

MATTERS OF TRUST



The quarterly market commentary is written for a wide variety of readers—those who want in-depth analysis and those who want an overview. Take a deep dive through the whole piece, or scan the key themes, market recap, or portfolio implications sections. We also include a “Did You Know?” section where readers can answer fun and thought-provoking questions. Check our online magazine Of Significance at TCWealthPartners.com/DidYouKnow for answers.

DISRUPTION & DISARRAY

The year that was 2018 seemed to be going okay (or mostly as expected)... until it wasn't. Progress on the back of economic and earnings growth seemed to break with the weight of negative sentiment.

As we stated last Spring, what is given can be taken away.

In fact, the quarter felt much like watching a B-rated thriller movie in which the main character puts himself or herself in harm's way—runs upstairs into a closet or a bathroom with no window instead of fleeing out

the front door. The action is crazy, but we know the movie will end differently. The hero or heroine will narrowly escape.

Many of the catalysts for negative sentiment seem like self-inflicted wounds—from geo-political standoffs to tariff threats to perceived constitutional crisis to concerns about central bank policies. The end of 2018 left us in disarray—figuratively screaming—all the while we suspected a better turn of events.

Disruption is re-shaping our world.



From the Desk of the
President and CIO
J. Reed Murphy

THE BOTTOM LINE

- ▶ Progress on the back of economic and earnings growth seemed to break with the weight of negative sentiment in the fourth quarter of 2018. The S&P dropped nearly 20% from its peak on September 20th to its bottom on December 24th.
- ▶ The month of December experienced the worst performance since The Great Depression (1931). The quarter was the worst since the Great Recession (2008). And, there were few places to hide in other asset classes as 2018 ended up being one of the worst for diversified portfolios.
- ▶ The primary reasons for the swift switch in sentiment include concerns regarding tariffs, interest rate hikes and geopolitical instability. Program traders made it worse.
- ▶ Most of our predictions for 2018 came to fruition, particularly during the more normal first nine months.
- ▶ We include new predictions for 2019 and pose a series of questions whose answers will influence actual outcomes.
- ▶ What could be the negative impact of a bad U.S. and China trade policy outcome?
- ▶ Will the Federal Reserve be more dovish or hawkish?
- ▶ Will the U.S. yield curve invert, and what impact might it have?
- ▶ Portfolio implications – Why so many moving pieces, and how should my portfolio be positioned?

While it encourages innovation, which is good for competitive and growing economies, it also upends jobs, business models, sectors and economies. This tectonic shift is also changing social norms—including how we interact personally and politically. Populism is on the rise globally and politicians are predictably promising to spend more and cut taxes while creating short-sighted economic policies to stimulate growth for the long-term. Central banks, particularly in the U.S., are starting to increase interest rates, causing more market disruption. These are some of the headwinds that we have written about in recent market commentaries - the monster chasing us to dark corners to hide. And they are partly the reason for the current market disarray.

Exhibit 1 shows that the S&P 500 was doing okay until it wasn't in the fourth quarter of 2018. Through September 30th, domestic large cap stocks were up approximately 10%. Then concerns for tariff wars, Fed interest rate hikes and politics seized markets. As a

result, the S&P edged to the brink of a correction (down 20% from recent peak) before it bounced at year-end.

JUST HOW BAD WAS IT?

The fourth quarter of 2018 was nothing short of remarkable. Consider the following:

- **Worst December Since the Great Depression (1931)** – The S&P hit its low on December 24th - declining within a whisker of official correction status. This lowlight marked a decline of 19.78% from its peak on September 20th. December ended down 9.18% - the worst December on record since 1931 when it was down 14.53%.

- **Worst Quarter Since the Great Recession (2008)** – The S&P 500 was down 13.7% for the quarter – the worst since the fourth quarter of 2008 when it was down 22.56%.

And, there wasn't anywhere to hide.

- **Third Worst Year Ever (Almost) for Domestic Stocks & Bonds** – According to BlackRock, 2018 almost became

The S&P hit its low on December 24th - declining within a whisker of official correction status.

the third year ever for both domestic stock and bonds to be down. If not for the last day of the year, the U.S. broad bond market would have been negative. There have only been two years on record when U.S. stocks and bonds were both down. In 1931 and 1969 stocks and bonds were down -43.3%/-2.3% and -8.5%/-0.7% respectively.

- **Worst Year for Broader Markets** – When broadening the markets to include domestic small cap stocks, international stocks, commodities, and real estate, it was the worst year on record. According to Ned Davis Research, 2018 was the first year that no major asset class posted a return greater than 5%. (Study limited to 1972 based on availability of asset class data.)

EXHIBIT 1: IT WAS GOOD UNTIL IT WASN'T



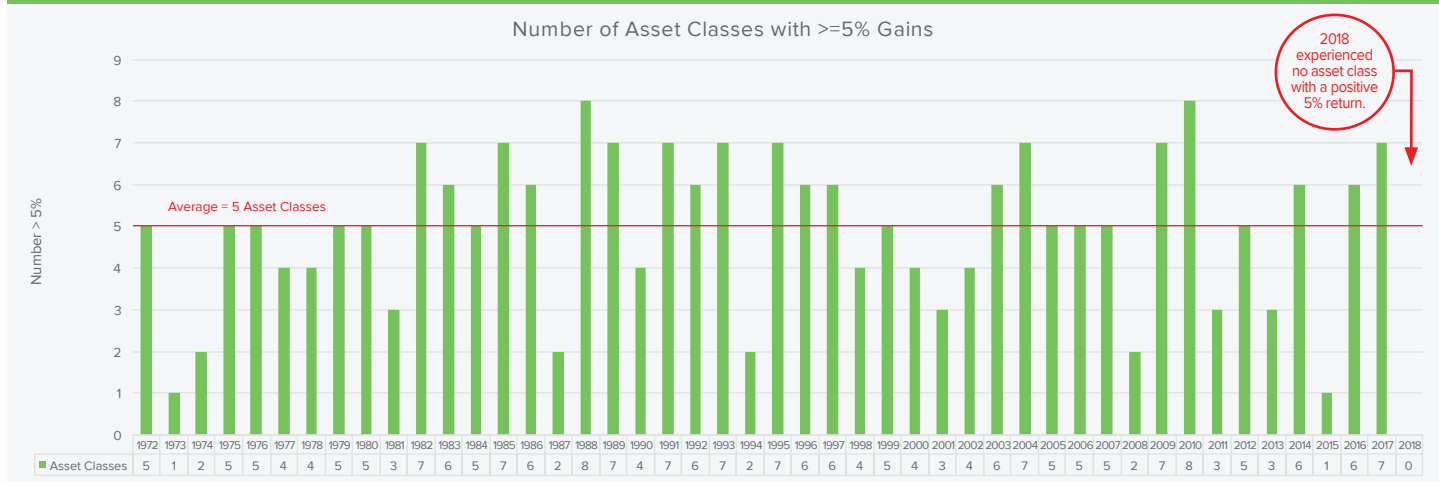
Source: TC Wealth Partners, Bloomberg.

REASONS

The primary reasons for the downward spiraling market in the fourth quarter were the following:

- **Trade Policy (Tariffs)** – Markets do not like tariffs. It creates winners and losers – usually more losers. It reduces productivity, increases inflation and slows growth. To that point, the International Monetary Fund (IMF) has reduced global growth rates based primarily on tariffs. Positive comments from

EXHIBIT 2: WORST YEAR FOR BROADER MARKETS ON RECORD (SINCE 1972)



Source: TC Wealth Partners, Ned Davis Research. Asset Classes: S&P 500 Total Return Index, Russell 2000 Total Return Index, MSCI EAFE Total Return Index (Local), MSCI Emerging Markets Total Return Index (Local), Barclays Long-Term Treasury Total Return Index, Barclays U.S. Aggregate Total Return Index, S&P GSCI Total Return Index, REIT Total Return Index. Ibbotson data used prior to start dates for Russell 2000 and Barclays Treasury Index.

President Trump coming out of a G20 meeting with China's Prime Minister, Xi Jinping, gave way to the reality that progress was not made (or not enough). Markets tanked on this misdirection.

- **Monetary Policy (Fed Rate Hikes)**

– Markets did not like that the Fed hiked 25 bps in December. They dropped their estimate for hikes next year from three to two. But this good news was swiftly diminished by their comments that the economy has a more balanced set of risks (i.e., softer economy than their comments from months ago).

- **Program Trading** – The third

horn of this devilish outcome is seldom talked about – quant-driven program traders. There are three major pools of investors: active managers, passive (e.g., index) managers and short-term traders. The size of passive investors has grown dramatically, while the size of active managers has shrunk. This

has created an environment that allows algorithmic trading to move markets when no fundamental data seems to support such moves. That is, when news events hit, and prices drop, passive index funds then must indiscriminately sell.

The result? There aren't enough active managers weighing underlying fundamentals to step in and stop momentum...at least in the short-run. This dynamic is amplified during periods of less liquidity and lighter volumes, such as the holidays. However, unless such declines are validated by legitimate deterioration in economic conditions, they are unlikely to endure.

We would be remiss to not mention that there are other concerns driving uncertainty in the markets, including but not limited to the following:

- **Global Economic Slowdown** – The overriding concern is that global economies are slowing down.

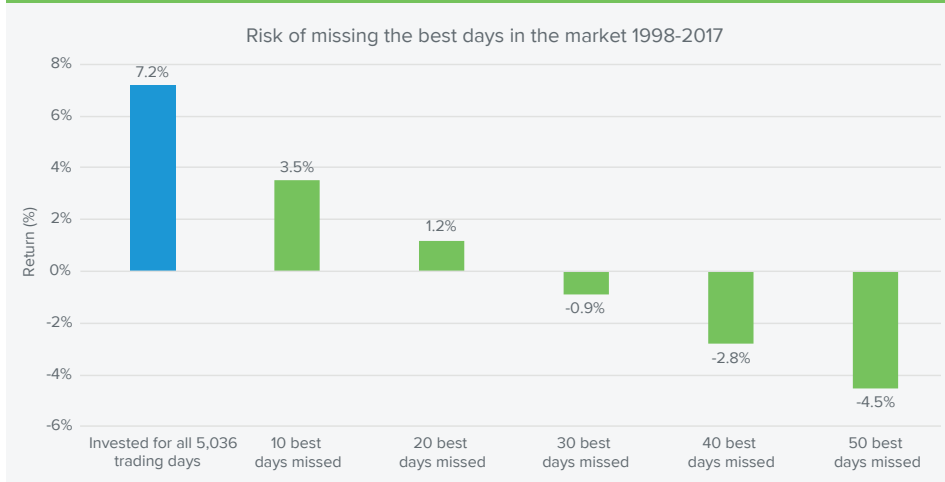
When the markets believe that trade and monetary policies are counterproductive to growth, they sell off.

- **U.S. Government Shut**

Down – Government shut-downs don't normally disrupt the economy or markets. However, when President

Government shut-downs don't normally disrupt the economy or markets. However, when President Trump reversed his previous commitment to sign a bill to keep the government open, the markets whipsawed.

EXHIBIT 3: MISSING THE BEST DAYS COSTS DEARLY



Source: Morningstar

Trump reversed his previous commitment to sign a bill to keep the government open, the markets whipsawed in reaction. The rumor that President Trump might fire his newly appointed Fed Chairman amplified concern.

• **Lack of Confidence in Government** – It is fair to objectively state that the markets aren't just worried about the Fed. Political drama is also wearing nerves thin. As strategists note, the President's actions make policy decisions even tougher to calculate in 2019. Markets don't like uncertainty and chaos. The political scene has plenty of both.

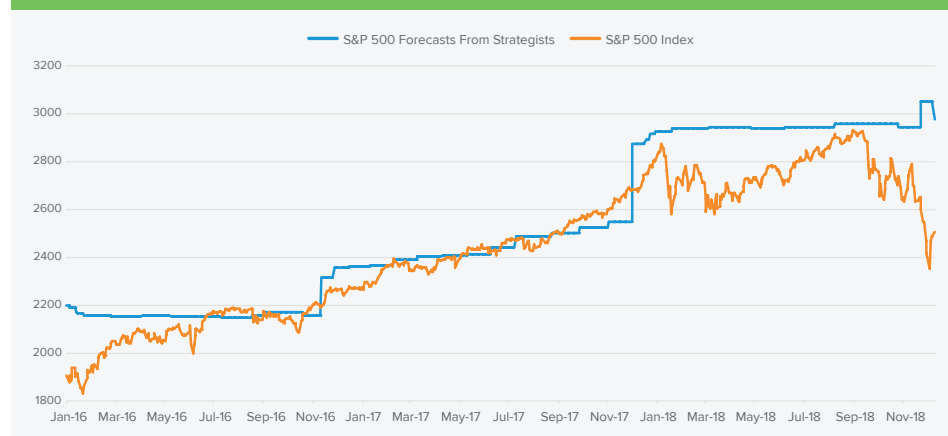
PERSPECTIVES

1. Framing Actual Returns – It is important to avoid the pitfalls of behavioral finance, including anchoring and recency bias. For example, the S&P 500 was up nearly 22% in 2017. As of December 31st, the trailing three-year annualized return is still a positive 8.6%.

2. Market Timing – Market volatility can be hard to stomach particularly if you are watching events daily. The frequency of reviews often leads to making decisions based on emotions instead of facts. The decision to sell must then be followed by the decision to buy, but the question is “When do I buy?” Some of the largest market rebounds come on the heels of market sell-offs. Exhibit 3 illustrates that sticking to a financial/investment plan and riding out volatility may prove beneficial.

Market timing just doesn't work. Even professionals whose jobs are to predict these things didn't foresee the fourth quarter playing out as it did. According to a Bloomberg survey of market strategists, the average S&P 500 price target for 2018 was 17% higher than where the year ended. As Exhibit 4 shows, S&P 500 performance was in line with strategists until the fourth quarter. These same analysts still see a positive road ahead with an average S&P 500 return for 2019 of 18.7%

EXHIBIT 4: STRATEGISTS DIDN'T SEE FOURTH QUARTER SELL-OFF



Source: Bloomberg.

Market volatility can be hard to stomach particularly if you are watching events daily. The frequency of reviews often leads to making decisions based on emotions instead of facts.

EXHIBIT 5: 2018 PREDICTIONS REVISITED

Prediction	Current Status
Tax Reform Policies Boost Economy/Markets	Yes. Tax reform incented spending and manufactured higher profit margins and earnings. GDP picked up to an annualized clip of 3.4% as of the third quarter. Corporate earnings are expected to grow 20.2% for 2018 with the fourth quarter marking the fifth straight quarter of double-digit earnings growth. Capital expenditures and consumer spending grew.
The U.S. Economy Has a Better Year than 2017	Yes. Not only did GDP pick up, job growth continued, wages increased, consumer confidence increased, etc.
Equity Markets March Higher but Volatility Returns	Yes and No. U.S. stocks marched higher for 9 months but ended down for the year as did international equities. Yes, volatility returned with a bang.
Interest Rates Rise, Challenging Bonds	Yes. Fed Funds rates did go up and the 10-year Treasury rate started at 2.41% and ended at 2.69% after hitting a high of 3.24% on November 8th.
U.S. Becomes #1 Oil Producer, Surpassing Russia and Saudi Arabia	Yes. It occurred sooner than we thought.
Trump Administration Takes on Tech	No Rating. While hard to gauge, improvements were made with some of the more egregious social media exploitations.
Bitcoin Bubble Bursts	Yes. Bitcoin plunged 75% during 2018 and 80% from its peak in late December of 2017 when we made the call.
Major Political Shake-up Occurs (You Pick)	Yes and No. This is rather subjective, and we gave readers two choices to consider. We would say that a Democratic blue-wave in taking over the House and the continued political drama qualifies for a continuation.
U.S. Takes First in the Winter Olympics	No, but can you blame us?
Chicago Cubs Beat Houston Astros in World Series	While we got one of the teams correct for the World Series, neither Chicago nor Houston won. We were wrong, but can you blame us?

higher. I wouldn't bank on these forecasts. However, even if these numbers come down, it could be a better-looking equity runway for 2019.

MORE QUESTIONS THAN ANSWERS

As we get further into this economic cycle, the level and importance of questions increases. As such, we are more focused on big questions that may determine the outcome for 2019 than forecasting. Here are some of the major questions that could drive

markets for 2019 and how we are assessing them.

1. Trade & Tariffs – Will the U.S. and China come to a productive outcome?

It is growing increasingly obvious that China's economy is slowing and that tariffs are having a negative impact on other foreign nations and U.S. companies. Will the Trump administration be incented to reestablish positive economic momentum going into a pre-election

The incremental negative impact of tariffs could trump fiscal stimulus in 2019.

year? Most likely. A China trade deal will help. Signs appear that the leaders of the two largest global economies want a positive outcome, but handicapping policy moves is harder than ever.

While calculations can be made on policy decisions (i.e., first derivative calculation), the subjective downstream (i.e., second derivative) negative impact based on animal spirits is harder to calculate and potentially much more damaging. Animal spirits represent the influence that emotions can have on economic behavior of corporate executives, consumers and investors. Either way, the incremental negative impact of tariffs could trump fiscal stimulus in 2019. (Current estimates of a potential negative headwind of \$50 to \$251 billion may exceed incremental fiscal stimulus of \$122 billion.)

2. Tightening Monetary Policy – Will the Fed be dovish or hawkish in 2019?

The Fed has two mandates - to manage for healthy employment and inflation. With our economy currently at full employment, wage growth at 3.2% and inflation at just 2.2%, a strong case can't be made that the economy is heating up too fast, which would warrant many additional hikes. However, the Fed may be looking

EXHIBIT 6: TARIFF IMPACTS

TARIFFS FIRST DERIVATIVE - ESTIMATED IMPACT (2019)

\$50 to \$251 Billion



TARIFFS CHAIN OF EVENTS & SECOND DERIVATIVE IMPACT (2019)

Decreases competition
Increases costs and inflation
Increases interest rates
Increases uncertainty
Decreases investment
Decreases growth
Decreases jobs

SECOND DERIVATIVE IMPACT

\$Unknown

Source: TC Wealth Partners, 2019 incremental tariff impact from Strategas Research Group.

at the data with a longer lens than the market. They may prefer higher normal rates, which would give them more tools for when the next recession occurs.

Exhibit 7 illustrates that the Fed has more room to run in increasing rates before monetary policy becomes too restrictive, and thus creates a recession. The real Fed Funds rate (actual minus inflation) has recently climbed above 0%. The accompanying table shows the real Fed Funds rate at the start of previous recessions.

However, two other dynamics need to be considered: the Fed's balance sheet and foreign demand. The Fed is running off the large balance sheet that was created during the Great Recession. Not reinvesting those assets impacts the demand and supply balance of longer-term bonds and consequently drives up interest rates. However, foreign demand for higher yielding U.S. bonds (treasuries and munis) could counterbalance the Fed's balance sheet liquidation.

Either way, the Federal Reserve has

The Fed has more room to run in increasing rates before monetary policy becomes too restrictive, and thus creates a recession.

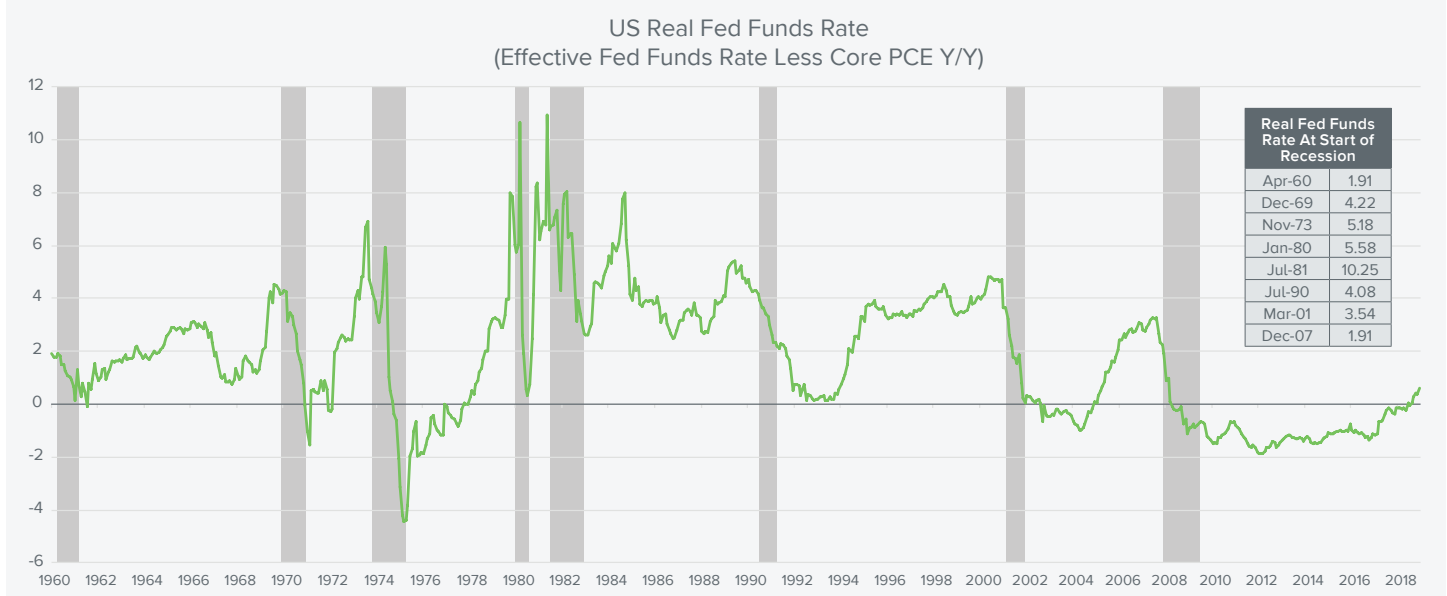
already softened their commentary on and outlook for interest rate hikes in 2019. We suspect fewer rate hikes and a more accommodative Fed.

3. Yield Curve – Will the U.S. yield curve invert, and will that foretell a recession?

This brings us to one of the most important and predictive metrics for economic growth and a potential recession: the yield curve.

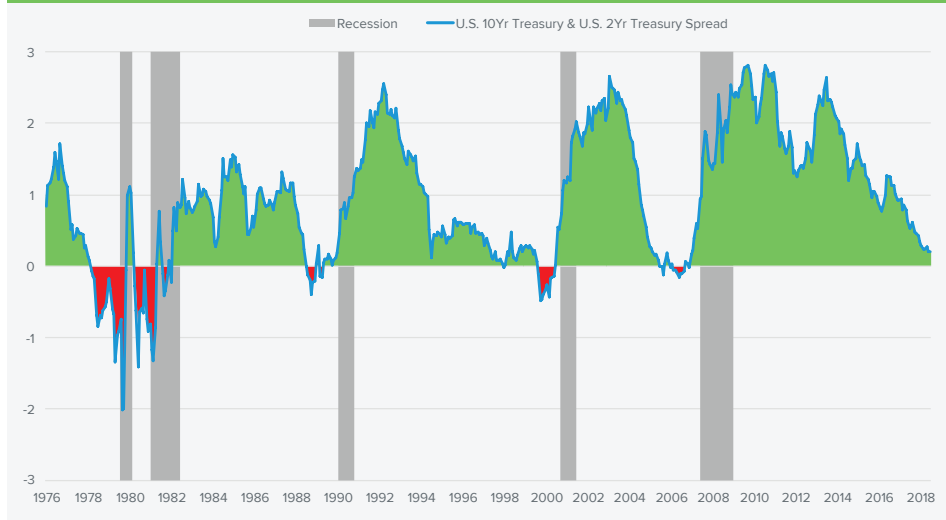
The Fed has now raised short-term

EXHIBIT 7: REAL FED FUNDS RATE SUGGESTS ROOM TO RUN



Source: Bloomberg, Strategas.

EXHIBIT 8: YIELD CURVE IMPLICATIONS



Source: Bloomberg.

Fed Funds rates nine times during this economic recovery. The Fed uses these rates to either stimulate or slow the economy. It is customary for the market to react and adjust longer-term interest rates in accordance with the Fed's short-term rate controls. As mentioned above, the Fed's balance sheet reduction and foreign demand may be impactful in determining the 10-year interest rate.

Herein lies the rub. It is healthy for the economy to have a large spread between short-term and intermediate/long-term rates. Banks are the backbone of lending and a significant financial provider of economic growth. Banks need to borrow money at short-term rates and lend at higher long-term rates.

If the yield curve is normal, then short-term rates are lower than long-term rates. If the yield curve is flat, then short-term rates are generally close to long-term rates. If short-term rates are higher than long-term rates, then

you have an inverted yield curve. An inverted yield curve serves to choke off economic growth as banks aren't incented to lend. Recessions have historically occurred 18-24 months on average after such occurrences; stock market peaks don't usually occur until a few months prior to that.

We suspect the yield curve will remain flat. But even if it goes negative, the economy and markets will still have some room to run.

4. Geopolitics & Fiscal Stimulus – Will governments forego austerity measures and cede to populism and provide fiscal pumping?

It is growing increasingly likely that foreign governments will start increasing fiscal stimulus either through tax cuts or spending. This is particularly more likely as foreign central banks are no longer cutting interest rates. Regarding the second largest economy, China has already made stimulus moves, and more are on the way. China

cut tariffs on December 23rd on over 700 items, albeit it wasn't the major news we were looking for.

Furthermore, the final outcome of Brexit, new leadership developments in Germany, civil unrest in France and the Italian budget negotiations with the European Union are a few other geopolitical dramas worth watching.

We suspect new fiscal spending may be the appeasement path politicians take that could also support equity markets.

5. Deficits & Debt – Will fiscal spending add to budget deficits and overall debt levels? Will markets start focusing on upcoming government and corporate debt cliffs?

In the United States we hit nearly \$1 trillion in our 2018 budget deficit, and the same will occur in 2019. The tax cuts and fiscal spending are currently contributing to increases in the deficit and overall debt. These are significant deficit levels on a U.S. economy of approximately \$20 trillion. Providing fiscal stimulus picks up, debt levels will increase here and abroad.

Recessions have historically occurred 18-24 months on average after inverted yield curves; stock market peaks don't usually occur until a few months prior to that.

U.S. government and corporations have a large amount of debt coming due in the next two to three years. Assuming we are nearer a recession in 2020, then the markets may encounter a liquidity problem, which could drive even more volatility.

We suspect that corporate and other higher risk debt may encounter rougher patches ahead.

PREDICTIONS FOR 2019

During volatile times it is easy to be swept up by emotions. The wisest of investors evaluate objectively and dispassionately. And, while there are numerous questions to ponder and future economic data to evaluate, it is important to remember that there are always risks and opportunities. So, we must come back to compartmentalizing these issues across three primary considerations – fundamentals, valuations and sentiment.

Fundamental Outlook for Growth

While global economic growth may be slowing, it is still positive. All eyes

are on China and the U.S. It is still safe to state that the U.S. and China are the envy of the world. And, if our two countries can produce a productive outcome on the trade policy front, then markets may reward investors. In the meantime, a U.S. recession is not in sight, but the probabilities of such an occurrence in 2020 are starting to creep up to levels worthy of consideration.

Valuations

Valuations on equities are attractive and more attractive than bonds. For example, the equity risk premium (corporate earnings minus Treasury yields) is over 300 basis points. According to Strategas, the forward one-year returns for domestic stocks during such levels is over 10%. As Exhibit 11 shows, U.S. stocks are not only attractive on a historical basis, but international equities are even more compelling.

Sentiment

In the long-term markets tend to be weighing machines as they evaluate

A U.S. recession is not in sight, but the probabilities of such an occurrence in 2020 are starting to creep up to levels worthy of consideration.

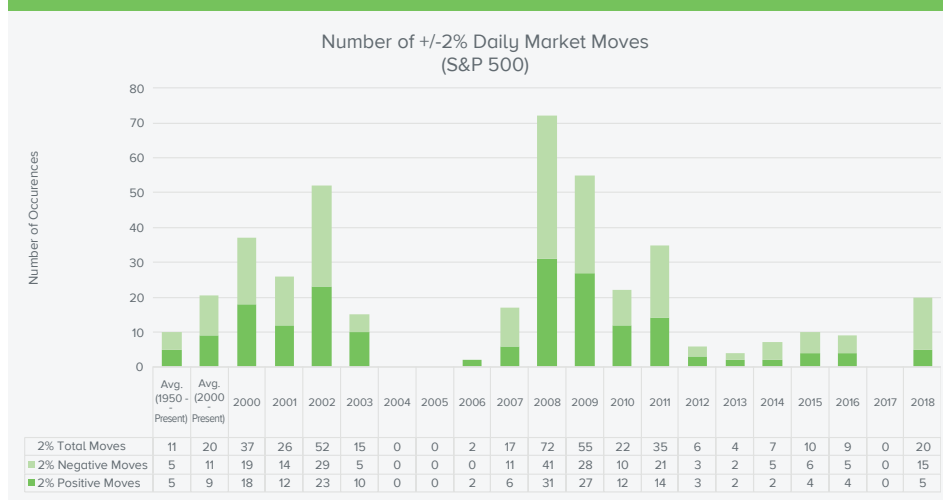
fundamentals and valuations.

However, over the short-term they are voting machines. During the fourth quarter we saw uncertainty, inconsistency and chaos drive sentiment into negative territory. While technical indicators for equity markets appear to have bottomed out, we must also continue to watch the sentiment of corporate America and consumers as they sort through the major issues we have discussed.

This leads us to predictions for 2019 – many of which have been highlighted in the questions above.

- 1. Trade & Tariffs** – U.S. and China will come to an agreement, but we should expect more drama before we get there.
- 2. Monetary Policy** – The Fed will slow down the number of interest rate hikes in 2019, but this will be data dependent.
- 3. Yield Curve** – The yield curve will continue to flatten creating more challenges for fixed-income investors.
- 4. Geopolitics & Fiscal Stimulus** – A slew of geopolitical issues will drive volatility, and politicians globally will

EXHIBIT 9: VOLATILITY IS BACK, EXPECT MORE



Source: TC Wealth Partners.

EXHIBIT 10: MARKET RECAP
PRIMARY MARKET RETURNS AS OF 12/31/2018

EQUITIES	3 Mo	YTD	1 Yr	3 Yr	5 Yr	10 Yr
Global Equities	-12.75	-9.42	-9.42	6.60	4.26	9.46
Domestic Large Cap	-13.66	-4.94	-4.94	8.59	7.83	12.40
Domestic Small Cap	-20.29	-11.35	-11.35	6.93	4.00	11.52
International Developed	-12.54	-13.79	-13.79	2.87	0.53	6.32
Emerging Markets	-7.47	-14.58	-14.58	9.25	1.65	8.02
MLP	-17.30	-12.42	-12.42	-1.06	-7.31	9.58
Global Infrastructure	-5.12	-9.50	-9.50	6.92	4.10	7.58
FIXED INCOME	3 Mo	YTD	1 Yr	3 Yr	5 Yr	10 Yr
Global Bonds (USD)	1.20	-1.20	-1.20	2.70	1.08	2.49
Domestic U.S. Aggregate	1.64	0.01	0.01	2.06	2.52	3.48
U.S. Corp High Yield	-4.53	-2.08	-2.08	7.23	3.83	11.12
U.S. Floating Rate	-3.45	0.44	0.44	4.83	3.05	8.57
International Developed (USD)	2.42	3.58	3.58	3.68	4.49	3.92
International Developed (Unhedged)	1.55	-1.68	-1.68	3.26	0.42	1.40
Emerging Market Debt (USD)	-1.26	-4.26	-4.26	5.15	4.80	8.20
Tax Exempt (Munis)	1.51	1.69	1.69	1.48	2.03	2.95
Cash	0.56	1.87	1.87	1.02	0.63	0.37
Real Estate - Global	-5.69	-9.18	-9.18	0.46	1.51	6.25
Real Estate - U.S.	-6.45	-5.04	-5.04	1.63	6.01	10.73

Source: TC Wealth Partners, Bloomberg.

succumb to fiscal stimulus. This may include central banks becoming more accomodative.

5. Deficits & Debt – The U.S. annual budget deficit will approach \$1 trillion. Politicians may seize on this, creating more political turmoil.

6. U.S. Economy – It will continue to expand and post the longest recovery ever.

7. Equities Perform Better – Domestic and/or international equities will do better than 2018.

8. Volatility Will Increase – As we

highlight in our questions, there are many more variables, and the importance of each grows the later we get into this economic cycle. As Exhibit 9 shows, volatility spiked back to historically normal levels. Expect more of the same in 2019.

9. Chicago Bears Playoff Bound – On the heels of a promising 2018 season, the Bears will make the playoffs in 2019. We will wait until January 2020 to decide if they make it to the Super Bowl.

10. Chicago Cubs World Series – Going with the same prediction from last year. Chicago Cubs make it to the

World Series but lose to the Houston Astros in seven games.

MARKET RECAP

US equities had been positive for most of the year following strong economic data, but during the fourth quarter lingering concerns over Federal Reserve policy, trade policy and the partial government shutdown shook investor confidence sending the markets sharply lower. During the quarter, the S&P 500 dropped 13.7%, and for the first time in 9 years posted a negative return, down 4.9% in 2018.

The unresolved tariff dispute between the U.S. and China, the tightening by the Fed, the rising U.S. dollar and the slowing global economy negatively impacted many international markets. During the fourth quarter, international equities outperformed the U.S. for the first time all year. International markets declined by 4.8% in December, 12.5% for the quarter and 13.8% for the year. On the heels of 37% gains in 2017, emerging markets saw losses of 14.6% for the year, but responded much more favorably than domestic stocks when news of tariff progress was made.

On the heels of 37% gains in 2017, emerging markets saw losses of 14.6% for the year, but responded much more favorably than domestic stocks when news of tariff progress was made.

EXHIBIT 11: EQUITY VALUATIONS

	P/E	20-yr. avg.	Div. Yield	20-yr. avg.
S&P 500	14.4x	15.8x	2.3%	2.0%
ACWI ex-U.S.	11.5x	14.2x	3.8%	3.0%
As % of U.S.	80%	90%	165%	149%

Source: JP Morgan.

High quality fixed-income assets benefited from the market's risk-off sentiment, finishing the month with solid gains and rebounding from poorer performance during the year. Even as the Federal Reserve hiked rates by 25 basis points in its December meeting, Treasuries rallied strongly across the yield curve, with rates on the 10-year Treasury ending the year at 2.69%, their lowest level since January. The broad U.S. bond market returned 1.8% to investors in the fourth quarter and eked out a gain of 0.01% for the year. High-yield fixed income, which is typically less affected by rates, had a rough end to the year. It saw a loss of 2.1% in December, leading to a quarterly loss of 4.5% and an annual loss of 2.0%.

PORTFOLIO IMPLICATIONS

Pulling all this together, we provide portfolio implications for the following investment categories.

Equities

Investing in equities can be particularly challenging now unless you are immune to the behavioral finance pitfalls of recency bias (recent returns were challenging in the fourth quarter). However, despite the sell-off and domestic headwinds of monetary policy, concerns for the length of this economic recovery and geopolitical noise, domestic stocks look attractive. The tailwinds of fiscal

stimulus, including corporate tax cuts and corporate repatriation, are creating forward-looking valuation levels that are attractive.

It is estimated that U.S. companies repatriated \$700 billion in overseas earnings in 2018. Much of this was and will be used to financially engineer better earnings through stock buybacks, and some is going and will continue to go to increasing dividends to shareholders. However, neither of these generate growth. The real focus will be on whether they continue to use these resources for pro-growth policies, such as capital expenditures.

On a related note, diversification can also be difficult unless you are immune to the behavioral pitfalls of anchoring and home bias as a

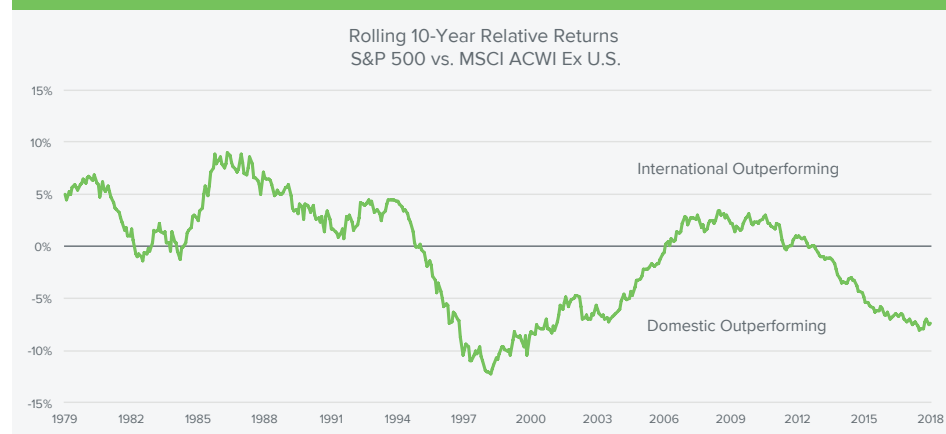
U.S. investor. The bottom line is that after superior returns in 2017, many international equity markets suffered in 2018 due to trade war concerns, rising U.S. interest rates, a strengthening U.S. dollar and some softening economic data.

Looking forward, international equity valuations are even more attractive than in the U.S. Exhibit 12 illustrates that the returns of international equities have trailed the U.S. on a rolling 10-year basis for a while with such a gap not seen since 2001/2002. As one international portfolio manager stated, "I just don't believe that condition is permanent... It will reverse at some point. If you believe in the power of diversification, now is not the time to capitulate on international investing. Now is the time to look for opportunities in places where other investors are running away."

Fixed Income

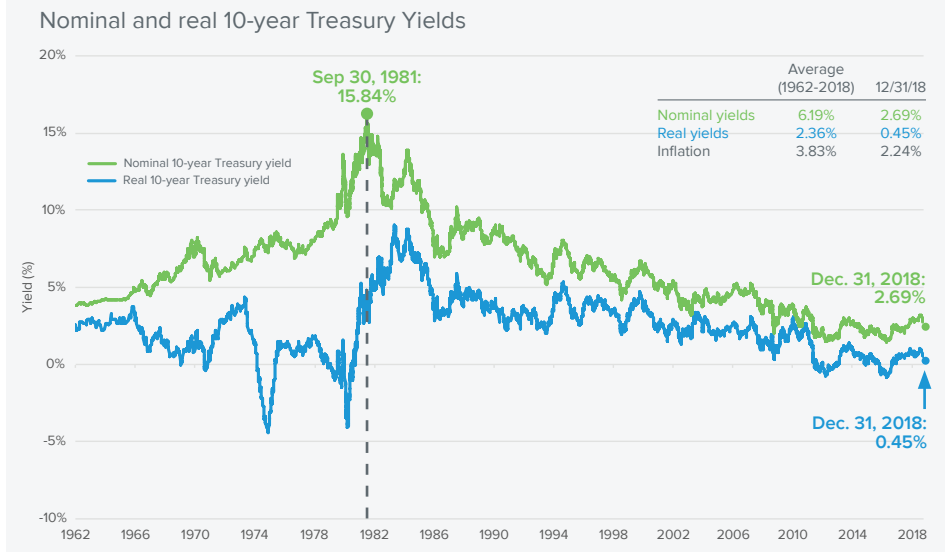
Bonds are expensive, and with rising interest rates the landscape requires acute management. The U.S. Federal Reserve has hiked

EXHIBIT 12: INTERNATIONAL VS DOMESTIC EQUITY RETURNS



Source: TC Wealth Partners, Bloomberg.

EXHIBIT 13: 10-YEAR U.S. TREASURY RATE



Source: TC Wealth Partners, BLS, Federal Reserve, Bloomberg, J.P. Morgan Asset Management. Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for December 2018, where real yields are calculated by subtracting out November 2018 year-over-year core inflation. U.S. Data are as of December 31, 2018.

short-term interest rates nine times during the current tightening cycle. While short-term rates are climbing domestically, longer-term rates should be somewhat contained. Foreign demand for higher yielding U.S. Treasuries may create upward pressure on prices and conversely downward pressure on rates.

Given the state of equity markets and the unappealing fixed-income outlook, it is important to cast a wider net and consider non-traditional strategies to provide returns and manage risk

Unless one considers opportunistic fixed-income strategies, including floating rate securities, the outlook for the fixed-income portion of portfolios may present negative or low returns for the foreseeable future. Nonetheless, fixed income should still be considered for its lower volatility or downside risk characteristics.

Complementary Strategies

Given the state of equity markets and the unappealing fixed-income outlook, it is important to cast a wider net and consider non-traditional strategies to provide returns and manage risk. To address this need, we continue to look at other less-traditional, and lower/non-correlated strategies, such as tactical allocators and lower-risk-mitigating strategies.

Reading between the lines, we are happy to put 2018 behind us. It certainly felt like a bad movie—with

no escape in sight. Unfortunately, much of the noise that drove concerns will persist and answers to questions will dictate how things unfold. In the meantime, we are focused on fundamentals and valuations and creating success for clients one at a time in a goals-based framework. We are looking for a more enjoyable and uplifting movie for all of our clients.

Please pass this message along. Our passion is to help others reach their goals and find comfort with their financial well-being. Be sure to visit our website (tcwealthpartners.com), subscribe to “Reed Between the Lines,” or follow Reed Murphy on Twitter at @BTLReedMurphy if you want to receive regular updates throughout the quarter on his perspective regarding investments and other subject matters.

Thank you for your continued support. ■

NOTEWORTHY

SPONSORSHIPS

WHEATON LIONS CLUB

Reindeer Run
December 2018
Winfield, IL

GIGI'S PLAYHOUSE

“I Have a Voice” Gala
February 2019
Schaumburg, IL

ATTENDED

TAMI BOWMAN

ASPPA (American Society of Pension Professionals & Actuaries)
Winter Conference
Downers Grove, IL

DID YOU KNOW?

Test your market and economics knowledge, and then visit our blog *Of Significance* at TCWealthPartners.com/DidYouKnow to see our answers!



CHRISTMAS SPENDING

Just how much did we spend during the holiday season this year?

- A. \$2.42 Billion
- B. \$5.78 Billion
- C. \$7.20 Billion
- D. \$25 Billion

S&P MOVEMENT

Volatility is back. While we experienced 20 days in 2018 where the S&P 500 moved by at least 2% up or down, how many 1% moves did we experience in 2018 and what is the long-term average?

- A. 20 and 48
- B. 64 and 51
- C. 49 and 30
- D. 35 and 38

ECONOMIC EXPANSION

The U.S. economy should record its longest recovery ever this year. While the runway has been long, the two other longest recoveries experienced economic GDP growth of approximately 40% and 50% from their prior peaks. How much has this economic expansion grown from its prior peak?

- A. 60%
- B. 45%
- C. 30%
- D. 15%

EQUITY GAINS

According to Dalbar, over the last 20 years the S&P 500 gained 7.68%. What return has the average "equity" investor gained for the same time period?

- A. 8.2%
- B. 7.2%
- C. 4.7%
- D. 2.6%

TC Wealth Partners^{LLC}
Trust Company
of Illinois

Investment advisory services provided through TC Wealth Partners, LLC, an investment advisor registered with the U.S. Securities and Exchange Commission. Trust services and retirement plan services are provided by the Trust Company of Illinois, a trust company chartered by the Illinois Department of Financial and Professional Regulation. Past performance is not indicative of future results.