STERLING CAPITAL

Weekly Market Recap
December 10, 2018

		Return	
Index	**Close**	**Week**	**YTD**
Dow Jones Industrial Average	24,389	-4.5%	-1.3%
S&P 500 Index	2,633	-4.6%	-1.5%
NASDAQ	6,969	-4.9%	1.0%
Russell 2000 Index	1,448	-5.6%	-5.7%
MSCI EAFE Index	1,758	-2.8%	-14.3%
10-yr Treasury Yield	2.85%	-0.14%	0.45%
Oil ($/bbl)	$52.34	2.8%	-13.4%
Bonds*	$105.48	0.8%	-1.0%

Source: Bloomberg, 12/07/18.

*Bonds represented by the iShares U.S. Aggregate Bond ETF.

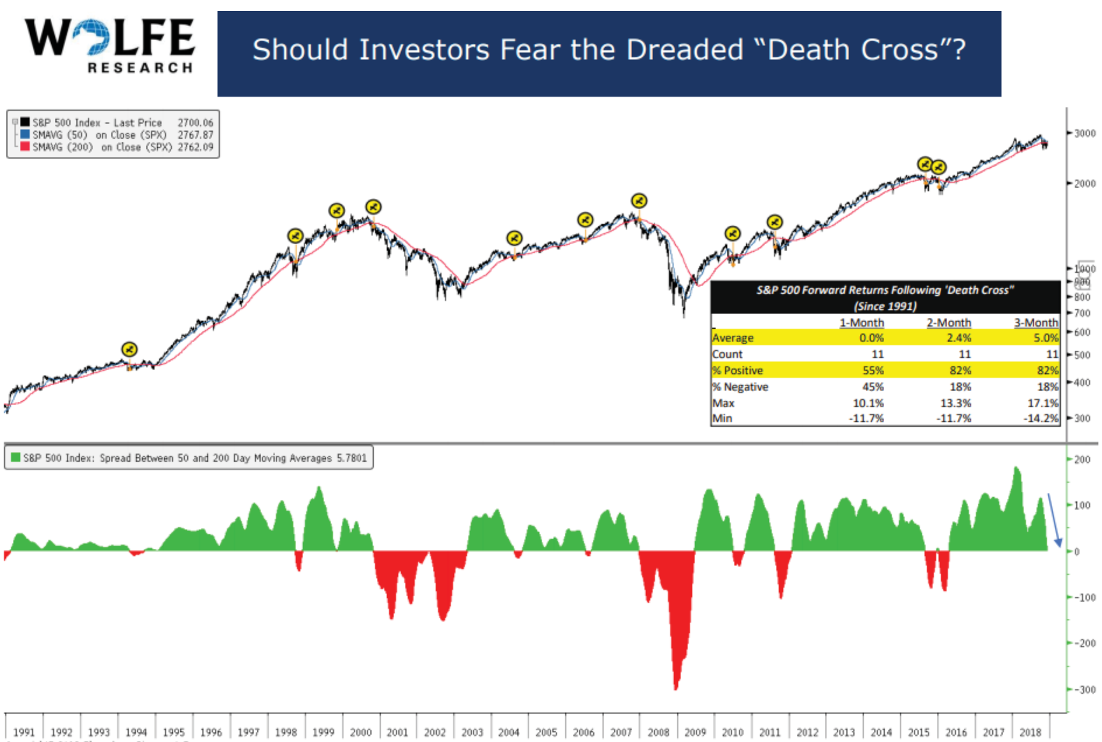
<u>Last Week:</u>

U.S. Equity Markets

- U.S. large cap equities (S&P 500 Index) declined -4.6% after posting their biggest gains of 2019 in the prior week as the announced trade truce between the US and China provided minimal optimism on Monday, but was overtaken by the lack of details of the trade truce, Trump's "Tariff Man" tweet, arrest of Chinese executives, and yield curve inversion concerns. It marked the worst start for U.S. equities in the month of December since 1950, according to *Barron's*. Higher-valuation growth stocks and small caps underperformed slower-growing value/defensive stocks
    - Utilities (+1.3%) and REITs (+0.4%) outperformed as investors favored defensive stocks with stable yields
    - Consumer Staples (-3.1%), Energy (-3.1%), Communication Services (-4.1%), and Consumer Discretionary (-4.2%) outperformed
    - Industrials (-6.3%), Materials (-5.2%), and Healthcare (-4.6%) underperformed
    - Information Technology (-5.1%) underperformed led by Nvidia (-9.8%), **Alphabet** (-5.7%) and Apple (-5.7%)
    - Financials (-7.1%) significantly underperformed as investor concerns of yield curve inversion weighed on banks; however, bank executive commentary was generally positive regarding US economic backdrop, credit ratings, and loan growth
- The Dow Industrials declined -4.5%, led by Caterpillar (-8.9%), JP Morgan Chase (-7.1%), Dow Dupont (-7.1%), Boeing (-6.8%), and Apple (-5.7%)
- Small-cap equities underperformed U.S. large caps as the Russell 2000 Index fell -5.6%
- The technology-heavy Nasdaq Composite Index (-4.9%) underperformed the S&P 500 Index as investors preferred defensive, lower-valuation stocks
- The S&P 500 is on track for its worst quarter in seven years, and also saw a so-called "death cross" form

Source: MarketWatch

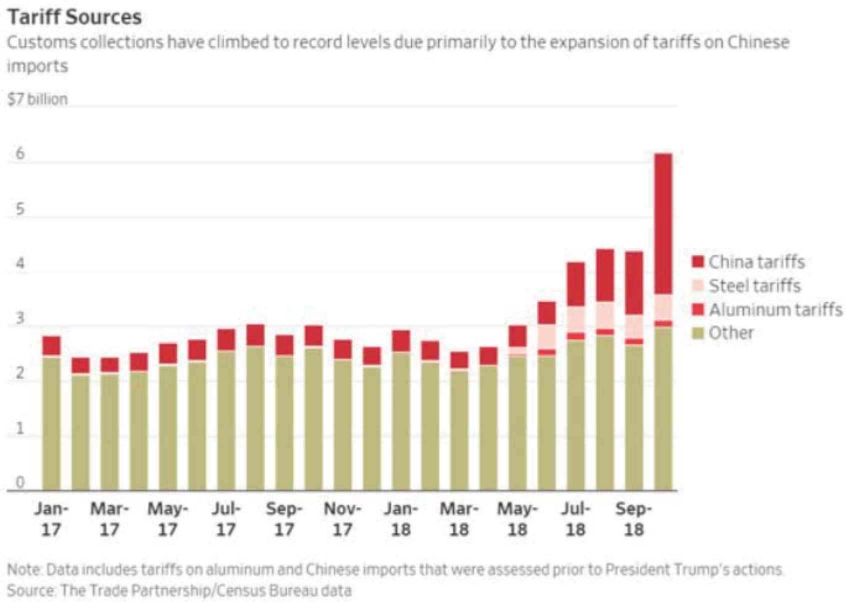
- However, on average the stock market has been higher 82% of the time two months after previous death crosses, as shown in the inset table of the attached exhibit



Source: Wolfe Research Technical Analysis and Bloomberg

International Markets and News

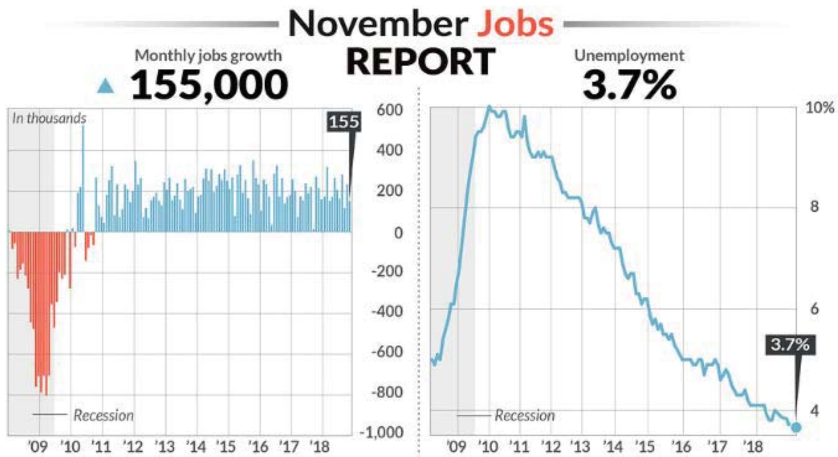
- European equities (STOOX Europe 600) fell more than 4% as hopes for reduced trade tensions between the U.S. and China soured, and ongoing uncertainty regarding Brexit, Italy's budget deficit, and slower economic growth weighed on markets
    - Utilities (-0.5%), REITs (-1.3%), and Personal & Household goods (-1.4%) outperformed as investors favored defensive stocks with stable yields. Insurance (-5.4%), Construction & Materials (-5.3%), Industrial Goods & Services (-4.8%), Auto & Parts (-4.8%) and Banks (-4.5%) underperformed
    - Germany's DAX index fell more than 4% for the week and slipped into bear market territory (20% since its January 23rd peak). The DAX Index is very sensitive to global economic growth concerns given its heavy exposure to automotive and export-driven companies
        - Germany's CDU elected a new leader of the party after German Chancellor Merkel decided to stand down as party leader, but Merkel intends to stay on as Chancellor until the next election in October 2021
    - Brexit uncertainty escalated ahead of next Tuesday's parliamentary vote on the deal with Prime Minister Theresa May continuing to defend her deal, but was unable to win over critics and it is thought that she could be defeated by 70 to 200 votes. With no parliamentary majority for a no-deal Brexit, it has raised expectations for a soft Brexit or even a second referendum
    - Italy's coalition government continued to argue over the extent of its budget changes in order to avoid a disciplinary procedure from the European Monetary Union (EU) before the December 19th deadline. Italy may have identified savings of ¬5B, but the EU is pushing for ¬8B
    - French President Macron came under pressure after more public unrest related to fuel tax rises and wider discontent over economic reforms, which led to the French government cancelling planned fuel tax rises for next year
- Chinese markets edged modestly higher (Shanghai Composite Index) during the week, but the arrest of a Chinese telecom executive jeopardized the trade truce struck by the U.S. and China at the G-20 summit last weekend
    - On Saturday (12/09/18), President Trump agreed to leave tariffs on $200B worth of Chinese products at the 10% rate on January 1st, 2019, and not hike tariff levels to 25%, with a goal to reach a more comprehensive agreement within the next 90 days, but if the parties are unable to reach a deal in this timeframe, the 10% tariffs will be raised to 25%
    - Canadian authorities detained and arrested Sabrina Meng Wanzhou, CFO of Chinese network gear maker Huawei Technologies, at the U.S.'s request for violating sanctions on Iran. The arrest of Meng, who faces extradition to the U.S., drew outrage in China and threatened to sink U.S./China relations to a new low, causing Chinese stocks to decline through the end of the week
    - Additionally, President Trump (via Twitter) referred to himself as "Tariff Man"
    - The expansion of tariffs on Chinese imports has driven record customs collections



- Japanese equities fell (Nikkei 225 Index) during the week as Japan's GDP may have fallen more than the government's initial third-quarter estimate, and November manufacturing activity slowed
  - A recent Reuters poll suggests that Japan's third-quarter GDP may be revised down from a contraction of -1.2% to -1.9%, potentially due to a greater decline in capital expenditures.
  - Economists think Japan's economy could struggle to generate growth in 2019 as the U.S.-China trade dispute may already be disrupting global supply chains, possibly crimping Japan's export-dependent economy
  - The Nikkei Japan Manufacturing Purchasing Managers' Index (PMI) fell in November to its weakest level since August 2017 due to falling demand from Europe and China. November's PMI dropped to 52.2 from 52.9 in October (index readings above 50.0 indicate expansion). The short-term boost from post-typhoon demand may be fleeting

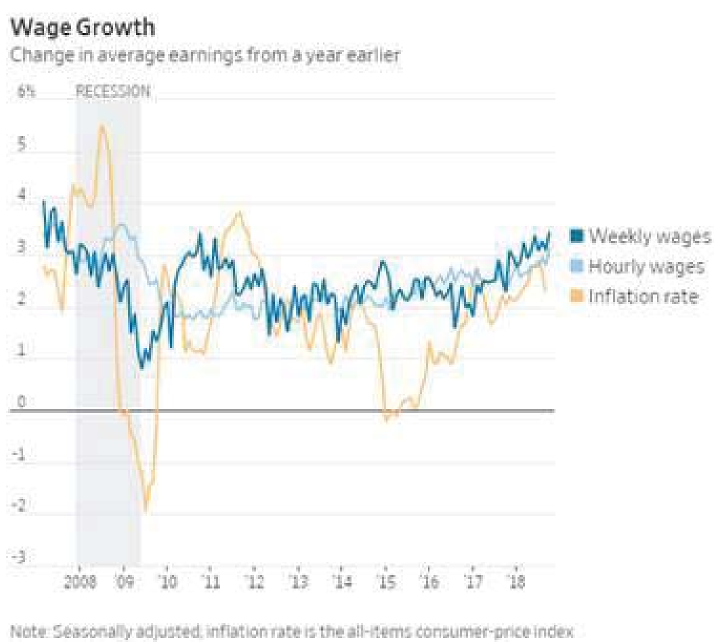
U.S. Economic and Political News

- Economic data was mixed
  - Markit's Services PMI dipped to 54.7 in November from 54.8 in October
  - The University of Michigan's Consumer Sentiment index registered 97.5 in its preliminary December reading, above the 97.3 consensus forecast, and in-line with November's 97.5 result
  - Challenger, Gray, and Christmas reported layoff notices have totaled 495,000 year-to-date, up 28% year-over-year and the highest 11-month total since 2015
  - The ADP Private Payrolls report showed an increase of 179,000, a bit below the 195,000 consensus forecast
  - November Non-Farm Payrolls reflected a gain of 155,000 jobs, while October's figure got revised lower by 13,000, and September's got revised up by 1,000
  - Unemployment remained steady at 3.7%



Source: Bureau of Labor Statistics

- Average Hourly Earnings rose 3.1% year-over-year, with rising wage inflation provides the Fed some ground cover for additional interest rate increases



Source: Labor Department

- Dallas Fed President Robert Kaplan offered up a dovish comment Thursday, saying he thinks "there is more uncertainty, global growth is decelerating. I am seeing some interest rate sensitive sectors showing some weakness. It is too soon to say what to make of it, but one of the key tools we have as a central bank is patience and I think we should be using that tool."
  - That begs the question of which investors would prefer: stronger global growth, or lower interest rates, because it seems unlikely for both to occur simultaneously
- Fed Funds Futures are pricing in a 76% probability of a quarter point increase in overnight interest rates at the Fed's upcoming December 19th meeting, but only one rate hike in 2019, down from three

  - The market also is pricing in a likelihood of interest rate CUTS in 2020, potentially linked to an economic slowdown
- President Trump nominated Heather Nauert to fill Nikki Haley's spot as UN Ambassador, while also nominating Bill Barr to replace Jeff Sessions as Attorney General
- Larry Kudlow, director of the National Economic Council, says the Congressional Budget Office's economic growth estimates are too pessimistic, and he doesn't see a recession coming "for the next couple of years at least." Kudlow made his remarks at the WSJ CEO Council
- Credit Suisse agrees with Mr. Kudlow as its recessionary indicators point to limited downside risk

Figure 13: Recession Dashboard

Recessionary indicators point to limited downside risk

Start of Recession	Yield Curve	Inflation Trends	Job Creation	Credit Perform	ISM Mfg.	Earnings Quality	Housing Market
Nov-73	↓	↓	↓	↓	↓	--	↓
Jan-80	↓	↓	↓	↓	↓	--	↓
Jul-81	↓	↑	↑	↓	↓	--	↓
Jul-90	↓	↓	↓	↓	↓	↓	↓
Mar-01	↓	↓	↓	↓	↓	↓	↔
Dec-07	↓	↓	↔	↓	↓	↓	↓
Present	↑	↔	↑	↑	↑	↑	↑

Key: ↓ Recessionary ↑ Expansionary ↔ Neutral

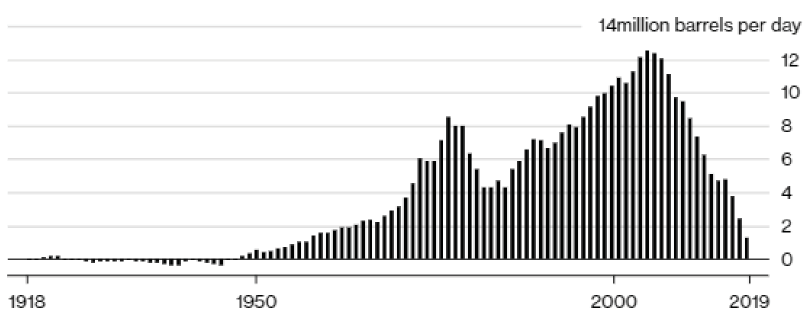
Source: Standard & Poor's, Federal Reserve, BLS, National Statistical Agencies, NBER, ISM, Census Bureau, Haver Analytics®, Credit Suisse

Commodities

- Gold gained 2.2% for its biggest weekly increase since August
- WTI crude oil was up nearly 3% for the week with some help from a big Friday rally that came after OPEC and its allies reached a deal on a 1.2M barrels per day production cut
- This past week, the U.S. was a net exporter of oil for the first time in nearly 70 years

American Oil Renaissance

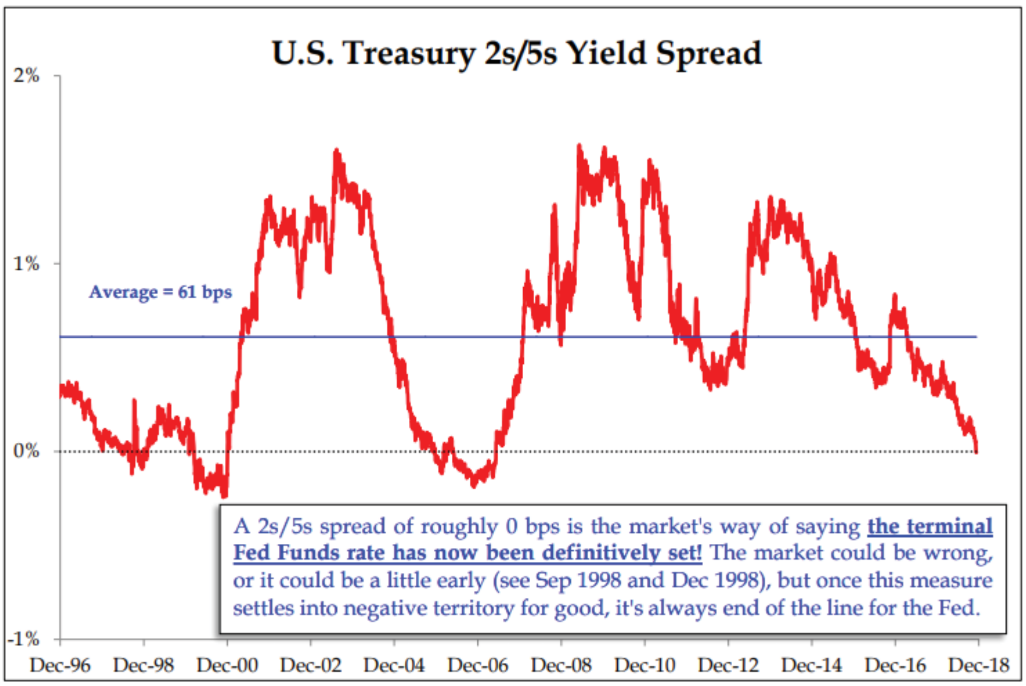
U.S. net imports of crude oil and refined petroleum products



Sources: 1918-1948 courtesy of Michael Lynch and adapted from American Petroleum Institute's 'Petroleum Facts and Figures 1959'; for 1949-2017 U.S. EIA 'Monthly Energy Review'. 2018 and 2019 are forecast from the EIA.

Fixed Income

- Despite the 2- to 5- year Treasury inversion, the more closely watched 2- to 10-year portion of the yield curve did not invert, but traded at its tightest level since 2007
    - Historically, an inversion of the 2- to 10-year and/or 3-month to 10-year Treasury spread has been a significantly more reliable indicator of an economic recession, while the 2- to 5-year inversion has been significantly less reliable
    - According to Credit Suisse, an inverted yield curve historically has been accompanied by a number of worrying signals (layoffs, credit deterioration, etc.), which are not occurring in the current environment
    - The lead time between inversion and the onset of economic contraction has ranged from 14 – 34 months and been quite inconsistent, and equities have gained 15-16% on average in the 18 months following inversions



Source: Strategas

This Week:

- Equities are down across the globe
- The U.S. earnings calendar will be relatively quiet as third quarter winds down, but economic data may be in focus
- U.S. economic data:
    - Monday: JOLTs Job Opening (Oct), Consumer inflation Expectations (Nov)
    - Tuesday: NFIB business optimism (Nov), Core PPI (Nov)
    - Wednesday: CPI core (Nov), Treasury Budget (Nov)
    - Thursday: Import / Export Prices (Nov)
    - Friday: Retail Sales (Nov), Capacity Utilization (Nov), Industrial Production (Nov), Manufacturing Production (Nov), Markit PMI Services / Manufacturing (Dec), Business Inventories (Oct)
- International economic data:
    - Monday: Germany: Current Account (Oct), Import / Export (Oct), Trade Balance (Oct); UK: Construction Output (Oct), Index Services (Oct), Industrial production (Oct), Manufacturing Production (Oct), Trade Balance (Oct), Japan: GDP Q3, Bank Lending (Nov)
    - Tuesday: Euro-zone: ZEW Economic Sentiment Index (Dec); Germany: ZEW Current Conditions (Dec); China: Vehicle Sales y/y
    - Wednesday: Euro-zone: Industrial Production; China: Fixed Asset Investment (Nov), Foreign investment (Nov); Japan: Machinery Orders (Oct), PPI (Nov)
    - Thursday: Euro-zone: Deposit Facility Rate, ECB Interest Rate Decision, ECB, Press Conference; Germany: CPI rate (Nov), Harmonized CPI (Nov)
    - Friday: Euro-zone: Markit Composite PMI Flash (Dec), Labor Cost Index (Q3), Wage Growth (Q3), Euro Council Meeting; Germany: Wholesale Prices (Nov), Composite Flash PMI (Dec), Bundesbank Semi-annual forecast; China: Industrial Production (Nov), Retail Sales (Nov), New Yuan Loans (Nov), M2 Money Supply (Nov), House price index (Nov); Japan: Industrial Production (Oct) Capacity Utilization (Oct)

As always, thank you very much for your interest in our thoughts and support of our services

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