MARKET AND ECONOMIC REVIEW & OUTLOOK

AN UPDATE FROM THE ADVISORS AT GASKIN ASSET MANAGEMENT — *CHARLOTTE, NORTH CAROLINA*

With a house full of guests and family over the holidays, we experienced a little gridlock in our driveway. Simply moving cars in and out required a bit of planning and the assistance of two or more drivers at times. Trouble was inevitable, and it struck me on New Year's Eve. I became stuck in place while backing out of my own driveway. It appeared, for a moment, that my transmission was malfunctioning. That is, the car would simply not go in reverse. After blaming my car for its "faulty" transmission, I decided to try 1st gear. Eureka! The car moved forward. All was not lost. After pulling forward in the driveway, I realized that my transmission was actually completely fine but I was not. I had made an incorrect assumption. After years of experience, I believed that the front yard would support a slight rollover of my left rear tire. Big mistake. Not now. Not after six months of epic rainfall. I also failed to remember that my lovely wife had tactically placed a stone in the corner of her flowerbed to prevent malefactors, such as yours truly, from driving through her daisies. So after running up against the protective stone, I was literally spinning my left rear tire in the front yard. In a matter of seconds, I had spun down almost to the rim. As you may recall from previous letters, I'm happy to let you laugh at my lapses if only to illustrate a point.

According to the U.S. Climate Data website, the rainfall totals for Charlotte for the second half of 2018 reached approximately 36.58" compared to the average for that timeframe of 20.91".[i] That's an increase over the average of almost 75%. That is a lot of water. Surely, I can be forgiven for underestimating the saturation level of my front yard or maybe not. Truth is, it has been a wet, muddy mess here in the Piedmont of North Carolina for months. And there is no way of knowing when things will return to normal. I am currently evaluating a plan that involves removing all of the native trees in my yard and replacing them with swamp vegetation such as bald cypresses and water lilies. Sounds reasonable, right? But then again, what if things dry out and return to normal?

LAST YEAR

The stock market is a little bit like the weather sometimes. Just when you begin to think you understand the patterns and grow accustomed to them, they change. The "normal" patterns can lull us into thinking we don't need an "umbrella". And once we've become accustomed to not needing a market umbrella, we might even forget why we ever had one. But then it happens. The clouds gather. The sun no longer shines every day and the rain begins to fall. Sometimes the showers are temporary and light while at other times it just keeps pouring. The 4th quarter of last year was one of those times when it just poured and poured with no sign of drying out.

Index Description	2018 Return	3 Year Average	5 Year Average	10 Year Average
DJIA	-3.48%	12.94%	9.70%	13.16%
NASDAQ 100	-0.29%	12.18%	12.92%	18.89%
S&P 500	-4.38%	9.26%	8.49%	13.12%
MSCI EAFE	-13.79%	2.87%	0.53%	6.32%
Russell 2000	-11.01%	7.36%	4.41%	11.97%
Bloomberg Barclays U.S. Agg. Bond	0.01%	2.06%	2.52%	3.48%

Source: Blackrock; as of 4:30pm ET 12/31/2018

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After a very positive 2017 and a rather impressive first half of 2018, the market began to slip as we approached the end of the year. There were many reasons given for the declines such as a new U.S. Congress, the back and forth tariff battles, Brexit and the Fed's interest rate decisions and prognostications. Then again, there were also many reasons for why the market should not have declined in our judgement.

Last year's market performance broke a nine (9) year positive performance streak for the S&P 500. While there are now a multitude of indexes to consider when evaluating "market" performance, the S&P 500 Index remains the "Go-To" source for judging the U.S. equity market's performance on a routine basis for many investors. The S&P 500 consists of 500 stocks chosen for market size, liquidity and industry group representation. It is a market value weighted index with each stock's weight in the index proportionate to the market value of its market value.[ii]

PERSPECTIVE

It is vitally important to understand that while the S&P 500 Index is widely used as a gauge of the health of the U.S. economy and our equity markets, all is not equal. For instance, as of January 31, 2019, the top ten (10) stocks comprised of 42.1% of the index while the largest single constituent stock equaled 7.2% of the total value of the index. [iii] In an effort to reduce expenses and simplify investing decisions, a growing number of investors cast their lot with the S&P 500 Index. While we recognize there is an argument to be made for this strategy, we also acknowledge the potential risk in this approach as evidenced by the high concentration of the top holdings in the index. This concentrated approach not only places an overweighting in a few stocks and sectors, it underweights other areas of the U.S. economy and markets that may provide more value and/or income in the future. For example, Information Technology stocks represent 26.4% of the index as of January 31, 2019 while Energy stocks only comprise 5.2%.[iv] This simply means that a positive move for oil stocks, by itself, may have a much smaller impact on the S&P 500 Index than a tariff which might impact cell phones. All is not equal when it comes to the various sectors of the market which is why our research involves a careful analysis of not just the markets in total but the individual economic sectors, in particular.

OUTLOOK

The outlook for the economy and the markets continues to evolve as of this writing. The S&P 500 Index has rallied 11.02% as of February 15, 2018.[v] We believe there are many factors driving the recovery in stock prices such as the Fed's recent interest rate bias shift and employment gains. In a recent Wall Street Journal article, Sam Goldfarb noted that the recent comments from the Federal Reserve seem to indicate that it may be at the end of its campaign to raise rates.[vi] Further, he believes investor confidence in a more "market-friendly" Fed posture could propel the U.S. economic expansion into another decade even though concerns about the slowing global economy and geopolitical concerns remain.

We believe the Fed's current stance is significant for the market for many reasons. First, corporations and the U.S. government use short-term debt to finance much of their activities. The fear of rising costs for that debt can have a dampening effect on plans for expansion. With renewed confidence that the Fed may have ceased raising short-term rates, the near-term costs for growth can be more easily projected and planned. Secondly, with stability in financing costs at a level that is still historically low, companies can potentially maintain a higher level of growth for the intermediate term thus pushing the expansion further. Lastly, as noted in the chart above, total return for the U.S. bond market has been muted with rising rates. Rate stability may drive U.S. and non-U.S. investors into U.S. debt securities allowing this asset class to produce potentially better returns this year when compared to 2018.

Another positive factor for the U.S. economy and markets is continued employment gains. According to Eric Morath of the Wall Street Journal, the U.S. labor market recently enjoyed its 100th straight month of increased employment.[vii] While the unemployment rate did rise slightly to 4% in January, it is still near the 49-year low it hit of 3.7% last fall. Further, wages have continued to rise for the sixth straight month hitting an average increase of 3% in January.

One more thing … Taxes and energy affect virtually every product and service in our economy. We believe the impact of the *Tax Cuts & Jobs Act of 2017* which went into effect on January 1, 2018 has not even begun to be fully understood or measured. Taxpayers and corporations will have a better understanding of how these new rules and rates impact their bottom lines after April 15th and beyond, in our judgment.

Finally, according to AAA and the U.S. Department of Labor, the average cost of gasoline nationwide was $2.24 per gallon as of Friday, January 18, 2019.[viii] After adjusting for inflation, the average cost of gasoline 50 years ago would have been $2.48 in today's dollars. Hard to believe, right? If we reflect back on the dark days of stagflation and gas lines during the mid to late 1970's, you may remember the fear we all shared of reaching the end of oil. Today, the U.S. is a net-exporter of oil with OPEC no longer dictating prices.[ix] If you will permit me, as a Gulf War veteran, I am quite pleased to see the Gulf States losing some of their influence over U.S. policy. There are many today who look to the "end of fossil fuels" for an entirely different reason which may be good in the long-term, if possible. In the meantime, however, gas is cheap and that's good for households and the economy in our view.

Thank you for taking the time to read through this newsletter. We welcome your calls or emails and look forward to speaking with you again soon.

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[i] https://www.usclimatedata.com/climate/charlotte/north-carolina/united-states/usnc0121/2019/1
[ii] "By the Numbers", January 2, 2019. MFS
[iii] "S&P Top 50", January 31, 2019, S&P Dow Jones Indices. https://us.spindices.com/indices/equity/sp-500-top-50
[iv] "S&P Top 50", January 31, 2019, S&P Dow Jones Indices. https://us.spindices.com/indices/equity/sp-500-top-50
[v] "Weekly Market Flash", February 15, 2019, Raymond James.
[vi] Goldfarb, Sam. February 2, 2019, "Fed's Rate Shift Comes as Relief To Debt Investors", The Wall Street Journal.
[vii] Morath, Eric. February 2-3, 2019, "Record Job Run Powers On", The Wall Street Journal.
[viii] "By the Numbers", January 22, 2019, MFS.
[ix] Blas, Javier, "The U.S. Just Became a Net Exporter of Oil for the First Time in 75 Years", December 6, 2018, Bloomberg.
https://www.bloomberg.com/news/articles/2018-12-06/u-s-becomes-a-net-oil-exporter-for-the-first-time-in-75-years