Fourth Quarter Recap:

A mini Santa Claus rally in the last week of 2018 was not enough to rescue what turned out the worst quarter in equities since the financial crisis of 2008/2009. Federal Reserve monetary policy, global trade tensions, and slowing corporate profits all led to the first decline in equities annually since 2015. Bonds, on the other hand, provided the stability and predictability that highlights the reasons we own them in the first place (more on that later).

U.S. Markets:

U.S. equities finally gave up their leadership position in the third quarter, with the S&P 500 falling more than 13%, and the tech heavy NASDAQ falling over 17%. Small cap stocks were down more than 20% for the quarter, and a significant portion of all U.S. equities find themselves in correction territory.

Foreign Markets:

International stocks were not spared the downside, but did hold up somewhat better than their U.S. counterparts. Developed markets lost north of 13% in the quarter, while emerging market stocks fell roughly 6%, leading all traditional equities in performance for the quarter.

Asset Class	*4Q*	*1 Year*	*5 Years (Ann.)*
U.S. Large-Cap	*-13.55%*	*-4.52%*	*8.34%*
U.S. Large Growth	*-15.82%*	*-1.65%*	*10.23%*
U.S. Large Value	*-11.66%*	*-8.42%*	*5.78%*
U.S. Small Blend	*-20.29%*	*-11.11%*	*4.44%*
Developed Int'l Stocks	*-13.34%*	*-14.75%*	*0.72%*
Emerging-Markets Stocks	*-6.43%*	*-14.77%*	*1.13%*
REITs	*-6.49%*	*-6.11%*	*7.25%*
Investment-Grade Bonds	*1.59%*	*-0.13%*	*2.35%*
Municipal Bonds	*1.69%*	*1.28%*	*3.40%*
High-Yield Bonds	*-4.67%*	*-2.26%*	*3.82%*
Global Bonds	*1.75%*	*-0.84%*	*0.77%*

Source: Morningstar Direct as of 12/31/2018

Fixed Income Markets:

Moving on to the bond markets, the 10-year Treasury yield closed 2018 at 2.69%, after spending much of the fourth quarter above 3%. Many have predicted the rise in interest rates, but 2018 continued the trend of confounding "experts" who try to predict markets. The overall yield curve flattened during 2018, with short-term rates rising much more than long-term, and the core bond index (as measured by the Barclays U.S. Aggregate Bond Index) rose nearly 1.9% for the quarter (with 2018 returns flat for the year).

In December, the Federal Reserve raised the federal funds rate 25 basis points (0.25%) to a range of 2.25% to 2.5%. This fourth hike in 2018 was widely expected, but the slowdown in the data during the quarter caused many Fed watchers to become concerned that policy is tightening too fast. The Fed's own comments continue to suggest they may look at raising rates further in 2019, and will be a key source of data as we look to the New Year.

As we said in our last quarterly update, and have reiterated throughout this year, bonds are a stabilizing asset class for our portfolios. Our clients who need money now will most likely fund those needs out of their bond portfolio in early 2019, allowing equities the opportunity to recover over time.

Brief Economic Update:

The fourth quarter saw a slight decline in GDP numbers, from 4.2% previously to 3.4% in the latest September print. Unemployment remains very low at 3.7%, and the economy created more than 2.4 million new jobs during 2018. While the Fed remains focused on both the labor markets and inflation, we see little evidence of any entrenched price increases.

The U.S. economy certainly benefited early in 2018 from corporate tax cuts, and the ability for companies to repatriate foreign profits. However, it does appear that many companies used this as an opportunity to buy back their shares, rather than reinvest in new plant and equipment. While business fixed investment did rise compared with 2016 and 2017, the numbers were only moderate when compared with previous expansions.

Our view is that, while it does appear the U.S. economy is slowing, the drastic volatility and price declines of the fourth quarter 2018 were more indicative of fears of a deepening trade rift with China, and concerns that the Fed would overshoot and raise rates too far, too fast. While not pleasant, we believe the main outcome from this correction is to bring prices down to more reasonable levels. Forward looking price to earnings ratios fell from the mid-20s by end of 2017, to now the mid-teens – this is a much more constructive place for equities.

Financial Planning is the Key

Our goal at Cahaba Wealth is to help our clients navigate the difficult financial decisions they face on a day to day basis. While we remain focused on the long-term, and have faith and confidence in more than one hundred years of market history to guide our decisions, we also realize that each our clients' finances are very personal, and represent hopes, dreams, experiences, and so much more. We know that rough patches in the markets are frustrating, and so we always fall back on our financial plans.

The best way to navigate through difficult markets is to have balance in your portfolio, know your time horizon or needing assets, and be disciplined about rebalancing. We are continuously monitoring our clients' accounts to ensure the allocation allows for all of these factors. We will continue to talk with clients about their tolerance for risk, and update portfolios accordingly.

The last piece of data we wanted to share was a view of the fourth quarter, comparing different asset classes (see the chart below from YCharts).

This compares the quarterly returns for the US Aggregate Bond Index (AGG), Global Real Estate (REET), the S&P 500 (IVV), S&P Small Cap Index (IJR), and the Total International Stock Index (IXUS). Not only did bonds provide a positive return in the quarter, but they did so in a very smooth, low volatility manner. This is precisely why we own bonds, and have been strident in ensuring our clients continue to own bonds, even in what has been perceived to be a rising rate environment. If you will recall, many of the talking heads were railing against owning bonds earlier this year, steadfastly assuring investors that when rates go up, bonds go down. To us, this type of certainty should be avoided at all costs. Quoting Voltaire, "Doubt is not a pleasant condition, but certainty is an absurd one."

We prefer to take the road less traveled in today's overhyped news cycle. We will keep our focus on low cost investments, with high tax efficiency, and work hard to understand our clients' needs. This should allow us to continue to provide cash flow when necessary, from sources that will not have suffered in the short-term.

-We thank you for your continued support!