MARKET OVERVIEW
Fourth Quarter 2018

Outlook

The same three pillars of support (policy, earnings, economic growth) which delivered sound performance well into September showed some cracks in the fourth quarter. Tightening financial conditions, slowing economic growth, trade conflicts, and peak earnings led many global markets into correction territory and several into bear market territory. Continued normalization of global monetary policies are in varying stages of threading the needle (U.S., ECB, BoE). Expect Fed attempts to balance market expectations of a prudent pace of normalization with persistent growth, robust labor markets, and modest inflation. Chinese policy responses, renewed patience from the Fed, and a hopeful resolution to U.S.-Sino trade conflict make the case for continuing a cautiously constructive view while latent inflation, margin compression, decelerating growth, Brexit, and several potential policy mistakes warrant close monitoring.

Cautious Observations

- Global growth backdrop has cooled including Europe, China, and the U.S.
- Latent inflation due to tight labor markets, rising wages, and the impact on monetary policy and corporate earnings.
- Continued monetary policy tightening by the Fed (balance sheet & rates), ECB (QE taper), and BoE (rates).
- Political risks include ongoing trade disputes, U.S. ethics investigations, Brexit, and global populist movements (Europe, South America, U.S., Asia).

Constructive Observations

- FOMC accommodative ‘patience’ and acknowledgement of tightening financial conditions and global economic considerations.
- Real fed funds rate remains under 0.50%.
- Continued (1st half 2019) U.S. fiscal stimulus impulse.
- Forthcoming Chinese stimulus (fiscal and monetary).
- Continued deregulatory trends in the U.S.
- Easing strength in global economic fundamentals and corporate earnings.

Underweight	Neutral	Overweight
Fixed Income		Equity Cash & Equivalents

Equity tilt—Overweight U.S. relative to international markets
Fixed income tilt—Short duration and credit bias
Alternatives tilt—Emphasize low correlation and income generation

Economic Overview

Growth

Fourth quarter GDP is expected to cool to 2.5%-3.0% range from the 3.5%-4.0% level in the prior two quarters. December U.S. ISM non-manufacturing and manufacturing survey data slowed from unsustainably high levels mid-year to 57.6 and 54.1 respectively. Likewise, global manufacturing and services PMIs have slowed from the mid-50’s to 51.5 and 52.6 respectively and 10 of 30 are in contraction territory, up from 2 last year. The U.S. is on track to establish its longest economic expansion on record by mid-2019. Year end 2017 tax cuts delivered 25.9% Q3 earnings growth with Q4 forecasted at 11.4%, a fifth straight quarter of double-digit earnings growth.

Employment, Consumer, Housing

The labor market remained on a tear during the quarter with December job creation (312,000) among the strongest readings of the expansion and headline unemployment at 3.9% (U-6 steady

at 7.6%). The most recent JOLTs report saw a welcomed drop in the number of job openings but still tallied 870,000 more openings than those actively seeking work while the quit rate fell 1.4% from elevated (and alarming) September levels. Wage growth is materializing with year over year growth of 3.2% and a 3mo/3mo rate of 3.8%. Growing wages are supporting healthy consumer spending growth of 3.5%, near 15-year high UofM consumer sentiment (98.3), and slightly weaker but still elevated consumer confidence readings (128.1). The housing market has slowed but remains well positioned based on an overall aging housing stock and undersupply. Higher interest rates pressured sales and construction activity while prices slowed from 6% to 4% levels.

Inflation

Inflation metrics (PCE, CPI, ISM prices paid) have remained benign, unlikely to stoke any urgency at the Fed. Core PCE of 1.8% and core CPI of 2.2% are near the Fed target of 2% with slowing growth, wage inflation, energy prices, and home prices pulling the numbers in different directions. The NY Fed inflation gauge is at its highest level (3.3%) since 2005 while the Cleveland Fed 10-year multi-factor forecasting model is only registering 2.15%.

Central Banks and U.S. Dollar

The market seems to have, at least temporarily, convinced the Fed that its comfort level with monetary policy normalization is different than what the Fed models or the economy can take. The Fed delivered a ninth rate hike and continued an 'autopilot' pace of balance sheet normalization. The Fed balance sheet is approximately $4t in mid-January, down over $400b from the beginning of the unwind in October 2017 – a notable removal of accommodation. Both rate hikes and the unwind resulted in a strong dollar for much of 2018 but a dovish Fed has pulled the dollar lower to begin 2019. The Fed also officially reduced its 2019 hike expectations from 3 to 2 at the December meeting where it delivered a 0.25% hike and then became "patient" at the firm request of the market gods by early January. The ECB formally ended its QE program at year end but expects to maintain balance sheet reinvestment at least until their first rate hike, no sooner that 2020. The PBOC has responded to slowing growth in China with four cuts to required reserves in 2018 and two more in January, this in addition to tax cuts and infrastructure spending.

On the back of four rate hikes and stronger economy, the USD appreciated 3% in 2018 after a 5.4% decline in 2017. The USD was up 0.38% during the fourth quarter as volatility ticked higher and forward rate hikes/economic growth were called into question. It was the Yen that took the safe haven mantle during the quarter. Much of the 4Q resilience in emerging markets can be attributed to the softer dollar environment.

Equity Markets

U.S. Equity

All good things come to an end and in the case of market corrections, every 15 months or so. The S&P 500 notched its second correction of the year, finishing the quarter at -13.5%, abruptly ending a streak of six consecutive positive months and a run of eleven of twelve positive quarters. Defensive sectors prevailed with utilities (+1.4%), staples (-5.2%), health care (-8.7%), and REITs (-3.83%) while cyclicals and growth sectors lagged energy (-23.8%), IT (-17.3%), industrials (*17.3%). Small/mid-caps underperformed large caps, growth underperformed value, and equity market volatility doubled to 25 during the quarter.

Third quarter S&P 500 earnings hit 25.9% with fourth quarter estimates of 11.4% along with notable negative guidance. The waning effects of the corporate tax cut will factor into 2019 results but are expected to be felt through the first half of 2019.

International and Emerging Markets Equity

Developed international equity markets fell less than U.S. markets but were still down double digits (-12.5%) while emerging markets (-7.4%) provided a rare occurrence of outperformance during an

increase in market volatility. Chinese and European growth concerns, trade conflicts, a looming Brexit, and tighter monetary policies (Fed, ECB, BoE) were stress points while Chinese stimulus, a more patient Fed, and a softer USD provided cover.

Fixed Income Markets

10-year treasury yields ended the year up 0.30% despite a sharp fall in the fourth quarter of 0.35% on a flight to quality bid. The yield curve flattened materially over the course of the year which picked up steam during the volatile quarter. Fourth quarter saw credit high yield spreads widen over 200bps to 5.33% on the risk off trade sentiments. High grade bonds moved from negative to positive territory for the year (Barclays Aggregate +0.01%) thanks to a strong fourth quarter (+1.64%) while high yield bonds lost substantial ground on the quarter (-4.53%), moving from positive to negative territory for the year (-2.08%). Levered loans sold off (-3.08%) in sympathy with high yield as they endured significant ETF and tax loss selling despite loan default rates falling to 13-month low of 1.61% during the quarter. U.S. high yield default rates also remained benign at 2.64%. Evidence of capital market appetite as the year ended was that there were no new high yield bond offerings in December—the first $0 month since 2008.

Municipals rallied in line with Treasuries for the quarter as the Bloomberg 5-Year Index rose 1.58%, taking the 2018 return to 1.69%. Longer dated bonds outperformed the short end of the curve and high yield issues weathered the quarter well as the Bloomberg High Yield Municipal Bond Index returned 0.30% for the quarter finishing the year as one of the top performing asset classes, +4.76%.

Real Assets/Commodities

Commodity markets fell sharply (-9.41%) due to slowing global growth and falling oil prices. Slowing growth in China factored heavily into declines across industrial metals while grains (droughts) and gold (safe haven) generated positive returns. Oil (-37.9%) is in a deep bear market as a result of slowing growth and resilient U.S. supply lines.

Opal Wealth Advisors, LLC ("OWA") is an SEC registered investment adviser with its principal place of business in Jericho, New York. This brochure is limited to the dissemination of general information pertaining to OWA's investment advisory services. Investing involves risk of loss.

For additional information about OWA, please request our disclosure brochure as set forth on Form ADV using the contact information set forth herein, or refer to the Investment Adviser Public Disclosure Website (www.adviserinfo.sec.gov). Please read the disclosure statement carefully before you engage our firm for advisory services.

Opal Wealth Advisors / 2 Jericho Plaza / Suite 208 / Jericho, NY 11753 / t. 516.388.7980 / f. 516.388.7968 / **opalwealthadvisors.com**