2018 Yearly Market Review

A record-setting year for stocks, but one investors would rather forget

As we reflect on 2018, it is tempting to sugarcoat the year by simply reporting that it was a record-setting year for stocks – because so many investors would rather quickly forget the end results.

So here are the end results: 2018 was the worst year for stocks since 2008 and only the second year that both the DJIA and the S&P 500 fell in the same year.

But if we could travel back to December 2017 and read the 2018 market predictions, we would have seen a lot of investor optimism with maybe a dash of worry. And guess what? The markets set multiple all-time records, but there was way more than a dash of worry in 2018. Let's review.

A Lot Happened in 2018

In the past 12 months, the markets were book-ended with new highs in January and the largest one-day point gain on the day after Christmas. And in between, we saw: four rate hikes from the Fed, three government shutdowns, trade wars with China, trade agreements with Canada and Mexico, more devastating fires in California, retreating oil prices, the largest lottery jackpot in U.S. history, gasoline below $2/gallon, increased volatility, unemployment touch 50-year lows, the acceptance of the term FAANG and their spectacular rise (and fall), an inverted yield curve, the passing of a President, record stock buybacks, the popping of the Bitcoin bubble, and the sudden interest in marijuana stocks.

After 252 Trading Days…

There were 252 trading days in 2018 and by the time the 252nd ended, here are the results:

- NASDAQ ended down 4%;
- The Dow Jones Industrial Average ended down 5.6%; and
- The S&P 500 ended down 4.38%.

Glass Half-Full

Since the bull market began almost 10-years ago, the S&P 500 has returned more than 180% for the 10-year period through December 31, 2018, recording one of the strongest bull-market gains in history. And despite the negative returns of 2018, the S&P 500 has still posted gains of over 36% for the past 5 years and 21% over the past three years.

Now for the results that investors would rather forget.

Sector Performance

Dissecting the performance of the eleven S&P 500 sectors in 2018, we found that:

- Only two sectors ended the year green: Health Care and Utilities, with a 2018 return of 4.69% and 0.46%, respectively;
- The worst performer for the year was the Energy sector, down 20.50%; and
- There were a lot of other sectors with double-digit losses in 2018, including Industrials (-15.00%), Financials (-14.67%), Materials (-16.45%), Consumer Staples (-11.15%), and Communication Services (-16.43%).

International Markets Struggled

Contrary to 2017, when international and emerging markets did better than their U.S. counterparts, markets around the globe fared worse, generally speaking.

- MSCI EAFE was down 16.14%;
- MSCI Europe was down 17.27%; and
- MSCI Far East was down 13.97%.

In fact, of the 32 MSCI Indices that track developed global markets, not a single one was positive. And of the 34 MSCI Indices that track developed countries, not a single one was positive this year.

A Very Strong Start to 2018

Stocks gained 7.5% in the first three weeks of the year, recording one of the best starts on record and giving investors hope for a banner year. In fact, the DJIA crossed the 26,000-point barrier for the first time on January 12th in a record seven trading days.

But then stocks dropped 10% in February as investors worried about rising interest rates and trade wars with China.

A midyear rally pushed stocks to again reach new highs and by late September, investors were feeling great as the market was up by double-digits. But then, things changed.

Volatility Came Roaring Back

Every investor knows that the VIX spiked toward the end of the year, but consider these mile-markers:

- The DJIA Dow had swung 1,000 points in a single session only eight times in its history and five of those took place in 2018.
- The S&P 500 was up or down more than 1% nine times in December alone, compared to eight times in all of 2017.
- It moved up/down more than 1% 64 times during the year – that's more than 25% of the trading days in all of 2018.
- In one seven day stretch in December, the DJIA fell by at least 350 points six times.

The Grinch Was Confused This Year

U.S. stocks turned in very positive numbers during the last trading week of the year on the heels of three consecutive weeks of declines.

In a departure from previous years which usually saw little trading activity and smaller market movements, the final trading week was marked by continued high volatility and record days – a record Christmas Eve decline followed by a record point gain on the day after Christmas.

But when the calendar turned, investors were left with the worst December performance since the Great Depression.

Consider this:

- For the month of December in 1931, stocks were hammered and the S&P 500 suffered losses of 14.5% (note that the S&P 500 first came to be in 1950, but it was back-tested through 1928).
- For December 2018, the S&P 500 lost 9%.
- The narrowly-defined DJIA also had its worst December performance in 1931 when it lost a whopping 17.0% – and it lost about 8.7% in December this year.

MAJOR STORIES THAT SHAPED 2018

Tax Cuts and Jobs Act

Early in the morning of December 20, 2017, the Senate passed the "Tax Cuts and Jobs Act" by a party-line vote of 51 to 48; (Republican Senator McCain was absent for medical reasons). Irrespective of one's political leaning, this legislative achievement was the most sweeping overhaul of the U.S. tax system in more than 30 years.

By almost all accounts, the Tax Cuts and Jobs Act was predicted to raise the federal deficit by billions of dollars – and perhaps as much as $2 trillion over the next 10 years. The big question is how much economic growth the new bill will create, thereby offsetting the increase to the federal deficit.

The Fed was Busy

The following text was released by the Federal Reserve four different times this year:

“In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate from [current rates] to [add ¼ of 1% to current rate] percent.”

2018’s four short-term rate hikes by the Fed was the most in a year since 2006. Generally speaking, all four of the rate hikes were among the most predictable and predicted rate movements the markets have ever seen.

But the path of rates was not very smooth and certainly not linear, as the 10-year yield reached 3.24% (the highest since 2011) early in the year before dropping back below 2.75% by year-end.

The Yield Curve Inverted

A portion of the yield curve (a spectrum of interest rates, more specifically a measure of shorter-term rates compared to longer-term rates) inverted in early December as the two- and three-year yields rose above five-year yields – the first time the latter has happened since 2007. With short rates exceeding long rates, this was interpreted as a sign of economic weakness and stocks sold off in response.

Record Low Unemployment

The number of Americans filing for unemployment benefits pointed to a tightening labor market, certainly a helpful ingredient to the stock market’s 2017 performance. At the very end of this year, U.S. workers filed 245,000 initial claims for unemployment benefits and since mid-October, claims were confined to a range of 223,000 to 252,000.

That last week in December marked the 147th straight week that claims remained below that important 300,000 threshold, which is associated with a strong labor market. That was the longest such stretch since 1970 and important because at that level, economists consider the labor market to register “full employment.” The unemployment rate also touched a 50-year low.

Consumer Confidence & Spending

Late in the year, U.S. consumer spending recorded its biggest increase in more than 8 years. The Commerce Department reported that consumer spending – which accounts for 2/3 of U.S. economic activity – jumped 1%. Further, consumer confidence reached a 17-year high in November, although it dipped slightly in December.

Buybacks Hit Record Levels

According to market research firm Birinyi Associates, there have been close to $10 trillion in stock buyback announcements since 1984. And since 2008, over $6 trillion in buybacks were announced.

But 2018 was a record year. In fact, analysts at Goldman Sachs announced that buybacks surpassed $1 trillion this year, up 46% from 2017’s levels and dramatically above 2007’s all-time high of almost $700 billion.

Oil Rose Steadily and then Plummeted

The price of a barrel of oil climbed throughout most of 2018, peaking in October and then plummeting 40% from its high.

While this was good for consumers and transportation companies, plummeting prices contributed to the Energy sector being the worst performing sector of 2018 and over the past 5 and 10 years. In fact:

- For 2018, the Energy sector lost 20.50%;
- Through year-end 2018, the Energy sector lost 34.33% for the 5-year period; and
- Of the 11 sectors in the S&P 500, the Energy sector was the worst performer over the past 10-years.

FAANG Bit and Was Bitten

The FAANG stocks – Facebook, Apple, Amazon, Netflix and Google – rose steadily throughout the year, up 35% at their peak, helping push the markets to new highs in September.

But increased scrutiny from Congress and regulators, higher rates, and general market unease helped push tech and the markets into the red for the latter part of the year, with each of the FAANG stocks entering bear-market territory.

Marijuana Became Big Business

The legal marijuana industry added over $1 billion in sales from 2016 to 2017 and the final sales figure for 2018 is expected to be close to $10 billion, according to research firm ArcView. Further:

- By 2025, the industry is expected to create 300,000 jobs
- Investment banking-firm Cowen & Co. predicts legal sales will reach $50 billion by 2026, representing a compound annual growth rate of more than 23% per year over the next decade (and reach $75 billion by 2030)
- Coca-Cola was in discussions with Aurora Cannabis to develop soda infused marijuana
- The market for marijuana could eventually eclipse soda sales – which is declining and was approximately $75 billion last year

What Will 2019 Bring Investors?

Now, let’s tackle the question on everyone’s mind: will 2019 continue to worry investors or will the markets reverse course and start showing more green numbers?

Well, that depends entirely on who you ask.

But no matter how your portfolio performed, take some time to make sure you understand the reasons behind your performance. And let’s make sure you are fully prepared for the coming year.