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A Year of Transition

In our previous newsletter from last October, we outlined the various risk factors that could very well slow down or maybe even derail the current growth cycle of our economy. These same factors are also tied quite closely to the overall performance of the stock market. What has changed since October has been the volatility of the stock market in the 4th quarter of last year, particularly in December.

So what might we expect to experience in 2019? For starters, the global economy has clearly hit a wall. China is in the midst of a major downturn in their economy – they are experiencing the slowest growth in three decades. The slowdown is not just in manufacturing, but the Chinese consumer has significantly pulled back from spending as well. There is major economic weakness throughout the Euro Zone. Italy slipped into a recession at the end of 2018 and Germany may not be far behind. At best, growth in Europe is flat. The real wild card event for Europe is the upcoming divorce by Britain from the European Union. The so called Brexit – due to happen in May represents a huge unknown – not only to the economy of the UK but to all of Europe.

At home, our economy remains in a growth cycle and at this point is still quite healthy – despite the negative global influences. Yes, the job markets is strong- but make no mistake - the US economy is in the process of decelerating. In 2018, GDP growth peaked in the second quarter at 4.2% annualized rate, declined in the third quarter, and further declined in the fourth quarter. Existing home sales, automobile sales and the Federal Reserve index of manufacturing all declined in 2018. Perhaps a good analogy would be if we are watching our economy as if it were a football game, we are clearly in the 4th quarter.

What can we expect from the stock market this year? It will take nothing but good news across the board to keep equity valuations rising. It was a combination of some of the factors outlined above that triggered the 4th quarter volatility and the big sell off in December that erased all the market gains for the year. Roughly 70-85% of all daily trading is done automatically – controlled by machines, models, or investment formulas. This fact alone is a major cause of stock market volatility. Recently, the trend in computer based investing has gone from bullish to bearish to a degree not seen in a decade. With the longevity of the bull market in doubt, we are expecting more volatility ahead. It will be increasingly difficult for world-class companies to increase earnings in light of a slowing global and US economy. Hence, earnings expectations are being trimmed by more than half the companies that make up the S&P 500 Index.

While January 2019 has started strong, we continue to exercise caution in our asset allocation strategies for this year. With the recent bounce in the stock market in January, it seems Wall Street has priced-in perfection for stocks just like it did in the fall of last year. This year should continue to produce positive news about our economy – we don't see a recession in 2019. But, a variety of headwinds exist – trade (tariff fights), increasing interest rates, slowing GDP and corporate earnings, and decreasing benefits from the Trump tax bill.

In summary, while our economy is still in good shape, it won't be as robust as it was in 2018. From an investment standpoint, we want to continue playing defense with the portfolio allocations, and continue to use extra caution. This year promises to be an uncertain yet bumpy ride.

As always, we at Kapusta Financial Group would like to thank you for the trust and confidence you place in our team.