2018 Market Recap

As the calendar turned to 2018, optimism was sky high. Markets had just finished one of their best years of the bull run that began in 2009 and it appeared the run was going to continue through the first few weeks of January. But the dreams of an infinite bull market were quickly dashed, as the S&P 500 suffered a 10% correction over the next few weeks. After stabilizing around the beginning of April, things started to look more like 2017 as US markets began their slow and steady march higher. But under the surface a storm of risks was brewing, and eventually they would conspire to deliver something that investors hadn't seen since 2008…. a year with negative returns.

As the Federal Reserve continued to raise interest rates into 2018, fixed income investments remained under pressure. The Fed raised short term rates by a total of 1% in 2018 to reach a current level of 2.5%. As rates moved up, bond prices continued to move lower and the Barclays Aggregate Bond Index was down as much as 3% on the year in May. International equities also struggled with the combination of increased tariffs and a strong dollar resulting in lower growth forecasts and increased uncertainty around the world, particularly in emerging markets. The large performance gap had many investors wondering why they should even consider international investments in the face of such strong US performance.

In addition to raising rates, the Fed continued to wind down its balance sheet by choosing not to re-invest maturing bonds. The process known as "Quantitative Easing" was now being reversed and along with it, another layer of uncertainty that markets would have to deal with. For the most part, investors seemed to shrug off the possibility that removing monetary stimulus would cause any sort of disruption. Some believed that the tax cuts announced late last year would help bridge the gap and act as a fiscal policy boost in the face of a reduction in monetary policy. Strong corporate earnings growth helped propel the S&P 500 to an all-time high close of 2,930 on September 20th.

As the market peaked in September, tariff talks continued to dominate headlines, the Fed remained firm in their intention to continue to raise rates and corporate CEOs began to show some reservation in their growth forecasts for the coming quarters. Over the next three months, the S&P 500 shed close to 20% in value. While no one catalyst was definitively responsible for such a violent move down, the mounting risk factors that surfaced throughout the year collectively contributed to the sudden re-pricing of assets.

As we look back at 2018, we see a market that was both normal and abnormal. Volatility, drawdowns and even negative years are certainly more typical than most investors believe (about 26% of the calendar year since 1925). But the rarities that occurred in 2018 also put it in infamous company. The best example of this: According to data compiled by Deutsche Bank, of the 70 asset classes they track, over 90% posted negative total returns for 2018 vs. only 1% in 2017. The 90% mark is the highest in 100 years!

Historical rarities aside, the challenges that investors faced in 2018 likely won't go away overnight. Nonetheless, HCM will continue to focus on delivering timely, transparent, and thoughtful advice to clients.