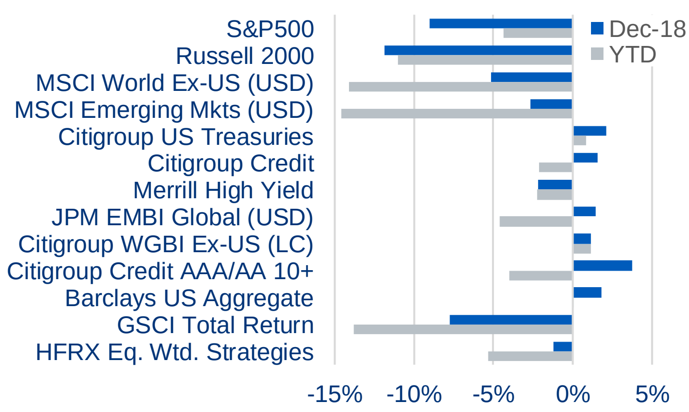
# Global Market Review

## Macro Summary

December capped off the worst annual performance for global equities since the financial crisis. Investors turned pessimistic in the fourth quarter as the yearlong wave of worries over central bank tightening, a slowing global economy, and the tumultuous state of global trade came to a head late in the year. Domestic political tensions exacerbated concerns as U.S. equities bore the brunt of the damage. The yield curve also inverted this month ahead of another rate hike from the Fed. Investors sought haven assets amid the equity tumult, driving global bonds higher. Commodities shared in December's rout as oil suffered its third straight month of deep losses.

***Performance of Major Market Indices***

*Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.*




## U.S. Equities Post Loss for 2018

U.S. equities suffered their poorest performance of the year in December, cementing their worst annual loss since 2008. The Russell 3000 fell 9.3%, bringing 2018's loss to 5.2%. December's pain spread throughout the market. Both growth and value stocks dropped about 9% along with large cap equities, while small cap shares fared somewhat worse, falling 12%. No sector posted a gain and energy, financials, and industrials all fell over 10%.

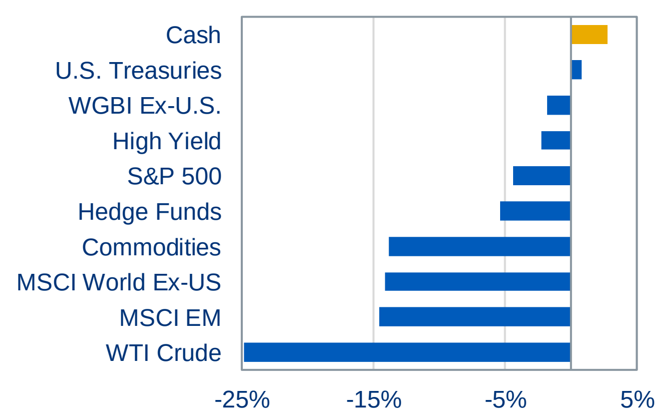
In the week following the Fed's fourth rate hike of 2018, the S&P 500 fell nearly 8%, culminating in the worst Christmas Eve loss in U.S. history. This period also coincided with a government shutdown – which has persisted into the new year – and the resignation of Secretary of Defense Jim Mattis. This political uncertainty added to the tempest of economic worries battering investors. Many of these concerns – an inverting yield curve, tightening monetary policy, and recent signs from corporate America of dimming growth prospects – have persisted throughout 2018 and came to a head in December, dragging on equity markets.

## Global Stocks Unhinged by Uncertainty

Non-U.S. equities also dipped in December. The MSCI ACWI ex-U.S. Index fell 5.1%, while the MSCI EM Index dropped 2.7%. With year-to-date losses of over 14% for non-U.S. equity indices, U.S. equity down 5%, and global fixed income down 2%, no major asset class outperformed cash in 2018 (Exhibit below).

***Cash Is King in 2018***

*Source: Bloomberg. 1-year returns ending December 31, 2018.*




1001 Nineteenth Street North
16th Floor
Arlington, VA 22209 USA

+1 703.243.4433 TEL
+1 703.243.2266 FAX

strategicgroup.com

While losses in December for global equities were not as severe as in the U.S., both developed and emerging markets continued facing headwinds that have marred their performance for much of 2018. A tumultuous political environment rattled European markets this month. Protests over stagnating purchasing power and economic inequality in France eroded the popularity of President Emmanuel Macron and drove stocks 4.6% lower. Across the Channel, British Prime Minister Theresa May survived a vote of no confidence in Parliament, but delayed an impending vote on her Brexit proposal as she faced near-certain defeat with the March 2019 deadline looming. This uncertainty brought volatility to the pound and left the MSCI UK Index 3.8% lower. The MSCI Europe Index fell 4.6% in December, ending 2018 down 14.9%.

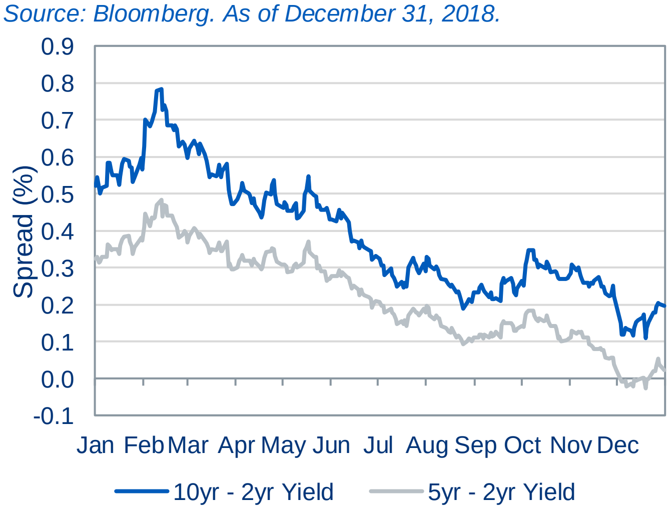
Ongoing trade tensions and rising U.S. interest rates continued to hurt emerging markets. The U.S.-China trade discussions lost the momentum gained at last month's G20 summit following the arrest of a Chinese tech executive for allegedly violating sanctions on Iran. This set negotiations back to square one, dragging down Chinese equities. An 18.9% slide for the MSCI China Index this year made it the worst performing major stock market of 2018. Elsewhere, while broad Asian markets slipped 3.2%, the MSCI Latin America lost a relatively modest 0.8%, buoyed by positive investor sentiment surrounding the January inauguration of Brazilian president, Jair Bolsonaro. Losses across emerging markets were also offset by a muted return for the dollar, which had previously pummeled the region earlier in the year.

## Yield Curve Inverts!

Seeking respite from the turmoil in global equities, investors piled into bond markets. The WGBI ex-U.S. Index rose 2.5% while to the JPM EMBI jumped 1.5%. U.S. Treasuries saw their largest gain of the year, led by longer maturity notes. The 10-year yield fell nearly 30bps in December and 10-plus year Treasuries gained 5.5%, while the Fed's fourth hike of 2018 propped up nearer term yields.

***Yield Curve Flattens, 5yr-2yr Inverts***

*Source: Bloomberg. As of December 31, 2018.*




These moves saw the yield curve flatten to the narrowest spreads since pre-crisis levels and, after flirting with inversion throughout the year, it finally flipped at the 5- and 2-year points of the curve (Exhibit above).

The Fed's December meeting also confirmed a suspicion that arose last month that the pace of hikes going forward may be more gradual. The median Fed projection of the neutral rate fell to 2.75%, only 25bps higher than the current rate after December's hike. This reflects the market's recent pricing of the yield curve and the expectation that rates have little room to run in light of recent signs of slowing growth and cracks in the health of the global economy.

## Hedge Funds Offer No Relief

Hedge funds have not fared much better than other major asset classes this year. The HFRX Equal Weighted Strategies Index rounded out 2018 with a 1.2% loss in December, bringing its year-to-date return to 5.4%, its worst annual performance since 2011. Equity long/short strategies underperformed the S&P 500 this year, falling to 9.4% after a 4.2% loss this month, and no strategy was positive for 2018. Only macro funds were able to post a gain in December, rising 0.8% on the relatively violent moves in rates. Even low beta strategies like equity market neutral and relative value were not immune to the fourth quarter's turbulence, each falling around 3% in Q4 after losses of 0.4% and 2%, respectively, in December.

## Oil Nose Dives into the New Year

Weakness in oil prices continued to weigh on commodities, despite agreements reached at OPEC's December meeting to reduce production by more than 1 million barrels per day. The WTI Crude Oil Index slumped 10.8% as worries over the impact of slowing global growth on demand continued to outweigh the prospect of production cuts. Such concerns have plagued the commodity throughout the fourth quarter, leading to a nearly 40% decline over the past three months alone. Precious metals were the only bright spot in the S&P GSCI Index, rallying 5.2%. After a strong start to the year, the GSCI ended 2018 with a 14% decline.

***Performance of Major Market Indices through 12-31-2018***

*Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.*

| | 1-Month | QTD | YTD | 1-Year | 3-Year | 5-Year |
|---|---|---|---|---|---|---|
| S&P500 | -9.0% | -13.5% | -4.4% | -4.4% | 9.3% | 8.5% |
| Russell 2000 | -11.9% | -20.2% | -11.0% | -11.0% | 7.4% | 4.4% |
| MSCI World Ex-US (USD) | -5.2% | -12.8% | -14.1% | -14.1% | 3.1% | 0.3% |
| MSCI Emerging Mkts (USD) | -2.7% | -7.5% | -14.6% | -14.6% | 9.2% | 1.6% |
| Citigroup US Treasuries | 2.1% | 2.5% | 0.8% | 0.8% | 1.4% | 2.0% |
| Citigroup Credit | 1.6% | 0.1% | -2.1% | -2.1% | 3.3% | 3.2% |
| Merrill High Yield | -2.2% | -4.6% | -2.3% | -2.3% | 7.3% | 3.8% |
| JPM EMBI Global (USD) | 1.5% | -1.2% | -4.6% | -4.6% | 4.7% | 4.2% |
| Citigroup WGBI Ex-US (LC) | 1.1% | 1.6% | 1.2% | 1.2% | 1.9% | 3.4% |
| Citigroup Credit AAA/AA 10+ | 3.7% | 1.3% | -4.0% | -4.0% | 4.6% | 5.9% |
| Barclays US Aggregate | 1.8% | 1.6% | 0.0% | 0.0% | 2.1% | 2.5% |
| GSCI Total Return | -7.8% | -22.9% | -13.8% | -13.8% | 0.5% | -14.5% |
| HFRX Eq. Wtd. Strategies | -1.2% | -3.9% | -5.4% | -5.4% | 1.0% | 0.2% |