

ROBERT V. SYTZ, JR., CPA, CFP®
JEFFREY A. HARRELL, CFA
BRETT S. MILLER, CPA, CFP®
K. WARREN POE, JR., CFP®
ERIC A. HARBERT, CPA, CFP®
THOMAS W. FARMER, CFP®
BRETT M. COVERT, JD, CFP®

Investment Commentary

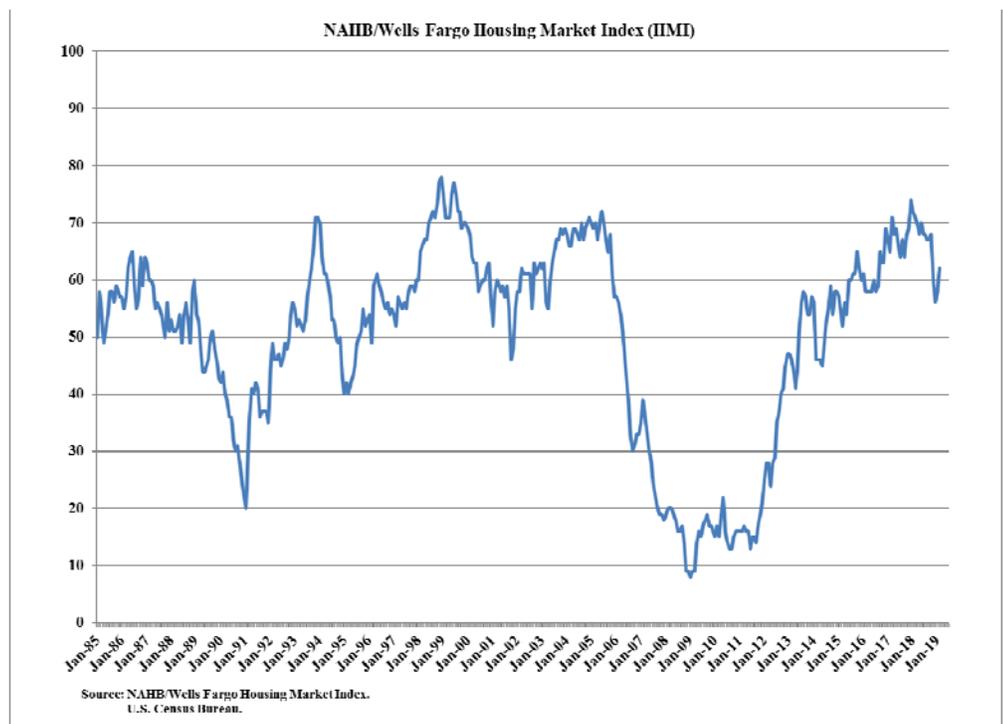
1st Quarter, 2019

Below you will find our investment commentary for the most recent quarter. We hope you find it informative and will consider our investment services in the future. If you have any questions or concerns about the market or your investment portfolio, please call our office to schedule a meeting or conference call.

Economic Review & Outlook

After the U.S. economy experienced one of the highest growth rates in more than a decade in 2018, expectations are for output to slow a bit in the first quarter according to a Wall Street Journal survey of more than 60 economists. Economists predict Q1 GDP will rise a mere 1.35%, representing the slowest growth rate for the U.S. economy on a quarterly basis since the final quarter of 2015.

The slower growth rate can partially be blamed on the difficult year-over-year comparisons as a result of the tax benefits that were enacted in 2018. Further, the Federal Reserve has taken a much more aggressive stance on normalizing monetary policy over the past twelve months. The repercussion of this more hawkish tone is most evident in the housing sector. The chart to the right represents the National Association of Home Builders sentiment index or HMI (Housing Market Index). This is a gauge of homebuilding activity looking out three to six months. As you can see, sentiment amongst homebuilders began to wane at the end of 2017 and throughout all of 2018. While affordability is clearly an issue as



home prices have risen sharply over the past couple of years, a compelling case can be made that the major catalyst for the decline in sentiment is due to higher interest rates. Home prices are not only a function of the local economy, but also financing. As mortgage rates rise, even a small increase such as 0.5% or 1% can result in a dramatically different monthly payment for would-be home buyers. As the Federal Reserve continued increasing interest rates last year, future sales became more uncertain. Eventually this spilled over to the financial markets, which saw a dramatic decline in the fourth quarter of 2018. While this may not have been comfortable for investors to experience, the result may have been exactly what the financial markets were looking for because the Federal Reserve has now shifted their outlook for interest rates. In fact, economists are now predicting little to no further hikes in interest rates for as far as the eye can see. This is a stark contrast to expectations as 2018 began and, as you can see from the recent pick up in sentiment, this could help turn things around in 2019. We think this is important because, as you can see from the chart, the HMI last peaked in the 2006 time period yet the housing market didn't feel as though it was in a major downturn until 2008. Thus, the HMI may be one of the best leading indicators available, so we plan to keep a close eye on it in 2019.



Bond Market Review & Outlook

As we just outlined in our economic review, the Federal Reserve did an about face at the end of 2018, resulting in a drastically different outlook for interest rates compared to just a couple months ago. Bonds benefited from this as interest rates fell during the quarter. The benchmark Barclays Aggregate Bond Index delivered a 2.9% return for the quarter. As one would expect, the largest gains came from the credit sectors of the market, highlighted by the Bank of America U.S. High Yield Index return of 7.4%. The take away for investors is to once again remind them that timing the bond market is just as impossible as timing the stock market.

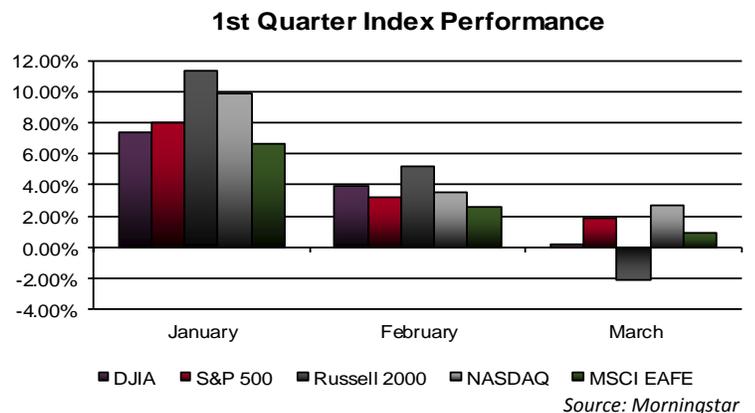
As 2018 progressed, investors became convinced the Federal Reserve would be raising interest rates consistently through 2020. This put downward pressure on bond prices as interest rates rose in anticipation of future rate hikes. Some investors began to question the validity of having bonds in their portfolio, instead preferring to invest in short-term cash instruments such as money market funds and CDs. While these securities have merit for specific funding needs in relatively short periods of time, we do not believe they should be part of a core long-term investment strategy. One of the greatest investors to ever live has been quoted as follows: “Today people who hold cash equivalents feel comfortable. They shouldn’t. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value.” That quote comes from Warren Buffett. We think investors should heed his advice and maintain a well-diversified portfolio of stocks and bonds, only using cash equivalents for short-term expenses.

Stock Market Review & Outlook

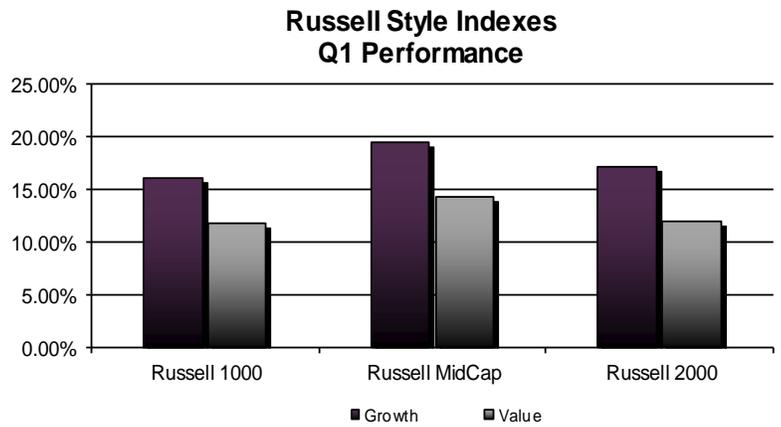
Although investors may have been singing the blues at their New Year’s Eve parties, the mood has changed for the better as the end of winter and beginning of spring put a smile back on their faces. After a blistering start to the year that saw indexes deliver their best January since 1987, stocks followed up these gains in February and March with the sharpest first quarter gain since 1998. The large cap Dow Jones Industrial Average and S&P 500 Index returned 11.8% and 13.7%, respectively. The small cap Russell 2000 Index delivered a return of 14.6%. Technology shares have fared exceptionally well in 2019 with the NASDAQ Composite returning 16.5%.

Although lagging behind the other broad markets, international shares did join the party returning 10.0% as measured by the MSCI EAFE Index. Needless to say, the concerns and angsts many investors were feeling in late 2018 have quickly turned to joy and confidence as we usher in 2019.

While the quick recovery in the financial markets certainly has calmed investor fears, we do want to take this opportunity to caution you that what we saw at the end of 2018 was not something to dismiss as a one-time event. The stock market did fall over 20% from the September 20th high to the low on December 24th, which was the largest decline in nearly 10 years. History suggests that 20% declines in the stock market have occurred every four to five years. The fact that we had our first one in ten years, and it lasted less than three months, suggests that investors should stay vigilant against another one occurring sooner rather than later. Of course, this does not suggest we would advise changing your investment strategy to try and time the next big move down. Instead it should remind investors that sharp declines will continue to be unpredictable and the best way to be prepared for them is to maintain a well-diversified portfolio that will mitigate the volatility on the downside.



Growth stocks have led the way so far in 2019 as you can see from the Russell Style Index chart. This is exactly what one would expect when you consider the stellar returns in the stock market this year. Smaller companies have outperformed large ones this year, likely a direct result of the continued trade war tension between the U.S. and the rest of the world. Small caps tend to have less international exposure and, it appears from looking at financial markets all over the world, the U.S. has been the clear winner thus far during the standoff. If a deal is reached between the U.S. and China, it would likely shift the leadership back to large cap stocks in the short term.



With the stock market now back to just a couple percentage points off its all-time highs, investors are asking whether the sharp drop in the fourth quarter was a harbinger of things to come, or just a short term set back in an ongoing bull market? We will find out as 2019 progresses and it likely will come down to whether or not the economy enters a recession in the second half of 2019 or 2020. There are few signs to suggest this is a high probability event, but recessions are notoriously difficult to predict and rarely come with clear advance warning. As we previously mentioned, the housing market will likely provide the best leading indicator as to where the economy is headed. Fortunately, the actions being taken by the Federal Reserve appear to be dampening the effect of higher interest rates and will hopefully stabilize any slowdown that has been taking place.

While there are always reasons to be cautious when it comes to forecasting economic growth, we remain optimistic that economic activity is on solid footing over the long-term. The unemployment rate has been in a steady downward trend for nearly a decade, suggesting the U.S. consumer has a reasonable level of confidence in job security at the moment. Further, the personal savings rate has been fairly consistent over the past decade as well and is more than double (3% vs. 6%) where it was before we entered the Great Recession in 2008. A strong job market and higher savings rate, combined with continued technological innovation that should keep a lid on inflation, is still a recipe for economic prosperity. This backdrop provides us with a tremendous amount of confidence in the long-term prospects for the U.S. economy, even though a recession at some point is inevitable. Investors who share this view should feel confident that even when a recession occurs and a bear market causes their investment portfolio to decline in value, as long as their holding period for these investments is measured in years (not weeks or months) the stock market should remain an excellent way to grow wealth over the long-term.

Sincerely yours,

Wealth Management Team
McGill Advisors

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