



## Quarterly Review & Outlook

### 4Q Review

2018 proved to be a “Tale of Two Cities” year, as investors were confronted with a range of contradictions: Unemployment ended the year at nearly a 50-year low and wages have been rising yet fears of a recession have increased. Corporate earnings were amazingly strong while stock prices sank sharply into correction territory by the end of the year. Investors are now left to question whether solid fundamentals or growing uncertainty will shape the markets.

Ironically, 2018 was relatively calm until the fourth quarter. Outside of a brief correction in January and February driven by fears of rising interest rates, investors focused on an accelerating economy and strong earnings growth. Stock prices rose to record levels by the end of the summer.

U.S. economic growth was quite strong in 2018, helped in no small part by the 2017 tax cuts. At the beginning of the year, we believed real U.S. gross domestic product growth would reach 3%. This level was much higher than consensus estimates, but it did come to pass. We also expected corporate earnings growth to rise but were surprised by the incredible S&P 500 earnings per share growth of 22.6% year over year.

What happened over the last three months? Stocks may have reached overbought levels by the end of the summer, so it wasn't shocking to see a selloff. But the magnitude of the decline has been surprising. We see two primary drivers of the current selloff. First is a genuine fundamental issue of higher interest rates and inflation. Neither has been moving strikingly higher, but they have advanced over the last 12 months, compressing equity valuations. Second, consider a large list of worries: concerns over slowing economic and earnings growth and trade issues are the most prominent, but investors are also worried about Brexit, the Italian budget stalemate, falling oil prices, political dysfunction and uncertain Federal Reserve policy.

### **DCP US All-Cap Review**

In the midst of this turmoil, the DCP US All-Cap Portfolio did outperform as would be expected, although not to the extent that we demand of ourselves. The US All-Cap Strategy fell 12.40% vs a 13.52% drop for the S&P 500.

The outperformance was driven by our zero weighting to the Energy sector, which turned in the worst performance of the quarter, as well as our cash allocation, which did help buffer some of the downside. Laggards for the quarter included our underweight to Utilities, the best performing sector, as well as our overweight to the Technology sector.

### **DCP International All-Cap Review**

Our International portfolio also outperformed the broader MSCI EAFE with a -12.24% return vs. -12.50% for the benchmark. The outperformance was driven primarily by stock selection in the Materials and Healthcare sectors, as well as our overweight to cash. The strategy was hurt by stock selection in the Technology sector, as well as our overweight to Chinese equities.

### **2019 Outlook**

We have many questions, but we think it is fairly certain that the U.S. will not fall into recession in 2019. We don't see any signals that make a reasonable case for recession. The consumer sector looks strong, particularly the labor market. The corporate sector is solid, although corporate management teams have scaled back some plans due to trade concerns. And the government sector appears to be expanding, as spending is likely to rise. We expect growth will slow next year compared to 2018, but to a still-above-trend 2%+ level.

However, we can easily make a bullish or bearish case for stocks. We could argue that recession fears will likely fade as data continue to be positive. Should that happen, stock prices could again rally on decent fundamentals, especially since valuations are more attractive now than they were a few months ago. Conversely, even if the economy continues to grow, investors will become increasingly concerned about slowing earnings growth. They will continue looking for reasons to sell, which could produce a trendless or even falling market into 2019.

At the end of the day, as professional investors we are obligated to make a call and lean toward a constructive view on equities. We think markets will remain choppy and frustrating and stocks will bounce around with extended runs and declines. Ultimately though, we think the bullish factors will generally overpower the bearish ones.

We expect 2019 market performance will be stronger than 2018. We think a reasonable year-end target range for the S&P 500 Index would be around 2,650, meaning a decent gain for stocks. To get there, recession fears cannot be realized.

As volatility remains elevated, we think 2019 will be a difficult environment for investors. Remaining selective and tactical would seem to be the order of the day. Long term investors may want to add to positions during periods of weakness and trim holdings during periods of strength.

Additionally, we point to several themes that we think may win out over the course of 2019. Specifically, we think focusing on factors such as high free cash flow, inexpensive valuations, the ability to grow top-line earnings and an eventual tilt toward non-U.S. sources of revenue would benefit investors.

The team and I at Durand Capital truly appreciate your loyalty and trust. As always, if you have any questions in regard to anything above, or just questions about the strategy in general, please do not hesitate to get in contact.

Sincerely,

**Jim Tassoni**  
*President/CIO*  
**Durand Capital Partners**