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LARGE CAP CORE GROWTH COMMENTARY

- For the year, the S&P closed down 4.39%.
- The US economy continues to perform well with perhaps a bump or two in the road.
- The just released ISM Manufacturing survey for December came in at 54.1, below expectations of 57.5 but still a good reading indicating an expanding economy.
- All told, the job market is in excellent shape.
- One potential problem has been interest rates which have been volatile as of late.

2018 has finally drawn to a close and we say good riddance. For the year, the S&P closed down 4.39%. Not too horrible for a down year although it was the worst annual decline since 2008. However, for the fourth quarter, the index fell 13.52% and for December the decline was 9.03%, the worst December since 1931! The Russell 1000 Growth Index, our benchmark, followed a similar path but was down 15.89% for the quarter and 8.60% for the month. The downside started at the beginning of October, as often seems to be the case, and ran through the last week of the year. Ten of eleven sectors were down for the quarter with utilities, the most defensive of sectors, posting a gain of 0.50%. Energy was the hardest hit sector, dragged down by falling oil prices which fell from $76 a barrel in October to $43 in December, down over 40%. Technology, the stellar performer for most of the year, fell 17.68% as the FAANGs stumbled badly for the period from not only high valuations but, suddenly, fears arose concerning fundamentals and business models. Apple Computer, which only joined the "four comma club" ($1 trillion market cap) last quarter, lost 37% from high to low in the fourth quarter and is back to only three commas for now. Much of the damage in December was probably due to tax selling where stocks with large losses are hit with seeming non-stop selling to lock in a tax loss prior to yearend. Sometimes these stocks will bounce in January in what is called the "January Effect."

Our Large Cap Growth Model performed well in the fourth quarter. However, it lagged the Russell Growth Index for the year by just seven basis points. Posting a return of -1.58% versus the benchmark's return of -1.51%. The poor performance of the FANG-type stocks was a major factor for the quarter with the NYFANG Index falling 19.86% for the period. While the LCCG Model is fairly heavily weighted in technology stocks, it is less so in the very-high PE names and this really boosted our performance. Our top performing sectors for the fourth quarter were Materials which were down "only"5.73%, Staples which fell 6.83%, and Health Care, down 7.25%. Health Care and Staples are, of course, less affected by the economy so it is not surprising to see them near the top. Conversely, our poorer performing sectors were Energy, down 24.23%, Communication Services, which fell 20.63% and Technology, down 17.11%. As for individual stocks, Eli Lilly won the performance derby by gaining 8.39 %. The company gave good guidance and had excellent reports on Trulicity. Verizon, a defensive name, and Coca Cola also did well. Lagging names included Activision Blizzard, Square Inc., and Schlumberger.

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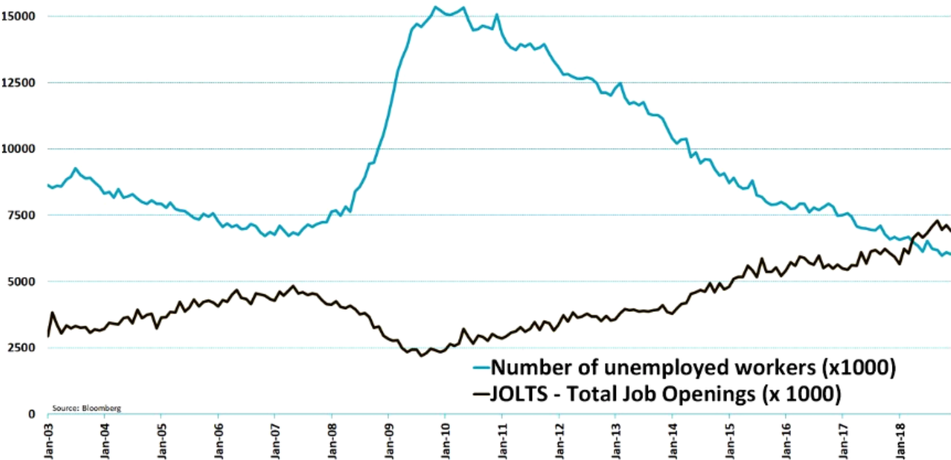
Turning to the economy, the US continues to perform well with perhaps a bump or two in the road. The just released ISM Manufacturing survey for December came in at 54.1, below expectations of 57.5 but still a good reading indicating an expanding economy. Problematic however, are the two most forward-looking indices in the survey: new orders and production, which posted sizable declines. New orders declined 11 points to 51.1 and production fell 6.3 points to 54.3. The impact of tariffs undoubtedly had an impact on these numbers. The ISM Non-Manufacturing Survey declined to 57.6 versus expectations of 58.5. This is a minor decline and note that for 2018 the index averaged the highest reading since the series began in the late 1990s. Services growth was broad with 16 of 18 industries reporting growth while only mining posted a decline. Obviously, services would be less impacted by tariffs. US employment statistics continue to look very strong. The December non-farm payrolls soared past the consensus, posting an increase of 312,000 versus expectations of 184,000. There were also revisions to past reports that added 58,000. The unemployment rate nudged up from 3.7% to 3.9% but that was due to an increase in the labor force of 419,000, a positive development. November's 3.7% rate was the lowest in almost 50 years. Average hourly earnings rose 3.2% on a year/year basis. And the recent job openings data, known as JOLTS, while showing a slight decline, still shows there are more job openings than the number of people seeking work by about 800,000. All told, the job market is in excellent shape. One potential problem has been interest rates which have been volatile as of late. Rates surged in September through November as Fed Chairman Powell made a series of seemingly "hawkish" comments. But, as the stock market plunged, Powell and other Fed members changed their tone to a more "dovish"one. The ten year treasury interest rate had hit 3.24% in November but after Powell's comments rates started falling. By year end the 10 year rate was down to 2.68% and the speculation was for fewer than the three 2019 rate hikes previously expected. Some economists have speculated that the Fed may actually end up cutting rates in 2019. Lower rates would especially be a boon for the weakening real estate market.



Source: Bloomberg

Turning to corporate profits, S&P 500 earnings were quite strong for the first three quarters in 2018 and fourth quarter earnings season, which begins shortly, is expected to produce another double-digit result. Current consensus for 4Q2018 is for growth of 11.4%. If accurate, it would be the fifth quarter in a row of double digit growth for the index. Of course, it will be the last quarter to be boosted by last year's tax cuts so growth is expected to fall back into single digits for 2019. Current FactSet consensus for 2019 is earnings growth of 7.4%, a fairly strong number given the tough comparison to 2018.

With the fourth quarter market pullback, equity valuations look much more attractive as we enter 2019. This has been the element that has been missing for the last couple of years. At the end of the year, the S&P 500's 12 month forward PE had fallen to 14.1x, well below the five year average of 16.4x and the December 2017 high PE of 20.0x. Note that from the 2017 high, the index PE ratio has fallen about 30%. With the decent earnings growth anticipated for 2019 and somewhat less hawkish Federal Reserve, we have noted the stage is being set for a strong upward bias for stocks. Of course there are headwinds. We will have to deal with divided

government now that the new Congress has been sworn in. We are headed for gridlock but that is not necessarily a bad thing, and history shows that markets often perform better during periods of divided government. Basically, it keeps politicians of both parties from creating too much economic mischief. From a technical perspective a lot of damage has been done to the charts, so markets are not likely to go up in a straight line. That said, in late December we got into an extremely oversold condition followed by a very powerful positive volume surge. This can often mark at least a near-term bottom in stocks.

Top 10 Model Holdings [1]

Microsoft Corp.
Apple, Inc.
Alphabet Class C
Home Depot, Inc.
O'Reilly Automotive, Inc.
UnitedHealth Group, Inc.
JP Morgan Chase & Co.
CDW Corp.
Cisco Systems, Inc.
Texas Instruments, Inc.

% of Total Portfolio: 38%

[1] Model Portfolios are based on a hypothetical account managed during the current quarter. Actual characteristics and income may differ materially from model. As of 12/31/2018.

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