FLAGSTONE

FINANCIAL ADVISORS, INC.

MARKET REVIEW
CALENDAR YEAR 2018

What Happened:

The Grinch stole our hopes for a Santa Claus rally. In terms of market performance, it was the worst December in decades. Unnerved by a trade war with China and the hawkish tone of the Federal Reserve, investors developed a sour mood, pushing stock prices downward. What's more, the fall elections gave us a split Congress, almost assuring an increase in political partisanship and legislative stalemates. There seems to be a lot to worry about.

Many are wondering if we are in a bear market, defined as a drop of 20% or more from a recent high. Well, it depends where you look. Through the first week of January, the Dow Jones Industrial Average and the S&P 500 Index have not lost 20% from their most recent highs, but are close. The Nasdaq Composite Index (largely comprised of technology stocks) and the Russell 2000 Index (small stocks), however, were not so lucky having lost over 20% in market value. On the bright side, bonds saw a nice rally in the 4th quarter as interest rates fell in response to investors' fears over the markets and the economy.

Investor cash flows are a good indicator of investor sentiment toward the market. As you might expect, the market correction prompted many to sell stocks and move their money into bonds and cash. This is a predictable reaction and it usually proves to be the wrong decision. Instead, we encourage our clients to stay calm and think long-term. This market correction will run its course and stock prices are likely to advance to new highs in the coming months.

Calendar Year 2018 Performance:

S&P 500 Index (large stocks)	-4.4%
Russell 2000 Index (small stocks)	-11.0%
MSCI EAFE Index (international stocks)	-13.8%
Barclays U.S. Aggregate Bond Index (bonds)	0.0%

Prognosis:

It is impossible to know when the market will hit bottom, but it will. In spite of the many troublesome headlines, our economy is in good shape. The unemployment rate of 3.9% is the lowest since 2000. The economy added 2.6 million new jobs in 2018, the 3rd best annual gain since 2000. Corporate earnings—perhaps the most important driver of stock prices—are expected to grow by 7%-8% in 2019. Inflation and interest rates remain low. In short, not everything looks gloomy.

There will be headwinds and volatility in the new year, but most indicators point to the market advancing modestly in 2019. While others may run for cover, we will stay the course, prepared to see the market recover. Wishing you all a wonderful 2019!

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