SIGNATURE RESOURCES CAPITAL MANAGEMENT

Market Update: 12.21.2018

WORRIES POOLING

Usually not so many at once. While international equity markets have been pressured most of the year, U.S. equities are sharply lower since the end of September. While it's generally usually more than a bit of a guessing game establishing causes for such shifts in market performance, we think the sudden severity of the recent decline left us thinking that such a review was worth exploring.

Parsing the Worries

Stressing that such comments are far more estimations than factual readings, factors we believe have driven the selloff include a) deteriorating global macroeconomic growth metrics, b) heightened unease with regard to domestic monetary policy, c) domestic political and geopolitical pressures, including unexpected policy shifts, and d) increased investor caution regarding the potential for a near- (1-2 years out) or medium-term (3-5 years out) recession due to all of the above. The latest plunge, we think, was sparked by growing concern that the Federal Reserve may foster a recession if it continues to raise rates amidst those waning metrics and rising fears of further slowing ahead. Add to that a looming government shutdown (which would be the third for this year) and an unexpected bump in D.C. chaos and last week's plunge in hindsight doesn't surprise.

Worries in Context

From our point of view, while we do see macroeconomic trends deteriorating a bit, that deterioration with a few notable exceptions comes in the form of slowing growth, not negative growth. That is, growing not as quickly is a different thing than not growing. Of course, growth will slow before activity begins to fall, so the deterioration in trends is still worth noting. But we continue to believe that an outright recession remains a bit further out than the market presently may be expressing. One will for sure happen in the future—such is the nature of macroeconomic cycles—we just don't expect it so soon from now.

Nevertheless, certain macroeconomic-related issues remain in focus, in particular those concerning heightened global trade tensions, the ongoing departure drama of the UK from the European Union (Brexit) and the growing populist movements in Europe that could lead to similar efforts at disunion. In our minds, broadly speaking, increased trade frictions can only be bad for equity markets, given their broadly negative potential net impacts on profitability. The issues the UK faces for its decision to leave the EU follow in line with that thinking, but outside of increased commerce-related frictions from which everyone may suffer, their losses (e.g., London potentially losing its status as Europe's financial center) may well prove others' gains. The lack of clarity we think still is likely to foster further market volatility in 2019.

Geopolitical stresses otherwise remain of concern, but we expect most of the challenges to persist in the geopolitical realm, with less of a macroeconomic impact. Otherwise, there may be economic and behavioral impacts around the globe from related tensions, but we think such fears presently are overdone. We thus expect (and tend to see this in history) any market impact from such tension to prove relatively short-lived.

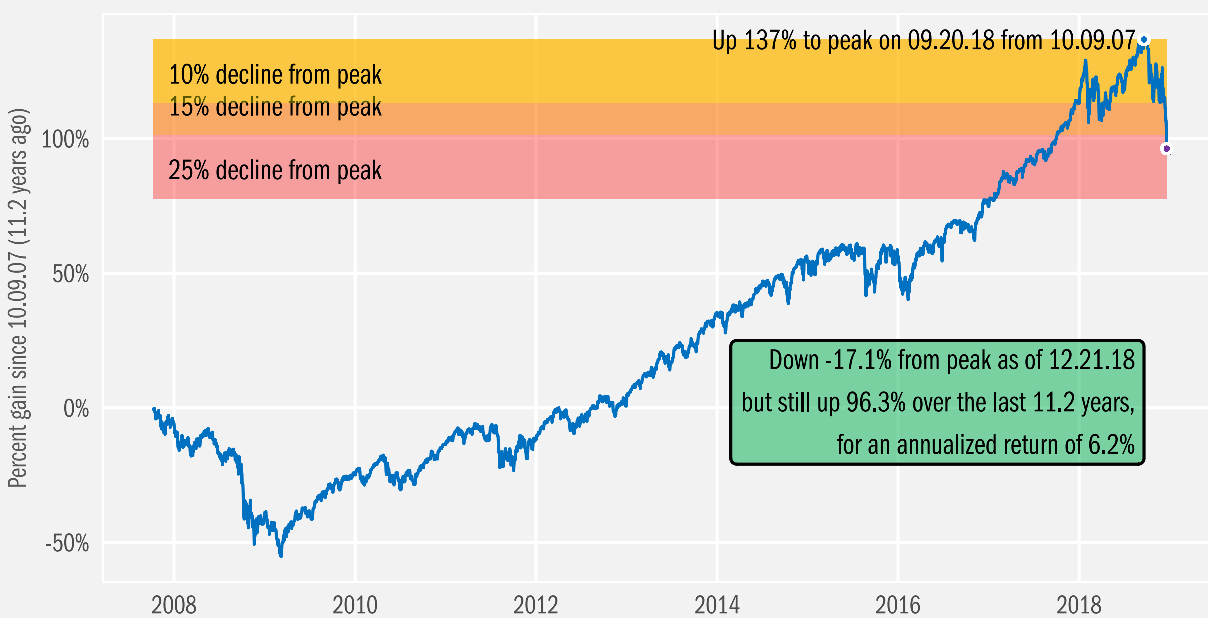
Further, we generally applaud the measured, methodical approach that the Federal Reserve has taken to normalize monetary policy. While various markets perhaps are reflecting investor disappointment with the decision to raise rates this month and the expression of an intention to continue to raise rates next year, a non-passionate view of that policy we think should continue to find it appropriate in the historical context. Further, given that the Fed's mandates essentially can be read as, "help, but do no harm to the economy," we believe that top-of-mind for the Fed is to be a source of stability, not instability, and that they duly will consider the broader investment environment in their assessments for future monetary policy shifts.

Worries Understood

Nonetheless, investor worry is obvious in the now mid-teen declines in broad U.S. equity indexes from their September peaks. Without a quick rebound, we may record the first broad-market decline in U.S. equities since 2008 on a total-return basis. Nonetheless, even with the recent drop the S&P 500 has returned just under 13% on an annualized basis since 2008—tripled and then some in value, including the reinvestment of dividends. And if we move a bit further back to the peak before the financial crisis, the S&P still just about doubled in value over that 11-ish-year time frame (up 6.2% per year on a total-return basis).

Without the risk of the sorts of drawdowns we are experiencing, we understand there to be little reason to expect such reward. We know such words often aren't so helpful in the midst of grander declines. This is why we so often have spoken to their potential for the past two years. Of course, where greater understanding and comfort are desired, please be sure to reach out to your advisor.

Figure 1: S&P 500 Index Total Return



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