

FOURTH QUARTER 2018

Beyond the Benchmark

QUARTERLY MARKET SNAPSHOT

	VALUE	CORE	GROWTH
Large	-11.72%	-13.52%	-15.89%
Medium	-14.95%	-15.37%	-15.99%
Small	-18.67%	-20.20%	-21.65%

This matrix illustrates U.S. equity benchmarks provided by Russell with the exception of Large Core, which is the S&P 500 Index.

	VALUE	CORE	GROWTH
Global	-10.74%	-12.75%	-14.66%
Non US	-11.70%	-12.54%	-13.33%
EM	-6.75%	-7.47%	-8.22%

This matrix illustrates international equity benchmarks provided by MSCI.

	SHORT	INTER	LONG
Gov	1.31%	2.54%	4.16%
Corp	0.78%	-0.18%	-1.80%
Hi-Yield	-3.88%	-4.67%	-5.07%

This matrix illustrates the fixed income benchmarks provided by Bloomberg Barclays Indices and BofA Merrill Lynch.

Executive Summary

Despite robust earnings and a healthy economic backdrop, 2018 turned out to be the most challenging year for investors in a decade. Fourth quarter equity performance was the worst since 2011. Positive returns for stocks in November were bracketed by months defined by swift selloffs as rising fears of peak earnings and slowing economic activity globally took hold of the market narrative. All told, domestic equity markets, as measured by the S&P 500 Index, dropped -13.5% during the quarter and -4.4% for the year.

Non-U.S. markets, as measured by the MSCI EAFE Index, fell -12.5% as BREXIT fears and Italy's budget standoff with the European Union (EU) continued to unsettle markets. Emerging markets, as measured by the MSCI Emerging Markets Index, held up best, -7.5%, but declined over -14.5% for the year.

During the quarter, the U.S. formally implemented tariffs on \$200 billion in Chinese goods while halting the next wave for 90 days as they work towards a resolution. The ongoing trade spat has hampered economic activity in China and the surrounding region.

The Feds hiked the Federal Funds rate by 0.25% again during the period, but lessened their expectations surrounding future rate hikes in response to a deceleration of economic data and waning inflationary pressure. The yield on the benchmark 10-year Treasury fell sharply from 3.05% at the end of trading the previous quarter to 2.69% at quarter-end. The decrease in yields pushed investment grade bond prices higher, especially for longer-term Treasuries that are particularly sensitive to interest rate changes.

Domestic Equities

S&P 500 Index companies posted earnings growth of approximately 25% in the third quarter, exceeding expectations. In total, nearly 80% of the companies beat earnings expectations while 60% reported better than expected revenue figures. The estimated earnings growth rate for all of 2018 is roughly 20%, which would mark the highest annual earnings growth for the index since 2010. However, investors seemed less interested in earnings and more focused on political instability and risks associated with a partial government shutdown, a continuing trade war with China and its impact on global trade, and a Federal Reserve that was backing off future rate hikes in response to slowing global growth and moderating inflation.

After an unusually tranquil period, market volatility returned in full force in the fourth quarter. The market's steep selloff was largely indiscriminate, as 10 of the 11 underlying sectors of the S&P 500 Index turned in negative results. Large cap stocks outpaced their small cap brethren while value bested growth. Utilities, Real Estate and Consumer Staples sectors held up the best, while Energy, Technology and Industrials led the decline. Investors quickly removed risk from their portfolios and virtually every equity asset class suffered a substantial decline as volatility surged. The S&P 500 Index nearly reached bear market territory, peak to trough decline of 20%, while small caps, which are considered to be more closely linked to U.S. growth, fell into a bear market in mid-December. A modest recovery in the last week of the year provided a respite, but the S&P 500 still recorded its worst December return since 1931.

International Equities

Non-U.S. markets struggled amid escalating trade tensions, a persistently strong U.S. dollar and mounting political concerns. The MSCI EAFE Index declined -12.5% in the fourth quarter and nearly -13.8% for the year. The Japanese market led the quarterly decline with the MSCI Japan Index falling -14.2% as Prime Minister,

Shinzo Abe, announced plans to move forward with increasing the country's consumption tax. Meanwhile, European stocks struggled as BREXIT concerns continue to weigh heavily on investor sentiment in the region. Fears increased throughout the period, as British Prime Minister Theresa May lost parliamentary support for her draft agreement on Britain's withdrawal from the EU and was forced to reshuffle her cabinet after key members resigned. Elsewhere, Italy's coalition government agreed to a small concession to bring their 2019 budget deficit down to 2.04%. The country remains largely at odds with the European Union (EU), which had urged Italy to rein in its spending further due to its high level of debt.

Emerging market stocks were negatively impacted by escalating tariff fears, U.S. interest rate hikes and a stronger U.S. dollar. The Chinese market continues to feel the effects of trade tensions as monthly indicators have recently provided evidence of slowing organic growth on the mainland. During the quarter, the U.S. formally implemented tariffs on \$200 billion in Chinese goods while tariffs on another \$267 billion were pushed out three additional months. The Chinese yuan fell for eleven straight weeks, its longest losing streak since China created its current exchange rate regime in 1994. Emerging market currencies faced headwinds in 2018, particularly those in the most vulnerable countries that have large current-account deficits and foreign financing needs. Turkey was in the headlines during the quarter as rising inflation, extensive U.S. dollar debt, and a dramatically falling currency raised the prospect of a default. Several other countries, including Argentina and South Africa saw their currencies tumble in the quarter.

Although the emerging market index declined 7.5% during the quarter, it represented the best relative performance of the major equity indices. The U.S. dollar stabilized late in the quarter after the Fed appeared to back off of three hikes in 2019 and indicated they were more data dependent and perhaps two or fewer rate hikes were likely. There is typically an inverse relationship between emerging market equity returns and the direction of the U.S. dollar and prospects for a weaker dollar provided some support for emerging market equities.



Fixed Income

High quality fixed income assets benefited from the risk-off sentiment, finishing the quarter with solid gains and rebounding from poor performance during the year. Even as the Federal Reserve hiked rates by 0.25% in December, the yield on the 10-year U.S. Treasury declined in the quarter. After reaching a multi-year high of just under 3.25% in October the 10-year yield closed out the quarter at 2.69%. The Barclays Universal Bond Index ended the fourth quarter up nearly 1.2%, which pushed the year-to-date return near the flat-line. Yields across all maturities declined in the quarter as long-term bonds were the best performers since they are most sensitive to falling interest rates. Municipal bonds continued to perform well, exceeding the returns of both U.S. Treasury and corporate bonds for the year. The relatively strong results of the municipal bond market have centered on continued supply constraints and ample demand. High-yield bonds delivered negative returns amid a sharp decline in energy prices and a fading economic outlook. Higher yielding bond prices fell as investors demanded more yield given the perceived increase in risk.

The European Central Bank kept short term rates unchanged. Post-meeting remarks by ECB President Mario Draghi centered on a deepening concern over the uncertain economic climate across the region. Despite softening economic data, the ECB announced an end to their bond buying program while it will keep reinvesting cash from maturing bonds for an extended period of time. The ECB lowered its 2018 forecast for GDP growth in the Eurozone to 1.9%, and shaved its 2019 forecast by a similar amount to 1.7%. Policymakers also reiterated they expect key interest rates to remain at record low levels at least through the summer of 2019. In light of growing concerns surrounding BREXIT, the Bank of England (BoE) chose to keep key short-term interest rates unchanged during the quarter.

Economy

The U.S. economy, as measured by the change in the Gross Domestic Product, increased 3.4% during the third quarter. The positive effects of corporate tax cuts and deregulation led to a solid increase in business spending, which has helped boost an already strong economy. U.S. unemployment rose to 3.9% as a robust employment market attracted previously discouraged workers back into the labor force. The tight labor market helped push wage growth to the fastest pace in nine years. The University of Michigan's consumer sentiment index fell slightly to 98.3. While the plunge in stock prices has recently garnered the most attention in the national press, consumers have focused more on their concerns about income and job prospects.

The Eurozone grew 1.6% year-on-year in the third quarter, following a 2.2% expansion in the previous period. Among the region's largest economies, Germany and Italy posted contractions, while France's growth picked up and Spain's expansion remained solid. The Eurozone's seasonally-adjusted unemployment rate fell to 7.9% in November from a downwardly revised 8.0% in the previous month. It was the lowest jobless rate since October 2008 as the number of unemployed continued to decline. The Chinese economy advanced 6.5% year-on-year in the third quarter, after a 6.7% expansion in the previous period. It was the lowest growth rate since the first quarter of 2009 during global financial crisis, amid intense tariff disputes with the U.S. and concerning off-balance-sheet borrowings by local governments.



Market Outlook

Stocks are well positioned to outperform bonds in 2019 as valuations have declined to below average levels and interest rates remain below their long-term averages. Economic growth is poised to slow modestly, particularly among developed markets, but stable growth in emerging markets should support growth globally and there is minimal chance of a recession on the immediate horizon. The Federal Reserve is becoming increasingly data dependent and is less likely to hike rates in 2019 as global growth is moderating and inflation has leveled off.

Slower growth in the U.S. relative to the rest of the world and stable interest rates will put downward pressure on the U.S. dollar. International equities are trading at notable discounts to domestic stocks and a more stable or weaker dollar will contribute to better relative returns for international stocks, particularly in emerging markets. Volatility will remain elevated as tariffs, political instability, growth concerns, and the path of interest rates will periodically impact sentiment and heighten uncertainty.





The Challenges of Modern-Day Retirement

By Pete Finlon

Baby Boomers are retiring earlier than any previous generation. Not only that – they’re living longer, too, and are focused on high quality of life and enjoying their retirement to the fullest. That said, as they approach age sixty-five, many Boomers are uncertain how to define their vision for retirement and achieve their goals. Applying this comprehensive look to your financial planning will help you develop a strong outline for your retirement plan and alleviate concern as you transition into your golden years.

Old school retirement planning takes a purely financial approach. In the past, people primarily worked for mostly one employer and by the time the big day came to move on, they were financially ready for the next stage in life: the kids were grown and gone, house or dwelling paid for, one or both parents deceased, and if married, you and your spouse were ready to relax, travel, socialize,

be grandparents and renew old hobbies and passions.

But what about the non-financial pieces? People often assume that their marriage, relationships, health, and social network won’t be impacted simply because they are no longer working. The reality is that retirement is much more than a financial plan; it’s a transformative life event that brings celebration as well as challenges in various facets of life. As Baby Boomers live longer and have higher expectations for their retirement years, they face new challenges that did not apply to previous generations.

Today, 82% of working individuals expect to work or are already working past the age of 65. With life expectancy increasing drastically, retirement can now last longer than one’s prime working years. Add in other real-life challenges such as assisted living, money management,

isolation, and health care, and it is easy to see why many people are apprehensive about crossing the bridge into their retirement years.

If you are preparing for the retirement transition today, ask yourself the following questions. Be honest with yourself, as these will help you prepare for the best retirement years possible.

- What will my transition from work to retirement look like?
- How will I fill leisure time with hobbies or other interests?
- What does my support system look like?
- Have I done a health assessment that includes mental wellness as well as physical wellbeing?
- Where will I live in retirement?

Taking the time to plan, discuss, and enjoy the process will ensure that the next stage of your life is one full of meaning, growth, laughter and fulfillment.

Wherever your path takes you, you will bring with you knowledge, confidence and personal satisfaction.

Aldrich Wealth takes an integrated approach to financial planning, investment management and tax services. We recognize that many of life's transitions come with challenges that aren't necessarily financially related. Our advisors guide you through life's transitions to enable you to feel prepared, and ultimately, enjoy each new chapter of life.

PETE FINLON

Pete is a certified retirement and transition coach/mentor who focuses on helping plan/solve and create action steps that give people job, life and personal happiness during their transitions.





What Rising Interest Rates Mean for You

By Tawny Hubbard, CPA

Since the 2008 market and economic collapse, the Federal Reserve has kept the federal funds interest rate near record lows in an effort to stabilize the financial system and stimulate economic growth. However, over the past few years they have started to slowly and methodically raise interest rates. In 2018, The Federal Reserve raised interest rates four times and is expected to do so twice in 2019. As interest rates march upward, financial organizations and consumers will start to feel the effects of this policy change one way or another. Here are a few strategies to help you minimize the impact of rising interest rates.

- **Save more.** If you have a savings account at a bank, you may have noticed the glacial pace it takes to earn interest over the years. You have low interest rates to thank for that. But with interest rates on the rise, you may be in luck. When the Federal Reserve raises interest rates, banks and financial institutions also typically increase the rates they offer on savings accounts, money market accounts, and certificates of deposit (CDs). Our advice? Put more money into saving to get more money back in interest. Additionally, depending upon the interest rate offered by your current bank, you may want to consider shopping around for a better rate.
- **Lock in low mortgage interest rates.** Although the interest rate climb does not have a direct connection to long term fixed mortgage interest rates, it does impact mortgage interest rates in the short term. Today, mortgage interest rates remain at historically low levels. If you are in the market to purchase a home, you may want to jump on these low interest rates now. If you're not quite ready to purchase, consider saving more for a larger down payment to reduce the amount you need to borrow in the future.
- **Watch your loan rates.** If you have an existing adjustable rate mortgage (ARM) or home equity line of credit (HELOC), keep your eyes on your interest rates. As the Federal Reserve raises interest rates, ARM and HELOC rates will likely increase as well. ARMs often reset once per year, whereas HELOCs are subject to change within 60 days. If you have an ARM, it might be advantageous to refinance to a fixed rate loan. As for HELOCs, consider speeding up your loan payments or converting the

outstanding balance to a fixed rate. Take time to crunch the numbers to determine what makes the most sense for you.

- **Revisit your cash flow plan.** One of the most frequently asked financial planning questions is whether or not you should pay down outstanding debt or invest for the future. If you are weighing these two options, your first step should be to compare your annual after-tax interest rate against your projected after-tax rate of return on investments. For example, if your mortgage interest rate is 4% and expected rate of return is 7%, your investment earnings are projected to exceed your interest savings, and investing may be your best course of action. In previous years, interest rates were often lower than projected rates of return, making it advantageous to invest. However, with interest rates on the rise, you may be financially better off accelerating your loan payments.

It is also important to factor in the tax implications of each option. When you file your tax return, you choose whether to claim the standard deduction or itemize your deductions. The Tax Cuts and Jobs Act nearly doubled the standard deduction and limited the state and local taxes deduction to a total of \$10,000. As a result, more than half of the individuals who itemized in 2017 are projected to use the standard deduction, and would not see any tax benefit to interest paid on mortgages.

Finally, consider the tax benefit of interest paid on student loans. You can deduct the standard \$2500 or the amount you paid in interest on qualified student loans used for higher education expenses, whichever is less. You can deduct the lesser of \$2,500 or the amount you paid in interest on qualified student loans that were used for higher education expenses. However, the deduction phases out at higher income levels.

The economy is difficult to predict. However, if the U.S. economy continues to perform well, the Federal Reserve will likely keep raising interest rates at a slow and steady pace. Take a moment to review your current financial situation and determine how you can be prepared for the impacts of rising interest rates.



TAWNY HUBBARD, CPA

Financial Planner,
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Tawny specializes in developing and implementing comprehensive financial plans that provide clients the best opportunity to achieve their

cash flow, investment, insurance and estate planning goals. Prior to her career in financial planning, she concentrated on strategic tax planning and compliance for high-net-worth individuals.



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Recognized as Financial Times Top 300 Financial Advisors

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Recognized Five Star Professional's "Five Star Wealth Managers"

Five Star Professional, as a third-party research firm, identified pre-qualified award candidates based on industry data and contacted all identified broker dealers, Registered Investment Advisor firms and FINRA-registered representatives in the Portland area to gather wealth manager nominations. Award candidates were then evaluated against 10 objective eligibility and evaluation criteria: 1) Credentialed as an investment advisory representative (IAR), a FINRA-registered representative, a CPA or a licensed attorney; 2) Actively employed as a credentialed professional in the financial services industry for a minimum of five years; 3) Favorable regulatory and complaint history review; 4) Fulfilled their firm review based on internal firm standards; 5) Accepting new clients; 6) One year client retention rate; 7) Five-year client retention rate; 8) Non-institutionalized discretionary and/or nondiscretionary client assets administered; 9) Number of client households served; 10) Educational and professional designations. 1,107 wealth managers in the Portland area were considered for the award. 224 were named 2015 Five Star Wealth Managers which represents approximately 21 percent of the total award candidates of the area. Wealth managers do not pay a fee to be considered or placed on the final list of 2015 Five Star Wealth Managers. The Five Star award is not indicative of the wealth manager's future performance. For more information on the Five Star Wealth Manager program and the research/selection methodology, go to www.fivestarprofessional.com/wmsummaryandresearch.pdf. To view AKT Wealth Advisors, LP award document, go to <http://www.pageturnpro.com/Five-Star-Professional/64888-PORWM15-Heather-Wonderly/puredefault.html>.

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