Although we expected more volatility and lower returns in 2018, we didn’t anticipate declines in almost every asset class. Investors know years with losses aren’t unusual – for example, stocks have dropped in about one of every five years.* As the chart shows, less volatile assets classes generally declined less than more volatile ones in 2018 but also had lower three-year returns, reflecting the usual trade-off between risk and return. A better-diversified portfolio with appropriate allocations to all asset classes can help reduce portfolio volatility over time while helping you toward your long-term goals.

Bull market survived – The S&P 500 and the Dow both edged near bear territory on Dec. 24 – down 19.8% and 18.8%, respectively. But they then bounced back sharply, keeping the U.S. bull market alive. However, emerging-market stocks entered a bear market in late October. And December’s declines put U.S. small- and mid-cap stocks as well as the Nasdaq index into bear markets.

Risks seem balanced – Many of the worries that triggered the second U.S. correction in 2018 are likely to continue to prompt volatility in all asset classes in 2019. We think current prices reflect pessimistic expectations and that the risks are more balanced. A resolution of tariff and trade uncertainties, modest global economic and earnings growth and slow rate hikes from a patient Federal Reserve could be catalysts for higher global stock prices.

Positive but volatile outlook – Solid fundamentals and better valuations are a positive environment for investors. We think U.S. economic and earnings growth will continue at slower rates in 2019, helping calm emotions and support rising stock prices. And low expectations mean international equities could benefit if growth in China and developed economies improves slightly. After lagging in the first three quarters of 2018, international equities (EAFE and EM) outperformed U.S. stocks in the fourth quarter, which we think could continue.

Action for Investors
The return to higher market volatility is a reminder to stay focused on what matters to you and not daily market moves. We recommend you stay invested over time in an appropriate mix of equities and fixed income based on your comfort with volatility and your long-term goals, and use a consistent investment process that includes adding investments at lower prices during pullbacks (and bear markets) if appropriate.

After 2018 marked this expansion’s best year of GDP growth, we expect modestly lower growth this year. Late-cycle symptoms are sapping some of the U.S. economy’s momentum. That said, we still view a recession in 2019 as unlikely given the healthy labor market and still-positive business investment cycle.

**No recession this year** – We think predictions of an economic downturn are premature. The pace of U.S. GDP growth will likely wane a bit as the tax boost fades and the housing and auto cycles mature. However, manufacturing and service activity remain in expansionary territory, job growth is still healthy, and interest rates are not yet at levels that will snuff out growth.

**Labor market still the key tailwind** – Unemployment is at a 50-year low, and we anticipate it to move slightly lower this year. Historically, the unemployment rate has risen by nearly 0.5% before a recession began, so current employment conditions suggest the expansion will be extended this year. Additionally, the household savings rate has averaged 6.8% since 2014 (versus an average of 3.6% from 2004-2007), signaling consumers are not tapped out. Along with faster wage growth and lower gasoline prices, this should support ongoing household spending (the lion’s share of GDP).

**Age spots bring new stripes** – This is the second-longest expansion on record, and while age is just a number, we expect the complexion to change in this latter phase of the economic cycle. As the markets adjust to a more modest economic backdrop, they are likely to be more sensitive to what will probably be a more balanced mix of encouraging and underwhelming economic readings. That said, expectations have grown overly pessimistic, in our view. In fact, since 1950, the final two years of an economic expansion saw average equity market returns of 8.8%.

**Action for Investors**

Late-cycle conditions are likely to produce higher market volatility, warranting an equity-fixed income balance in line with your long-term target. We think the economic backdrop can still support stock market gains, but large-cap equities and sectors with less cyclical earnings offer an opportunity to reduce some risk within equity allocations.

*Source: MorningStar Direct, Ibbotson SBBI US Large Stock TR USD is used to represent S&P 500 returns. Past performance is not a guarantee of what will happen in the future.*
Near the end of 2018, U.S. stock prices dropped more severely than seemed justified given the still-positive outlook for the fundamentals of economic and earnings growth. In our view, stocks have become more attractive and the pullback may have helped extend the bull market by lowering expectations. When the fundamental outlook has remained positive, pullbacks have been an opportunity for investors to add stocks at lower prices when appropriate.

**Solid fundamentals** – We expect slower but above-average economic and earnings growth in 2019, which should support rising stock prices over time. Optimistic consumers, solid job growth and relatively low interest rates support rising consumer spending. Despite concerns about higher costs, companies seem to be finding ways to keep margins and profits high. And a resolution of trade and tariff tensions could improve prospects for cyclical and trade-sensitive sectors.

**Better valuations make large-cap stocks attractive** – In 2018, the S&P 500 dropped 6.2%, while earnings rose more than 20%. We expect earnings to increase 7% to 8% in 2019, a slower but above-average pace. As the chart shows, the S&P 500’s forward P/E fell to 15.3x, its most attractive valuation since 2013. Stocks are no longer expensive, with the P/E well below their 16.7x average over the past 28 years. In addition, large-cap stocks have had above-average returns following past years when they’ve declined while earnings rose.¹

**Bear market in smaller U.S. stocks** – Small- and mid-cap stock prices were down 22% and 27%, respectively, at their Dec. 24 lows, putting both into bear markets. Improved valuations and our expectations for rising earnings make them attractive relative to large-cap U.S. stocks. Although smaller stocks are more volatile than their larger counterparts, they have also had higher long-term returns, compensating investors for the higher risk.²

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<big><strong>Action for Investors</strong></big>

The sharp stock market pullback, including a bear market in smaller stocks, has improved equity valuations but also is a reminder that stocks are volatile. Consider your comfort with volatility and long-term goals as you determine the appropriate equity investments to add to your portfolio.

¹ Source: Bloomberg, 01/01/1987-12/31/2018, S&P 500. Past performance is not a guarantee of what will happen in the future.

² Source: Morningstar Direct, 12/31/2018. Past performance is not a guarantee of what will happen in the future.

Investing in equities involves risks. The value of your shares will fluctuate, and you may lose principal.
Continued economic expansion supports our view that equities will outperform bonds as interest rates rise slightly. However, the return of sustained market volatility highlights the importance of including fixed-income assets in your portfolio during the late stages of the bull market.

**Flat yield curve signals modest growth** – As both short-term and long-term rates increase slowly, the gap between them, known as the yield curve, has flattened, as shown in the chart above. When the yield curve is flat, short-term bonds provide a rate that is close to long-term bonds without the additional interest rate risk. Historically, flat yield curves have been consistent with modest economic growth, while slightly higher rates imply lower fixed-income returns. However, slower growth and a return of normal volatility highlight the important role bonds play in helping reduce portfolio risk. Since it’s impossible to predict future interest rates, owning a laddered bond portfolio with staggered maturities helps cushion market swings whether rates move up or down.

**Fed to be patient and flexible** – A key source of market volatility is investor concern that inflation will increase more than currently anticipated, leading the Federal Reserve to overtighten and slow economic activity or, even worse, trigger a recession. Though this is a risk, inflation is still quite moderate, and we are not expecting a spike in consumer or producer prices anytime soon. We also expect Fed policy to be flexible and responsive to changes in the economy, and to likely pause rate increases over the course of the year. In our view, the Fed’s gradual approach to rate hikes will likely extend the current bull market.

**Action for Investors**
With rates continuing to edge higher, we remain cautious about long-term bonds and recommend that they represent no more than 15% of fixed-income portfolios. If you are overweight in long-term bonds, consider adding short and intermediate maturities to take advantage of the flat yield curve and to reduce the impact that rising rates can have on your portfolio.

Investors should evaluate whether a bond ladder and the securities held within it are consistent with their investment objectives, risk tolerance and financial circumstances.
Global Stock Market Valuations Are Near Most Attractive Level Since the Financial Crisis

![Graph showing Developed-market P/E Relative to S&P 500 and Emerging-market P/E Relative to S&P 500]

Developed-market Average
Emerging-market Average

Developed-market P/E Relative to S&P 500
Emerging-market P/E Relative to S&P 500

Source: FactSet. MSCI EAFE index, MSCI Emerging Markets index and S&P 500 index.

QUARTERLY MARKET OUTLOOK: FIRST QUARTER 2019

International Outlook

We expect global economic growth to fade a bit more in 2019, hurt by stalled momentum in Europe, moderating growth in the U.S. and the ongoing slowdown in China. That said, a global recession is not yet imminent, and we think market sentiment has become overly pessimistic. Persistent but modest global expansion, mixed with ongoing policy and trade risks, will likely cause volatility to persist, but we believe international equities are poised to perform better this year.

Past the peak, but still growing – Last year’s decelerating growth in the U.S. and China, along with stalled momentum in Europe and Japan, has led to decidedly sour expectations for the global economy this year. Challenges will persist, but incoming data suggest some stabilization may be on the horizon. Foreign interest rates remain low, and monetary policies are still designed to boost economic growth in Europe and Japan. Low unemployment rates should help support growth, and profit margins are rising. Of note, China is likely to provide additional stimulus, suggesting policymakers are pursuing strategies to soften the slowdown. In our view, slower global growth can extend the cycle without signaling its end.

International uncertainties remain – In addition to Brexit and Italian debt worries, the European Central Bank will likely begin to wind down its stimulus later in the year. Similar moves by the Federal Reserve in 2015 prompted short-term market anxiety. And U.S.-China trade tensions are unlikely to be resolved immediately. Although we don’t expect a full-blown trade war, lengthy negotiations mean additional volatility is likely.

Opportunities in the aging cycle – U.S. stocks have outperformed global developed-market stocks in seven of the last 10 years. Historically, performance rotates, and as the cycle ages, we think the global cycle is positioned to last longer.

► Action for Investors

We recommend adding broad-based developed-market and emerging-market equity investments, if appropriate. International stock valuations reflect a particularly pessimistic outlook, and the decline in relative price-to-earnings ratios for developed- and emerging-market equities has pushed global stocks to levels not seen since the financial crisis.

Past performance of the markets is not a guarantee of what will happen in the future. Investing in equities involves risks. The value of your shares will fluctuate, and you may lose principal. Special risks are inherent to international and emerging-market investing, including those related to currency fluctuations and foreign political and economic events.
Uncertainty surrounding trade negotiations was a key source of market volatility in 2018. We expect trade tensions to eventually subside, increasing the attractiveness of international equities over the long term.

**Trade is important to global growth** – A quarter of the U.S. economy and over half of global growth are tied to trade. S&P 500 companies earn about 40% of their revenue from countries outside the U.S. Hence, equities as whole benefit from trade agreements, but international equities benefit more than U.S. equities because of how important trade is to global growth. For this reason, investors are closely watching trade tensions between the U.S. and its three largest trading partners (China, Mexico, and Canada). Recent data suggests that new trade restrictions between the U.S. and China are having an effect on trade. As seen in the blue bars of the chart above, U.S. exports to China totaled $102.4 billion in the first 10 months of 2018. This represents a 1% year-over-year decline in exports, compared with a 13% increase in 2017, a year before new tariffs were announced.

**Trade uncertainty adds to market volatility** – While there have been some bright spots, trade negotiations between the U.S. and China are complex. Uneven progress toward a deal is likely to be accompanied by continued market volatility.

**Trade agreements improve global growth** – Despite some bumpiness ahead, we expect ongoing negotiations to lead to updated trade agreements and an eventual easing of trade restrictions between the U.S. and its other major trading partners. In our view, periodic bouts of market uncertainty have created opportunities for investors to add international equities and take advantage of modest global growth ahead. Developed- and emerging-market equities have better valuations than U.S. equities and represent good buying opportunities for long-term investors.

**Action for Investors**

We believe that investor concerns over trade conflicts are overly pessimistic, particularly for international equities, which are trading at a discount to U.S. equities and to their own history. Consider diversifying your portfolio by adding broad-based international equity investments to take advantage of attractive valuations and favorable long-run economic conditions.

Investing in equities involves risks. The value of your shares will fluctuate, and you may lose principal. Special risks are inherent to international and emerging-market investing, including those related to currency fluctuations and foreign political and economic events.
Asset Class Outlook

Equity versus Fixed Income (Target = Middle) - We think the bull market in stocks can continue, supported by above-average but slower economic and earnings growth. Interest rates remain low but are likely to continue to rise slowly. A laddered bond portfolio and an above-average amount in cash may help provide downside protection for portfolios as volatility picks up.

Domestic versus International (Target = Middle) - We recommend overweighting international equities and underweighting international fixed income as global growth continues, expectations appear too pessimistic and equity valuations have improved.

Asset Class Diversification

Aggressive (Target = Middle): We remain cautious on commodity investments. The bear market in emerging-market equities reflects the stronger dollar and worries about additional trade disruptions. We think the pullback is an opportunity and recommend a small allocation.

Growth (Target = Middle): U.S. small- and mid-cap stocks dropped more than large-cap stocks and are more attractively valued. Opportunities and risks appear balanced for international small-cap stocks.

Growth & Income (Target = Middle): We think risks and opportunities are balanced for real estate investments. Below-average valuations for large-cap U.S. stocks do not reflect our expectations for above-average but slower economic and earnings growth. We recommend overweighting international developed-market large-cap equities because expectations are low, dividend yields are attractive, and we expect modest earnings and economic growth to continue.

Income (Target = Low): Long-term interest rates tend to move with inflation, which should rise slightly as labor markets tighten. Higher short-term interest rates make them relatively attractive. But rates on high-yield bonds aren’t high enough to compensate for their additional risk, so the aggressive-income target is low. We think international fixed income looks relatively unattractive due to low foreign interest rates that also have started to rise slowly.

Cash (Target = High): We recommend overweighting cash to reduce the impact of rising interest rates and to use to invest during pullbacks.

Investors should understand the risks involved in owning investments, including interest rate risk, credit risk and market risk. The value of investments fluctuates, and investors can lose some or all of their principal. The prices of small-cap, mid-cap and emerging-market stocks are generally more volatile than those of large company stocks. Special risks are inherent to international investing, including those related to currency fluctuations and foreign political and economic events.
Investment Performance Benchmarks

As of December 31, 2018

<table>
<thead>
<tr>
<th>Benchmarks for Investment Categories</th>
<th>Total Return</th>
<th>1-Year</th>
<th>3-Year</th>
<th>5-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Cash</td>
<td>1.9%</td>
<td>1.0%</td>
<td>0.6%</td>
<td></td>
</tr>
<tr>
<td>U.S. Bonds</td>
<td>0.0%</td>
<td>2.1%</td>
<td>2.5%</td>
<td></td>
</tr>
<tr>
<td>U.S. High-yield Bonds</td>
<td>-2.1%</td>
<td>7.2%</td>
<td>3.8%</td>
<td></td>
</tr>
<tr>
<td>International Bonds</td>
<td>-2.1%</td>
<td>3.1%</td>
<td>0.0%</td>
<td></td>
</tr>
<tr>
<td>U.S. Large-cap Stocks</td>
<td>-4.4%</td>
<td>9.3%</td>
<td>8.5%</td>
<td></td>
</tr>
<tr>
<td>Real Estate</td>
<td>-4.0%</td>
<td>4.2%</td>
<td>8.3%</td>
<td></td>
</tr>
<tr>
<td>International Large-cap Stocks</td>
<td>-13.8%</td>
<td>2.9%</td>
<td>0.5%</td>
<td></td>
</tr>
<tr>
<td>U.S. Mid-cap Stocks</td>
<td>-9.1%</td>
<td>7.0%</td>
<td>6.3%</td>
<td></td>
</tr>
<tr>
<td>U.S. Small-cap Stocks</td>
<td>-11.0%</td>
<td>7.4%</td>
<td>4.4%</td>
<td></td>
</tr>
<tr>
<td>International Small-cap Stocks</td>
<td>-17.9%</td>
<td>3.7%</td>
<td>3.1%</td>
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</tr>
<tr>
<td>Emerging-market Stocks</td>
<td>-14.6%</td>
<td>9.2%</td>
<td>1.6%</td>
<td></td>
</tr>
<tr>
<td>Commodities</td>
<td>-13.8%</td>
<td>0.5%</td>
<td>-14.5%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Morningstar Direct, 12/31/2018. U.S. large-cap stocks represented by the S&P 500 Index. U.S. mid-cap stocks represented by the Russell Mid-cap Index. U.S. small-cap stocks represented by the Russell 2000 Index. International large-cap stocks represented by the MSCI EAFE Index. U.S. bonds represented by the Barclays U.S. Aggregate Bond Index. Cash represented by the Barclays U.S. Treasury Bellwethers 3Mon Index. High-yield bonds represented by the Barclays U.S. HY 2% Issuer Cap Index. Commodities represented by the S&P GSCI Index. Emerging-market stocks represented by the MSCI EM Index. International bonds represented by the Barclays Global Aggregate Ex U.S. Index. International small-cap stocks represented by the MSCI EAFE Small-cap Index. Real Estate represented by the FTSE NAREIT All Equity REITs Index. All performance data reported as total return. An index is unmanaged and is not available for direct investment. Performance does not include payment of any expenses, fees or sales charges, which would lower the performance results. The value of investments fluctuates, and investors can lose some or all of their principal. Past performance does not guarantee future results.

<table>
<thead>
<tr>
<th>U.S. Equity Sector Performance</th>
<th>Total Return</th>
<th>1-Year</th>
<th>3-Year</th>
<th>5-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Materials</td>
<td>-14.7%</td>
<td>7.2%</td>
<td>3.8%</td>
<td></td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>0.8%</td>
<td>9.6%</td>
<td>9.7%</td>
<td></td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>-8.4%</td>
<td>3.1%</td>
<td>6.3%</td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>-18.1%</td>
<td>1.1%</td>
<td>-5.6%</td>
<td></td>
</tr>
<tr>
<td>Financials</td>
<td>-13.0%</td>
<td>9.3%</td>
<td>8.2%</td>
<td></td>
</tr>
<tr>
<td>Healthcare</td>
<td>6.5%</td>
<td>8.1%</td>
<td>11.1%</td>
<td></td>
</tr>
<tr>
<td>Industrials</td>
<td>-13.3%</td>
<td>7.6%</td>
<td>6.0%</td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td>-0.3%</td>
<td>16.4%</td>
<td>14.9%</td>
<td></td>
</tr>
<tr>
<td>Communication Services</td>
<td>-12.5%</td>
<td>2.2%</td>
<td>2.6%</td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td>4.1%</td>
<td>10.7%</td>
<td>10.7%</td>
<td></td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>-4.4%</td>
<td>9.3%</td>
<td>8.5%</td>
<td></td>
</tr>
</tbody>
</table>

It’s natural to compare your portfolio’s performance to market performance benchmarks, but it’s important to put this information in the right context and understand the mix of investments you own. Talk with your financial advisor about any next steps for your portfolio to help you stay on track toward your long-term goals.

QUARTERLY MARKET OUTLOOK: FIRST QUARTER 2019