LASSUS WHERLEY
A Subsidiary of Peapack-Gladstone Bank
...a View from the Top
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The Good, The Bad, and The Really Ugly!

We start with our thoughts on recent happenings in the financial markets and end with an answer to a timely question from a client.

Happy New Year and welcome to 2019. Roller coasters are one thing but when the speed is so fast it truly does create that feeling in the pit of your stomach. The financial markets have taken us on quite the exciting ride over the last few months and headline risk continues to drive much of this volatility.

We went from positive financial markets through September to a lot of craziness starting in October and continuing through December.. Ending with one of the worst Decembers ever. There are many factors feeding the shakiness in this market and we will discuss a few of them in this newsletter.

It is really difficult to define exactly what triggered the downturn beginning in October because there are many moving parts. There are a few things we believe have been instrumental in creating much of the negative sentiment.

Washington headlines are certainly not helping the overall situation and continue to create uncertainty in the financial markets. Financial markets and those of us who invest in them really dislike uncertainty. Unfortunately we currently have a lot of uncertainty concerning all the factors we track.

As we discussed in the last VFT, rising interest rates, the continuing trade war with China, and the end of accommodative policies are some of the factors

making headlines.

Although many have criticized the Fed for the latest rate increase in December, it appears to us that it was a necessary decision in order to make sure there is room to reduce rates when we eventually enter the next reces-

sion. Some would argue that it was really Fed Chairman Powell's comments that the financial markets reacted to when he stated there could be more increases in 2019. The economy has continued to grow at a slow pace and we just had one of the most successful holiday seasons for retail in a long time. Based on these results we seem to have a way to go before entering that recession territory. We will continue to monitor growth and look for signs of an approaching recession but we aren't seeing those signs yet.

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My crystal ball has not been very clear lately so I cannot predict what this market is going to do in the short term, but we do expect some upward movement interspersed with downward movement. Given that the economy is still reasonably healthy, the bull market may not be dead yet. Everyone is talking about a bear market but there is still the possibility that we are experiencing a very steep correction vs. a bear market. Only time will tell whether it is a correction or turns into a bear market. The short-term trend has been pretty convincingly down but the long-term trend still seems to be up.

And then we have China and the ongoing trade negotiations or lack of negotiations. We are still holding out hope for some type of agreement and evaluating what the impact will be on the economy and the financial markets.

I saw an article on CNBC.com that quoted Wharton's Jeremy Seigel talking about the motivation for both Trump and Xi Jinping to make a deal. The premise was that China cannot afford a further contraction of the economy and Trump is very focused on the stock market so this should drive them to talk. We can certainly hope that this is true and we see some results soon.

We also have the Democrats taking back the House and the Republicans holding onto the Senate after the mid-term election, with plenty of excitement around several races.

Another risk we have hanging over our heads is the partial government shutdown. There doesn't appear to be an end in sight at this point but regardless of whether it ends tomorrow or goes on for a much longer period of time there will be a negative financial impact on the economy. The latest word is that there will be a meeting between President Trump and congressional leaders from both parties. Hopefully they

will actually negotiate and not just lecture one another.

As we evaluate the risks for both the economy and the financial markets, one of the risks is certainly what is happening with the indictments of people involved in the 2016 presidential election and many questions surrounding others. So we will stay tuned and watch as events unfold in Washington, D.C. and around the world.

There have been many developments including those mentioned above but none completely explain the extreme volatility in the financial markets in the 4th quarter and continuing in the first few days of January. Some economists including Dr. David P. Kelly, CFA and Chief Global Strategist for J.P. Morgan Asset Management, believe the decline partially reflects the growth of momentum trading and the impact of thin liquidity around the holiday season. We would add that computer algorithms are really good at causing speed-of-light moves in the markets. They are used by some active mutual funds and many hedge funds to make small profits that are magnified by sheer volume.

The reality is that the fundamentals of the market remain strong especially after the recent drop in value. The S&P 500 Index is selling at approximately 14.3 times forward operating earnings which is about 11% below its 25-year average. This is down from the 16.8 times operating earnings we saw at the end of September. The bottom line is the financial market, as measured by the S&P 500 Index, certainly appears to have pretty good value at these levels.

Financial Markets Performance

The result for the financial markets was actually reasonably good until we moved into October. Starting with October the fourth quarter was very difficult and very negative for most markets. The S&P 500 fell 13.52% in the fourth quarter giving back the gains from earlier in the year to end down 4.38% for 2018. The Russell 2000, which we use as representative of US small-cap stocks, was down 20.20% in the fourth quarter and ended the year down 11.01%. As mentioned above, the increase in volatility and dramatic drops can be at least partially attributed to an increase in momentum trading and probably computer algorithms which drive some of the really quick moves in the markets. Also, headlines continue to drive volatility and we don't expect that to change any time

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The international financial markets also increased in volatility with the EM, which represents emerging markets including China, Russia, Brazil and India, dropping 7.47% in the fourth quarter and ending down 14.58% for 2018. The EAFE, which we use to represent Europe and Asia in the large-cap international arena, was down 12.54% for the fourth quarter and 13.79% for the year. The only positive performance for the year 2018 was found in bonds, with municipal bonds outperforming according to the BBgBarc Municipal TR USD index ending the year at a positive 1.28%. The US fixed income corporate arena as represented by the BBgBarc US AGg Bond TR USD index showed a plus .01% return for the year, which was basically breakeven.

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Although we are dealing with continuing volatility in the financial markets, the economy is still in reasonably good shape and contiues to grow. Many of the developments we have discussed will continue to create headline risk and drive ongoing volatility in the financial markets.

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Question: *What do you think will happen when the turnover in Congress takes place in January?*

Answer: Based on discussions within the Democratic caucus we will probably see many bills brought forward very quickly including one to bring government workers back from the partial government shutdown. There will be a lot of discussion between the House and the Senate given that the two legislative branches are under different party control.

We are hoping to see more bipartisan negotiation around the environment, immigration and international relationships but time will tell. The reality is that it will be a very interesting first few months given the many differences between the 2018 House and the Democratic-controlled 2019 House. The only way for Congress to move forward with positive action is if both parties work together at some level.

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Given the many moving parts of the economy and the financial markets we will continue to review and rebalance as needed to keep portfolios in line with their strategic target asset allocations and maintain cash levels as needed. We can't fix the uncertainty in the financial markets but we can make sure we are focused on long-term objectives. That long-term focus is even more important during a time when there is much turmoil in the world.

Please keep in touch and remember that you are a long-term investor regardless of what happens in the financial markets in the short term. You know our mantra. We are long-term investors!!!!

Let us know if your cash needs have changed or there is something else we can help with. Please let us know if you have any questions. And remember to practice that deep breathing when the world starts to get to you.

We all have those days where we wonder if we have stepped into another dimension but we manage to work our way through and recognize that this too shall pass.

Lassus Wherley News

Betty S. Thomas has completed the CFP® certification process and is now a CERTIFIED FINANCIAL PLANNER™ professional. It is quite an accomplishment. Congratulations Betty!

Stay warm and try to enjoy this crazy winter!

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