Quarterly Outlook

JANUARY 2019

Fourth Quarter 2018

The worst December since the Great Depression capped a difficult year for markets at home and abroad. The S&P 500 dropped -13.52% in the fourth quarter to end the year down -4.38% (total return) - the first negative annual return since 2008. Only the utilities sector managed to post a positive return for the quarter, gaining 1.36%. All ten of the remaining economic sectors lost ground in the quarter, with energy, technology and industrials stocks retreating the most, with returns of -23.78%, -17.34% and -17.29% respectively. Year to date as of December 31st, the health care, utilities and consumer discretionary sectors posted gains of 6.47%, 4.11% and 0.83% respectively, while energy, materials and industrials saw the largest declines of the year (-18.10%, -14.70% and -13.29% respectively).

The US economy may have passed its peak, and we expect 2019 to mark a return to "normal" in terms of business activity and GDP growth.

Losses in US equity markets belied favorable domestic economic conditions, as the macroeconomic situation remained expansionary despite slight softening. Third-quarter GDP expanded at an annualized rate of 3.4%, while corporate earnings grew by 32.08% (the best read since the first quarter of 2010). Further, the labor market remained robust, with the nonfarm payrolls report beating consensus estimates in each month of the fourth quarter. However, these uplifting economic data were not enough to assuage investors' fears regarding political uncertainty, trade concerns, and rising interest rates.

Chinese trade woes continued to drive volatility in the fourth quarter, and for good reason. Higher raw material costs translated to reduced profits for many domestically focused firms, while decreased demand stung companies with large markets in China. Apple, whose shares dropped -30.12% in the quarter, was among the hardest hit by the tariffs. In December, the US and China declared a 90-day halt to new tariffs pushing the new deadline to March 1, 2019. If no deal is reached within 90 days, both parties agreed that the 10-percent tariffs will be raised to 25 percent.

The Fed raised the federal funds rate by another 0.25% in December, bringing the total increase to a full one percent in 2018. Chairman Powell mentioned one to two possible rate hikes in 2019 during the Q&A session after the December meeting. The Core PCE index (the Fed's preferred measure of inflation) stayed below the 2% target despite multi-year low unemployment, which generally results in inflation acceleration due to increased consumer spending. Chairman Powell later clarified that decisions on future rate hikes will be data-driven and that no specific plan is in place for 2019.

After a highly successful 2017, international markets posted double-digit losses for 2018. The synchronized global growth that we have seen and discussed since the end of 2017 has slowly faded away. German GDP, an historically reliably predictor of European economic health, declined unexpectedly in the

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second quarter by -0.2%. The MSCI ACWI ex USA (All Caps) Index, which covers approximately 99% of the global equity opportunity set outside the US, lost -14.43% in 2018.

Going Forward: Tandem's Outlook

We are entering a new year with many of the issues that rattled markets in the fourth quarter left unresolved. With an ongoing partial governmental shutdown in the US, an open-ended trade war with China, a Fed cautiously navigating the end of quantitative easing, and several key political changes in Europe on the horizon, markets are likely to remain volatile in the near term.

The US economy may have passed its peak, and we expect 2019 to mark a return to "normal" in terms of business activity and GDP growth. While the probability of recession in the next 12 months remains low, business and consumer confidence have tapered off somewhat, and we do not expect the market to return to a growth trajectory until some of the aforementioned sources of instability are resolved. That being said, we do not anticipate a replay of 2008.

Tandem treats risk as seriously as returns, with a focus on downside protection as well as upside opportunity. In times of uncertainty, we advise clients to remain calm and focused when it matters most.

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