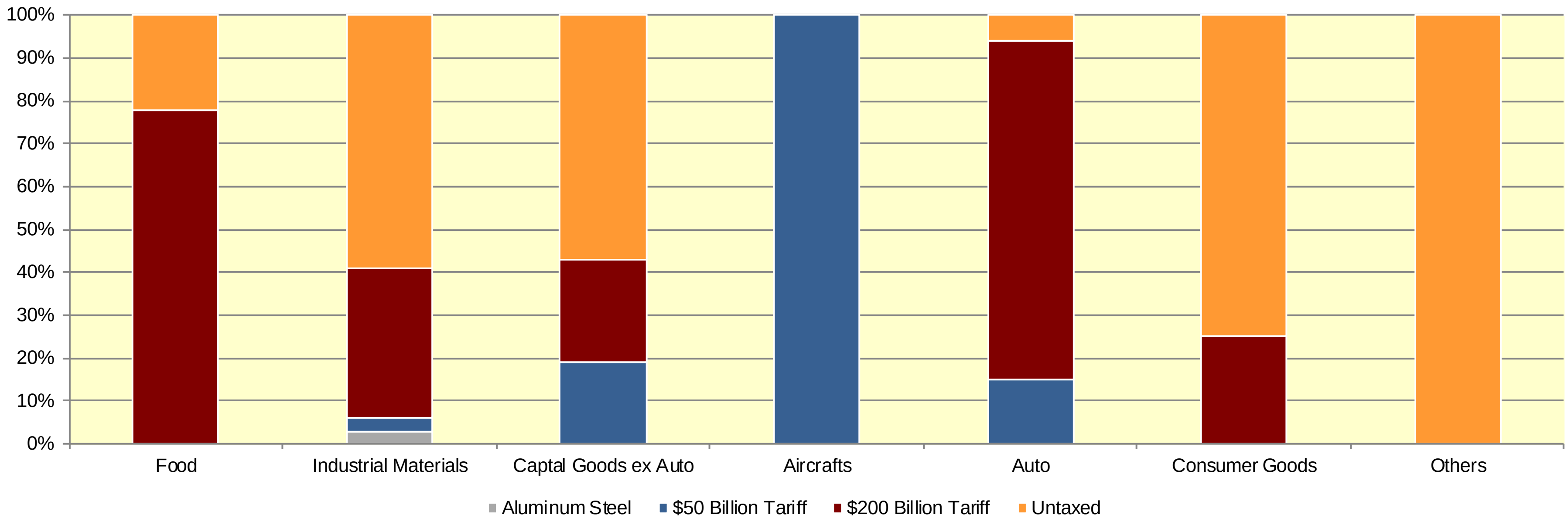
Globalization Backlash

U.S. Wealth Distribution



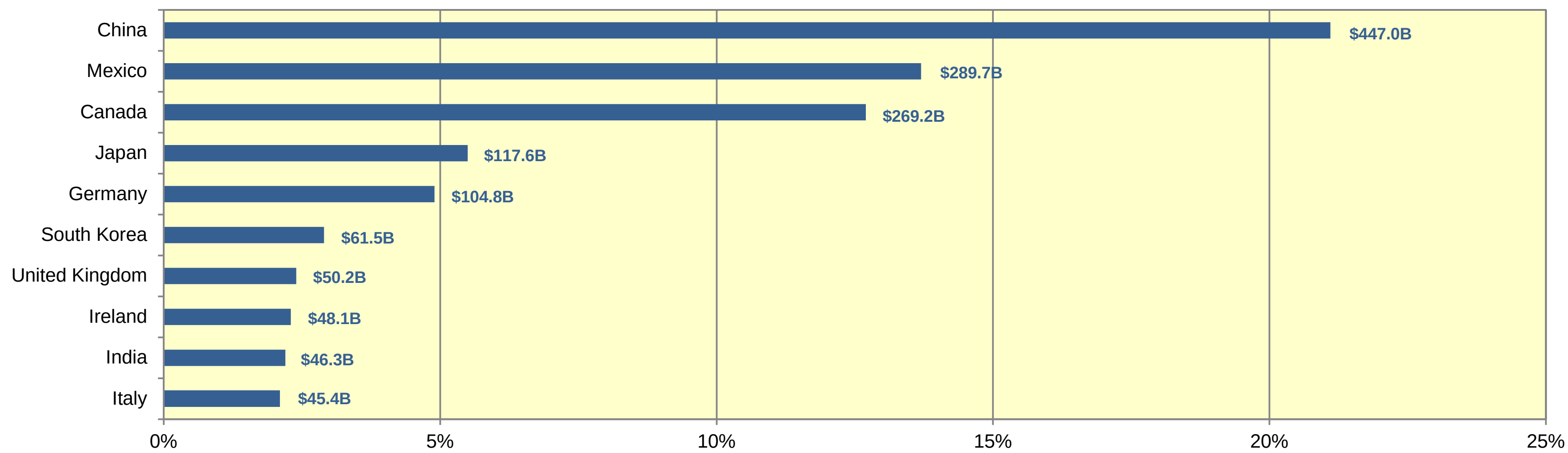
U.S. Tariffs on China



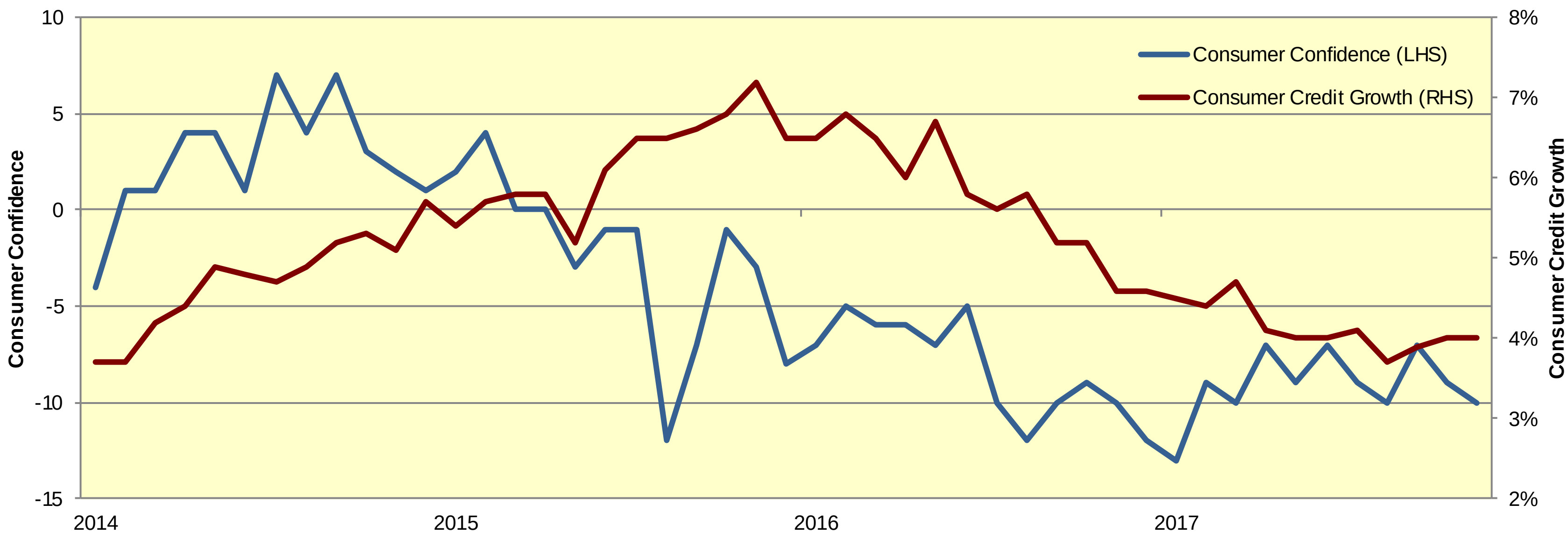
Source: World Inequality Database (Top); Bloomberg (Bottom).

Globalization Backlash

U.S. Imports (YTD Oct. 2018)



U.K. Consumer Confidence vs. Credit



Source: U.S. Census Bureau (Top); Bloomberg (Bottom).

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