McQueen, Ball & Associates
Private Wealth Management

Quarterly Insights

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Gauging Market Volatility

2018 reminded investors how volatile markets can be with 64 of the 252 trading days resulting in a market movement (measured by the S&P 500) of greater than 1%. By contrast 2017 had only 8 days with over 1% movements. The S&P 500 finished the year -4.38% after being up 10.56% at the end of the third quarter. The speed of the selloff in the 4th quarter left most investors wondering what happened.

There was certainly a change in sentiment as the equity markets flipped from being overly positive to completely negative. Markets shifted from ignoring some potential problems to obsessing over them. This is a marked contrast to the end of the third quarter when the S&P 500 closed near record highs.

One potential problem is slower growth due to higher interest rates. For the fourth time during the year the Federal Reserve raised the benchmark rate which now stands in the range of 2.25%-2.50%. The rise was accompanied by hawkish statements from Fed Chair Jay Powell. However, the statements and interest rate hike were preceded by a dovish Fed report lowering forecasts of GDP growth and inflation, fueling concern the Fed would envenom an already slowing economy. It has often been said bull markets don't die of old age, but rather they're killed by the Federal Reserve.

The president was quick to publicly admonish the Fed both prior to and after the interest rate hike for their decision. Some questioned whether Mr. Powell raised rates due to a strong economy or was forced to act to demonstrate the Fed's independence. Either way, we believe the Fed will likely take a more cautious approach to raising rates in 2019.

Trade disputes with China remained a focus for investors. The market has ongoing concerns that increased costs as a result of tariffs could pressure corporate profits. Currently, the US and China agreed to a 90 day cease-fire to allow negotiations to take place. As of close of the year these appeared to be progressing well. However, the ambiguity of the trade negotiations allow for several interpretations.

Also adding to the negative sentiment was the U.S. government shutdown. A bipartisan spending deal was stopped by President Trump over lack of funding for a US-Mexico border wall. Congressional Democrats, who have the votes to do so, have vowed to deny any funding for a wall. It is unclear how long the shutdown will last and what the resolution will be. The situation is likely a window into the divided government that awaits us in 2019.

If correct in that assumption, we would anticipate volatility in marketplaces to continue. Large swings in the market by themselves are unsettling. Nonetheless, if they aren't validated by deterioration in fundamentals they will likely be temporary. Over time the stock market reflects the health and growth of the real economy.

Economic data at year-end was still largely positive. Unemployment remains very low, auto sales have been strong, and durable goods orders showed a rebound in December. MasterCard's SpendingPulse, which provides insights into overall retail spending trends, pointed to the best holiday season in six years.

Of course there is always a concern that markets themselves can change fundamentals. Negative markets can impact household wealth and undermine consumer confidence. Consumers who feel less wealthy due to a stock market drop are likely to curtail spending which is known as the "Wealth Effect."

In this regard we have witnessed a concurrent decline in consumer confidence as the stock market has fallen. The Conference Board Consumer Confidence Index fell in December. Nevertheless, the cyclical areas of the economy that are most vulnerable to consumer spending such as housing, autos, and investment spending haven't shown material weakness.

As an offset, oil prices collapsing from their high of $76.40/bbl in early October to approximately $45/bbl at year-end may provide support to consumer spending. Lower oil prices and by extension lower gas prices can act as a de-facto tax cut for consumers increasing their income.

At the end of December almost two thirds of the stocks in the S&P 500 were down 20% from their peak. A shift in investor sentiment saw the markets begin to price in pessimism instead of optimism for the first time in several years. One area that was particularly prone to this change were stocks with high starting valuations. By example, FAANG stocks (Facebook, Apple, Amazon, Netflix, and Google) were down an average of -23.45%.

Yet there remains reasons for optimism. Although a moving target, Price/Earnings ratios are now trading at below historical averages. Since 1920 there have been twenty instances where the P/E ratio of the S&P has fallen by 20% or more. In the year following those instances the market recorded a positive return three-quarters of the time.

Market psychology is difficult to predict. Provided the economy remains healthy we believe with time equities will reflect the underlying fundamentals of the economy. As the Ben Graham, the father of value investing, stated "In the short run, the market is a voting machine, in the long run it is a weighing machine."

Market volatility can put even the most seasoned investors' fortitude and composure to the test. We recognize investing decisions based on emotions can impair long-term results and will maintain our discipline by holding a balanced allocation and taking a long-term view in regards to investing in equities. Of course we are always available to address concerns and welcome you to call for a more in-depth personal discussion.

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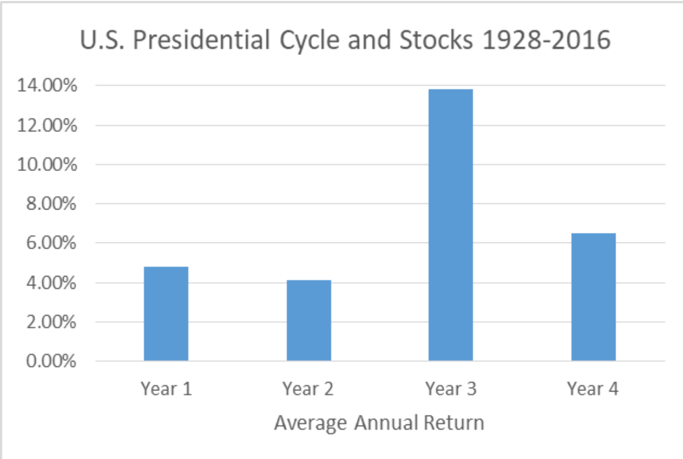
Presidential Cycles and the Stock Market

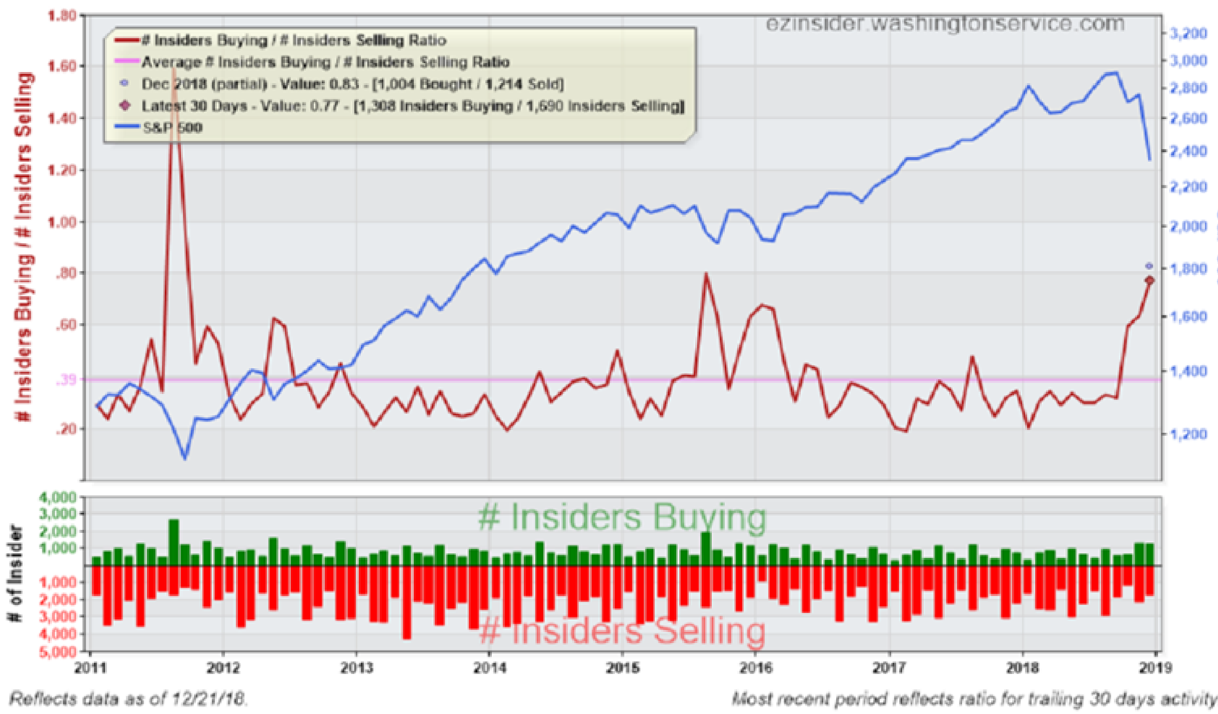


As we enter the third year of the presidential term, the validity of the Presidential Cycle Theory and its correlation with stock market returns faces its latest retest. In theory, in year three of the Presidential term, the President re-enters campaign mode and works hard to strengthen the economy. Therefore, the third year of the cycle, the year before the actual elections, is generally the best one for equities.

While this year in the presidential cycle is typically strong on average, recent history has been less conclusive. In fact, Mid-term years (Year 2) have been better than Year 3 of the presidential cycle more than half the time in the past 36 years. Year 3 Stock markets (S&P 500 Index) have gained only 1%, 2% and 5% in the past three cycles. Which scenario comes to fruition this year remains to be seen.

Insider Buying

While overall investor sentiment turned negative in the 4th quarter and the S&P 500 fell into bear market territory corporate insiders ramped up their purchases. Research has shown that insider buying in aggregate has been a positive signal for upcoming shifts in market sentiment. Analysts are still predicting that 2019 will be a record year for S&P 500 profits. It stands to reason that insiders may feel more confident by benefiting from greater insight into the company's future prospects. Bloomberg recently published the chart below from The Washington Service showing that insider buyers are outpacing sellers by the most since August of 2011. We believe this may be a sign that insiders still feel confident in the underlying demand for their products and services despite the ongoing macro -economic headline risks.



Tax update for 2019

The key items and changes for tax year 2019 include the following:

- The annual exclusion for gifts remains at $15,000 for 2019.
- The lifetime estate and gift tax exemption for 2019 rises to $11,400,000 or $22,800,000 for couples if portability is elected after the death of the first-to-die spouse.
- The annual elective deferral (contribution) limit for employees who participate in 401(k) or 403(b) increases to $19,000. The catch-up contribution limit for employees aged 50 remains at $6,000.
- The limit on annual contributions to an Individual Retirement Account (IRA) and Roth IRA's rises to $6,000. The additional catch-up contribution limit for individuals aged 50 and over remains $1,000.
- The cap on SIMPLE IRA's climbs to $13,000. People age 50 and above can put in $3,000 more.
- The income limits for making full contributions to a Roth IRA will increase to $122,000 (contributions are phased out completely when income reaches $137,000) for individuals, and $193,000 (contributions are phased out completely when income reaches $203,000) for married couples.
- The annual cap on deductible contributions to Health Savings Accounts (HSA's) rises in 2019 to $3,500 for self-only coverage and $7,000 for account owners with family coverage.
- People who forgo health insurance in 2019 won't have to pay a penalty. The new tax law repealed the fines under Obamacare's individual mandate.
- The standard deduction rises to $24,400 for couples (plus $1,300 for each spouse over age 65) or $12,200 for singles ($13,850 if 65 or older).
- The threshold for deducting medical expenses jumps from 7.5% of adjusted gross income to 10%.
- Alternative Minimum Tax (AMT) exemption amounts increase to $111,700 for couples and $71,700 for singles.
- Tax rates on long-term capital gains and qualified dividends do not change.

For more information about McQueen, Ball & Associates and our products and services please contact us at 610-954-0400 or by email at info@mcqueenball.com

McQueen, Ball & Associates, Inc.

McQueen, Ball & Associates is an independent, fee-only investment advisor, offering integrated services that combine investment management with tax planning, estate planning and trust administration. Since 1981, our firm has been committed to providing objective financial advice to families with complex financial affairs, substantial business interests and large family estates.

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