CORBETT ROAD

MACRO MUSINGS

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2018 YEAR IN REVIEW

SUMMARY

- **The market remains volatile, but MACROCAST™ continues to indicate a low probability of a sustained, recessionary bear market.**
- **Weakness in MACROCAST™ is primarily coming from our Technical indicators, as well as some deterioration in our Aggregate Economy indicators.**
- **Cash was the only major asset class that finished the year in the green. It was the top performer for the first time in 4 decades.**
- **The market was down more than 10% in the fourth quarter. This has only occurred 19 times in the previous 75 years. More often than not, it did not lead to further weakness.**

THE MESSAGE FROM MACROCAST™

As a reminder, MACROCAST™ is Corbett Road's proprietary investment model. MACROCAST™ measures the appeal of risk assets by looking at the **VITALS** of the market—**V**aluation, **I**nflation, **T**echnical Analysis, **A**ggregate Economy, **L**iquidity, and **S**entiment. By looking at multiple factors, we can better gauge market conditions and the probability of a major market decline.

The most recent score for MACROCAST™ matches the lowest reading of 2018, which also occurred in January. Despite the drop, the current score suggests a sustained major market decline is unlikely.

The strongest reading in MACROCAST™ the past few years was in the **Aggregate Economy** category, which focuses on leading indicators of economic activity. This category is now neutral.

Our **Sentiment** indicators are positive, thanks to pessimism among investors after stocks fell in the fourth quarter. That may seem counterintuitive, but negative feelings among investors help reset expectations, and stocks do better over the long run when fear is rampant than when market participants are optimistic.

Technicals are weak. Despite the strong start to the year, the S&P 500, Dow Jones Industrial Average, and Nasdaq are still trading below their 200-day moving average trendline (200dma). The market is in an uptrend if it trades above the trendline and in a downtrend if it is below. Volatility also tends to rise when stocks trade below the 200dma.

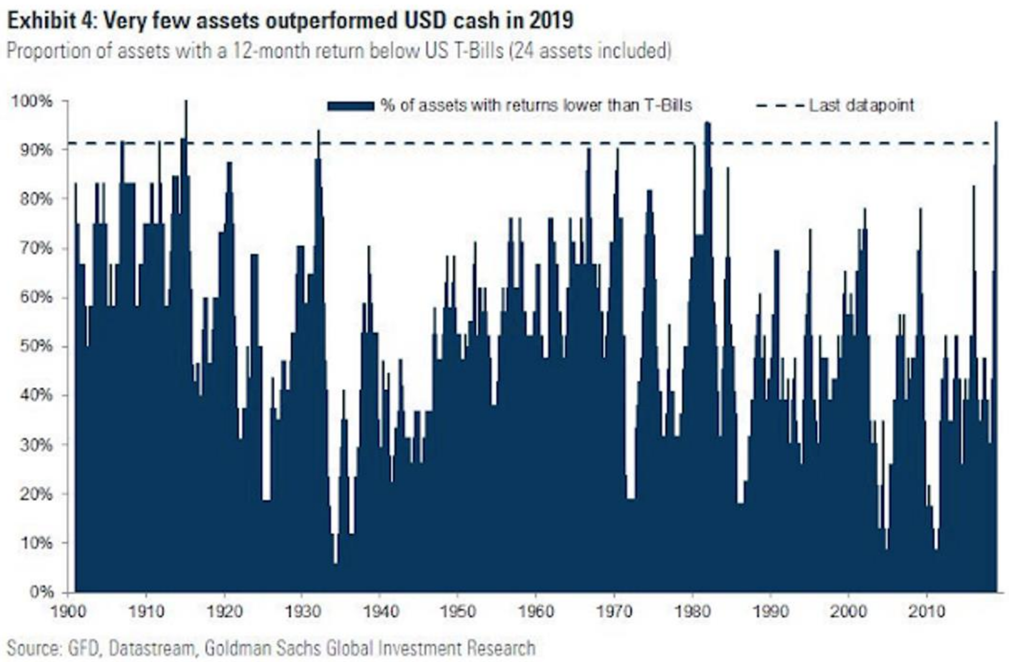
FORGET 2015. 2018 WAS THE REAL YEAR NOTHING WORKED.

At the end of 2015, Bloomberg released an article with the title "The Year Nothing Worked". It seems they jumped the gun and should have saved that headline for 2018. In any given year, there is generally one asset class that provides standout returns. If it is a great year for stocks, you could expect various equity groups to provide double digit returns. For example, in 2017, the S&P 500, International Developed, and Emerging Markets all generated returns of 20% or higher.

In a "risk off" year, you could expect gold or long-term treasuries perform well. In 2011, equity markets were flat while the aggregate bond index was up almost 8% and gold's return was north of 11%.

Not last year. Cash was the only asset class with a positive return, and the 3-month Treasury Bill returned around 2%.

Now, before you go and start stuffing your mattress, note how unusual it is for cash to lead in performance. You have to go back to Reagan's first term to find a time when cash outperformed as many asset classes as it did last year (chart from Goldman Sachs):



*The above chart should read 2018 not 2019

ASSET CLASS REVIEW

Asset Class Returns

2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
REIT 31.6%	EM 34.5%	REIT 35.1%	EM 39.8%	HG Bnd 5.2%	EM 79.0%	REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%	Cash 2.0%
EM 26.0%	Int'l Stk 14.0%	EM 32.6%	Int'l Stk 11.6%	Cash 1.4%	HY Bnd 57.5%	Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l 25.6%	HG Bnd 0.0%
Int'l Stk 20.7%	REIT 12.2%	Int'l Stk 26.9%	AA 7.6%	AA -22.4%	Int'l Stk 32.5%	EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%	HY Bnd -2.3%
Sm Cap 18.3%	AA 8.9%	Sm Cap 18.4%	HG Bnd 7.0%	HY Bnd -26.4%	REIT 28.0%	HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.1%	EM 11.6%	Sm Cap 14.7%	REIT -4.0%
AA 14.1%	Lg Cap 4.9%	AA 16.7%	Lg Cap 5.5%	Sm Cap -33.8%	Sm Cap 27.2%	Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%	Lg Cap -4.4%
Lg Cap 10.9%	Sm Cap 4.6%	Lg Cap 15.8%	Cash 4.4%	Lg Cap -37.0%	Lg Cap 26.5%	AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%	AA -5.6%
HY Bnd 10.9%	Cash 3.2%	HY Bnd 11.8%	HY Bnd 2.2%	REIT -37.7%	AA 24.6%	Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%	Sm Cap -11.0%
HG Bnd 4.3%	HY Bnd 2.7%	Cash 4.7%	Sm Cap -1.6%	Int'l Stk -43.1%	HG Bnd 5.9%	HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%	Int'l Stk -13.4%
Cash 1.4%	HG Bnd 2.4%	HG Bnd 4.3%	REIT -15.7%	EM -53.2%	Cash 0.2%	Cash 0.2%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6%	Cash 0.3%	Cash 1.0%	EM -14.3%

Abbr.	Asset Class – Index	Annual	Best	Worst
Lg Cap	Large Cap Stocks – S&P 500 Index	7.77%	32.4%	-37.0%
Sm Cap	Small Cap Stocks – Russell 2000 Index	7.49%	38.8%	-33.8%
Int'l Stk	International Developed Stocks – MSCI EAFE Index	5.22%	32.5%	-43.1%
EM	Emerging Market Stocks – MSCI Emerging Markets Index	8.26%	79.0%	-53.2%
REIT	REITs – FTSE NAREIT All Equity Index	8.52%	35.1%	-37.7%
HG Bnd	High Grade Bonds – Barclay's U.S. Aggregate Bond Index	3.87%	7.84%	-2.0%
HY Bnd	High Yield Bonds – BofAML US High Yield Master II Index	7.13%	57.5%	-26.4%
Cash	Cash – 3 Month Treasury Bill Rate	1.25%	4.7%	0.0%
AA	Asset Allocation Portfolio*	6.67%	24.6%	-22.4%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/18.

*Asset Allocation Portfolio is made up of 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Some additional insights:

1. ***Bonds provided no gains.*** When the market performs poorly, bonds often outperform, offsetting that weakness. For instance, in 2011 the S&P 500 finished flat, while the aggregate bond index was up almost 8%. 2018 provided no such comfort, as the Agg Bond Index finished flat. However, it is important to note that bonds handily outperformed stocks during the market sell off last quarter. This shows they still provide protection against volatility even without positive returns.

2. ***Emerging markets went to the back of the pack.*** Emerging markets went from first to worst from 2017 to 2018. Notably, the asset class outperformed US equities in the 4th quarter sell off—a good reminder that emerging market stocks remain among the most volatile asset classes.

3. ***Despite finishing negative for the first time since 2008, the S&P 500 outperformed Novel's Asset Allocation strategy for the tenth consecutive year.*** Novel Investor outlines a basic asset allocation portfolio, which they include in the above table under AA. We first highlighted the recent weakness of the Asset Allocation portfolio in 2015. In 2018, despite finishing with a -4.4% return, the S&P once again outperformed the AA portfolio. Despite having a 40% allocation to bonds, it still struggled due to poor small cap and international stock performance. Even with a large bond allocation, the AA model often outperformed the S&P 500 from 2000-2008.

What the Lousy Q4 2018 Might Mean for This Coming Year

The fourth quarter of 2018 was the twentieth time the market was fallen 10% or more in a single quarter since 1945. Bespoke Investment Group looked at all the times this occurred historically and the subsequent performance going forward:

S&P 500 10%+ Down Quarters Post WWII

Quarter	% Chg	Next Qtr %	Next 2 Qtrs %	Next Year %
9/30/1946	-18.83	2.27	1.40	1.00
9/30/1957	-10.45	-5.73	-0.75	18.01
6/29/1962	-21.28	2.78	15.25	26.70
6/30/1970	-18.87	15.80	26.72	37.10
12/31/1973	-10.03	-3.66	-11.84	-29.72
9/30/1974	-26.12	7.90	31.19	32.00
9/30/1975	-11.89	7.54	22.53	25.48
9/30/1981	-11.45	5.48	-3.63	3.65
12/31/1987	-23.23	4.78	10.69	12.40
9/28/1990	-14.52	7.90	22.60	26.73
9/30/1998	-10.30	20.87	26.49	26.13
3/30/2001	-12.11	5.52	-10.29	-1.12
9/28/2001	-14.99	10.29	10.23	-21.68
6/28/2002	-13.73	-17.63	-11.11	-1.55
9/30/2002	-17.63	7.92	4.04	22.16
12/31/2008	-22.56	-11.67	1.78	23.45
3/31/2009	-11.67	15.22	32.49	46.57
6/30/2010	-11.86	10.72	22.02	28.13
9/30/2011	-14.33	11.15	24.49	27.33
12/26/2018	-13.97	?	?	?
	Average	5.13	11.28	15.94
	Median	7.54	10.69	23.45
	% Positive	78.9%	73.7%	73.7%

At the very least, these numbers suggest that poor performance in one quarter was not a harbinger of doom. A year later, the market was higher 15 out of 19 times with a median gain of 23%.

2019 is off to a good start, with a rally of 6% in the market. Still, we advise caution, as last year had a similarly strong start before a sharp 10% decline at the end of the month, leading into February, and a negative finish to the year.

We will continue to look toward MACROCAST™ to determine if any further volatility is the start of a potentially deeper and longer downturn.