January 5, 2019

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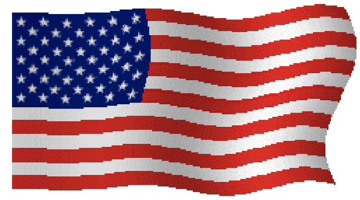

Three Market Headwinds Cause Historic Volatility

A decade of consecutive positive annual returns from the S&P 500 ended in 2018. In the final three months of the year the S&P 500 registered its worst quarterly performance in seven years and ended 2018 with a negative annual total return for the first time since 2008.

Contrary to most of the headlines we saw during the last three months, the sharp declines in stocks weren't directly driven by trade wars or ongoing political dramas, all of which were with us for the majority of 2018. Instead, the break down in stocks was driven by a trifecta of classic economic and market concerns emanating from underwhelming corporate earnings guidance, suddenly lackluster economic growth and disappointment towards Federal Reserve monetary policy.

Stocks initially dropped in early October as the third-quarter corporate earnings season disappointed markets. While most companies beat consensus estimates, as they often do, profit warnings from select multinational and industrial firms such as PPG Industries (PPG) and FedEx (FDX) highlighted growing concerns from analysts about peak earnings growth for U.S. corporations. That rising concern was reflected by the market's performance during the heart of the third-quarter reporting season, as the S&P 500 declined 6.84% in October.

After a respite from selling in November that saw stocks bounce back slightly from the October losses, earnings concerns were compounded in December by suddenly disappointing economic readings. In early December, multiple economic indicators including manufacturing surveys and the November jobs report missed Wall Street consensus estimates, adding the potential of slowing economic growth to the list of headwinds on stocks.

Finally, uncertainty regarding U.S. monetary policy in the wake of the December rate hike by the Federal Reserve added yet another source of concern for investors, and that additional unknown caused a massive spike in market volatility in late December. Specifically, the Fed increased interest rates for the fourth time in 2018, despite the declines in stocks and wavering economic data, and signaled it expects to increase rates two more times in 2019. That policy decision, which was more restrictive than investors were hoping for, caused stocks to plunge as the major equity indexes dropped to fresh 52-week lows during the final two weeks of December. Markets did bounce modestly during the final days of 2018 to finish off the worst levels of the year, but still solidly negative on an annual basis.

Despite the legitimate concerns about economic growth, earnings and Fed policy, the news in the fourth quarter wasn't all bad.

First, the U.S. and China agreed to a temporary trade war "truce" and began an intense, 90-day negotiation period aimed at ending the trade war.

Second, the European Union and the Italian government reached a compromise on Italy's proposed 2019 budget that satisfied European Commission rules, thereby avoiding a political showdown.

Lastly, most major indicators of U.S. economic growth, while exhibiting a loss of momentum, remained in solidly positive territory, meaning the economy is still growing (albeit, potentially at a slower pace). The November Employment Situation Report showed positive jobs growth and an unemployment rate under 4% while regional manufacturing surveys remained in positive territory.

In sum, 2018 was a very difficult year in the markets and for investors. Not only did most major stock indices post a negative full-year total return for the first time since 2008, but the declines came with two episodes of intense, confidence-shaking volatility in the first and fourth quarters.

But, it's important to remember that while volatile markets can and will occur, just like they did most recently in 2011 and 2015, the fundamental drivers of the multi-year rise in stocks remain generally in place, and that's important context to remember as we begin a new quarter and calendar year.

4th Quarter and Full Year 2018 Performance Review

The fourth quarter of 2018 was the worst quarter in years as the S&P 500 saw its biggest quarterly decline since Q3 of 2011. Of the four major stock indices (S&P 500, Dow Industrials, Nasdaq, Russell 2000) only the tech heavy Nasdaq managed a positive total return in 2018.

All market capitalizations saw a negative return in Q4 and for the full year of 2018. However, on a relative basis, large caps outperformed small caps over the course of the year and especially in the fourth quarter as investors' concerns shifted from trade to economic growth during the final months of the year.

From a style standpoint, value outperformed growth in Q4 but growth handily outperformed value on a full-year basis, thanks predominantly to relative outperformance of information technology and consumer discretionary stocks, however both growth and value styles finished the fourth quarter and the full year with negative total returns.

Looking at sector performance, most major market sectors ended the fourth quarter with a decidedly negative total return, although utilities were the exception as the sector closed with a modest positive total return in Q4. Generally speaking, market sectors that are historically more sensitive to changes in economic growth underperformed in 2018, most notably in the fourth quarter. Energy, basic materials, industrial and financial sectors all declined sharply in Q4 and finished with decidedly negative annual returns. Less economically sensitive sectors such as utilities, healthcare and consumer staples saw more mixed annual performance. Healthcare was the best performing S&P 500 market sector for 2018, while utilities also finished the year with a small positive return.

As previously mentioned, two sector outliers were information technology and consumer discretionary. Both sectors declined sharply in the fourth quarter, but thanks to strong performance earlier in the year, consumer discretionary finished 2018 with a small positive return, while information technology relatively outperformed the S&P 500.

S&P 500 Total Returns by Month in 2018											
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
5.73%	-3.69%	-2.54%	0.38%	2.41%	0.62%	3.72%	3.26%	0.57%	-6.84%	2.04%	-9.03%

Source: Morningstar

US Equity Indexes	Q4 Return	2018 Return
S&P 500	-13.52%	-4.38%
DJ Industrial Average	-11.31%	-3.48%
NASDAQ Composite	-16.76%	0.04%
S&P MidCap 400	-17.28%	-11.08%
Russell 2000	-20.20%	-11.01%

Source: Morningstar

Looking overseas, 2018 was a very difficult and disappointing year for foreign markets as they faced multiple headwinds which negatively impacted returns including political uncertainty via Brexit, lackluster economic growth in Japan and China, and emerging market political stress in Turkey (especially during the third quarter). Most foreign markets generally tracked the S&P 500 during the fourth quarter, but badly underperformed on an annual basis.

More specifically, foreign developed markets saw similar declines to the S&P 500 during the fourth quarter, but finished 2018 with substantial losses given the economic and market headwinds.

Meanwhile, emerging markets badly underperformed U.S. stocks through the first three quarters of 2018, but relatively outperformed in the fourth quarter. Some political and trade-related clarity via the calming of the Turkish currency crisis and the temporary U.S.-China trade truce helped contain emerging market declines in this most-recent quarter.

International Equity Indexes	Q4 Return	2018 Return
MSCI EAFE NR USD (Foreign Developed)	-12.54%	-13.79%
MSCI EM NR USD (Emerging Markets)	-7.47%	-14.58%
MSCI ACWI Ex USA NR USD (Foreign Dev & EM)	-11.46%	-14.20%

Source: Morningstar

Commodities investors also had a tough year in 2018 as major commodity indices fell sharply during the fourth quarter and ended the year decidedly negative thanks to the plunge in oil in the final three months of the year.

During the fourth quarter oil dropped to multi-year lows thanks to supply and demand worries. Demand-related concerns emanated from potentially slowing global economic growth, while on the supply side, OPEC oil production cuts were smaller than expected.

Gold notably bucked the negative trend in commodities during the fourth quarter. Gold was one of the best performing assets across markets posting a positive return in Q4 thanks to macroeconomic uncertainty and a weaker dollar. For full-year 2018, gold still had a negative return due to weakness through the first three quarters of 2018.

Commodity Indexes	Q4 Return	2018 Return
S&P GSCI (Broad-Based Commodities)	-22.94%	-13.82%
S&P GSCI Crude Oil	-37.94%	-20.49%
LBMA Gold Price	7.73%	-0.93%

Source: Morningstar

Switching to the fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) saw positive returns during the fourth quarter, and that helped produce a fractionally positive total return in 2018. Stock market volatility combined with falling inflation metrics helped bonds rally during the fourth quarter.

Looking deeper into the fixed income markets, longer-duration bonds outperformed those with shorter-durations during the fourth quarter, which was a reversal from the previous two quarters. But, in 2018, shorter-duration bonds still outperformed, which is typical when the Fed is raising interest rates.

Corporate bonds, both investment grade and high yield, fell during the fourth quarter. High-yield bonds bore the brunt of the selling and finished the quarter with substantial losses. For full-year 2018, both investment grade and high-yield bonds closed with decidedly negative total returns, as concerns about slowing economic growth and corporate earnings weighed on both bond classes.

US Bond Indexes	Q4 Return	2018 Return
BBgBarc US Agg Bond	1.64%	0.01%
BBgBarc US T-Bill 1-3 Mon	0.56%	1.82%
ICE US T-Bond 7-10 Year	3.75%	0.90%
BBgBarc US MBS (Mortgage-backed)	2.08%	0.99%

BBgBarc Municipal	1.69%	1.28%
BBgBarc US Corporate Invest Grade	-0.54%	-3.69%
BBgBarc US Corporate High Yield	-4.72%	-2.57%

Source: Morningstar

1st Quarter and 2019 Market Outlook

Investors begin 2019 reeling from the worst quarter in years and with markets facing multiple headwinds including an uncertain outlook for corporate earnings, potentially slowing economic growth, and a lack of clarity on Fed policy. Yet, at the same time, these concerns have been at least partially acknowledged by the markets as the major U.S. stock indices begin 2019 more than 10% off their 2018 highs, as expectations for earnings and economic growth have been reduced.

At a minimum, we can expect continued volatility in stock, bond and commodity markets in the coming months. And, whether the markets continue the fourth-quarter declines or rebound will depend largely on the resolution of those three uncertainties facing markets: Earnings, economic growth and Fed policy.

Regarding earnings, the bulk of the fourth-quarter 2018 earnings results will be released this month, so within the next few weeks we should learn whether U.S. corporate results have stabilized, or whether the disappointing guidance we saw from companies in Q3 continued.

Economically, investors will be focused on widely followed economic reports (including the December Employment Situation Report, ISM Manufacturing PMI, Retail Sales, Core PCE Price Index) to determine whether U.S. economic growth has indeed peaked.

From a Fed policy standpoint, the next Fed meeting occurs at the end of January, but there’s an important change in Fed procedure to consider in 2019. Fed Chair Jerome Powell will hold a press conference after each meeting in 2019 (the change was announced well before the recent market volatility). That additional, regular communication should afford the chairman the opportunity to communicate more effectively with investors and potentially resolve uncertainty regarding Fed policy.

Finally, we begin 2019 with numerous geopolitical situations to watch. First, the U.S.-China trade talks are ongoing and there remains hope that the two sides will reach an agreement to reduce existing tariffs before the 90-day negotiation period expires. In Europe, Brexit remains unsettled, although negotiations among Britain’s largest political parties continues in an effort to approve the Brexit agreement with Europe.

Bottom line, this is an environment that requires vigilance and heightened focus on financial market moves, economic news and political developments.

However, while we can expect volatility to continue, especially early in 2019, it’s important to remember that the last two episodes of similar volatility (2011 and 2015) proved to be long-term buying opportunities.

Past performance is not indicative of future results, but history has shown that a long-term approach combined with a well-designed and well-executed investment strategy can overcome periods of heightened volatility, market corrections, and even bear markets.

We understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility like we experienced in the fourth quarter is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's important for you to stay invested, remain patient, and stick to the plan. We've worked with you to establish a personal allocation target based on your financial position, risk tolerance, and investment timeline. Therefore, we aim to take a diversified and disciplined approach with a clear focus on longer-term goals.

We understand that volatile markets are both unnerving and stressful, and we thank you for your ongoing confidence and trust.

We hope you find the information in this newsletter useful, and always welcome your feedback.

Best regards,

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