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summaries

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MARKET COMMENTARY

After a strong 2017, performance in 2018 proved to be a challenging year for all investors. Other than cash and short term bonds, there were few places to hide from declines in both equity and bond markets. Bond markets proved to be tenuous in the first half of the year as rates began to rise. While bond investors recouped some losses in the 4th quarter, December proved to be particularly brutal for equity investors as, among other issues, increased concerns about a full blown trade war with China and the Federal Reserve's commentary about future rate increases wreaked havoc with equity markets.

On average, a market correction of 20% occurs every three and a half years. Regardless of frequency, market declines are still unnerving to investors. Markets do recover, however, as noted after the 2009 bear market. In fact, the S&P 500 has increased over three- fold times above its'09 bottom and over one and a half times its 2007 peak – even after the December swoon.

In volatile markets, it is important for investment advisory firms such as Sigma to stick to its discipline and make sure clients are not swayed by emotions which can lead them to stray from their long term asset allocations for short term gratification. Selling into weakness and buying into strength are two sure ways to destroy one's long term financial plans. Market timing has never worked. Even if one makes the correct market call to sell at the top of the market, for an investor to get the long term benefits of the equity markets requires them to make a second correct call to profitably reinvest funds back into the markets. Making the correct call even once is a rare event. Market timing is not a successful strategy for achieving one's long term goals. To enjoy the optimum benefit from investing in equities requires long term staying power.

Also, after-tax returns are an important facet of long term investment success. There are many techniques that can be employed to optimize a clients' after tax returns. One such technique includes an asset location preference. Depending on a client's profile (time horizon, tax bracket, need for income etc.,) certain investments may make more sense to put into a taxable vs. a traditional tax deferred account vs. a ROTH IRA etc.

Along the same lines, tax loss harvesting is another technique that can be employed during market downturns. During market corrections certain investments may be sold in order to realize losses to be used to offset taxable income or investment gains. In order to get the benefit of the tax loss one needs to be out of that security for 30 days. Ideally, the sold investment will be replaced with a similar security that will provide a return similar to the initial investment, providing the opportunity to participate in the upside should the original security increase during that 30 day period. After 30 days, the transaction is reversed.

In short, tax loss selling is opportunistic. In time, the portfolio will recover to prior levels but the investor will also have the added benefit of tax loss carry forwards

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that can be used to shelter future taxable gains taken in the portfolio. Tax losses harvested in '08-'09 time frame created a situation where client portfolios benefitted for several years, paying much lower taxes on realized capital gains versus what they might have otherwise expected to pay on a portfolio of their size. In fact, the February 2018 Sigma summary noted that for most clients, tax losses taken in their taxable portfolios from '08-'09 time frame had been fully used, and going forward clients would likely experience higher capital gains taxes.

While Sigma prefers that securities purchased for clients never go down, that is not a realistic scenario. The market decline over the past few months provided the opportunity to harvest losses that can be used to offset gains taken early in 2018 as well as to protect future realized returns in taxable portfolios.

Entering 2019, investors anticipating further dramatic market declines are likely focused on several issues including potential interest rate hikes from the Federal Reserve, a possible full blown trade war with China, a recession in the US economy, slower US corporate earnings growth, concerns about global recession and finally, a divided Congress on top of what has already been a chaotic political environment. While all of these issues require monitoring, it is not expected that the US economy will slide into a recession (defined as two quarters of negative GDP growth) in 2019. While the growth rate of the economy may slow from 2018, it is likely to still be above the growth rate of the several preceding years. That said, some sectors of the economy, such as energy and housing will likely experience weakness in 2019 vs. 2018. The global economy may experience more weakness than the US.

The consumer is healthy and drives two thirds of the US economy. Given the lower tax rates and tight labor markets it is expected that consumers will provide underlying support to the economy. If rates do rise it will be because the economic data supports an increase (a positive). In aggregate, corporate earnings are expected to continue to grow albeit at a slower rate than the past two years. Trade talks with China will continue for many years to come. As milestones approach (such as the 90 days now in place) or issues of contention are leaked to the press, the markets will react accordingly. Ultimately, however, this is a high stakes game and both sides are expected to continue to work on a better trade relationship. Finally, the Trump administration's efforts to reduce regulations continues to provide a better operating environment for corporations. In short, while uncertainties remain, on balance the equity markets remain the asset of choice for long term investors.

To Sigma clients, the trust placed in the firm is much appreciated and not taken for granted. All advisors share the sense of duty to faithfully fulfill the obligation that is attendant to that trust.

Best wishes for a healthy and prosperous 2019!

Denise M. Farkas, CFA
Chief Investment Officer

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