MOUNTAIN PACIFIC
INVESTMENT ADVISERS INC

SECOND HALF 2018 MARKET COMMENTARY

In 2018 the stock market was unusually volatile, as it made a new high and then corrected, not once but twice, and cost investors a negative 4.4% return in the process. This was the first negative annual return in this ten-year bull market. Let's briefly review the year, using the S&P500 Index as a proxy for the market.

In January, the Index raced out of the gate, rising 7% before peaking on January 26 at 2872, a new high. The Index then declined sharply by 10% to 2581 on February 8. For the next five months, the Index meandered between 2600 and 2800, before breaking out in September to another new high, 2940 (on the 19th). In early October, the Chairman of the Federal Reserve, Jerome Powell, surprised the market with "hawkish," or tightening, comments, and the Index faded 7% during the month. In November, the Index tried to recover, but when the Fed confirmed its intentions on December 19, the Index swooned another 10%, touching 2350, down 20% from its high. The financial press loudly proclaimed, "bear market," and even "recession"!

Investors sold their common stocks primarily because the Fed failed to recognize the gathering risks to the economy, like slowing global growth (particularly in Europe and China), the escalating trade war with China, and weakening commodity prices (crude oil dropped from $75 in October to $45 at year end). The 2019 Index earnings per share estimates slipped from $178 to $170, now up only 5% on the year. Investors worried that earnings were "peaking" in the aging economic expansion, and at a price-earnings multiple of 15 times, the Index was fairly valued, at 2550.

It's hard to believe these bearish forecasts. The last two "recessionary bear markets," in 2000 and 2008, were precipitated by severe financial imbalances, a tech bubble, and a housing bubble, respectively. Today there is no comparable systemic financial imbalance. Many observers are worried about the level of low quality corporate debt after ten years of expansion. Corporate bond prices have declined relative to Treasury securities, a measure of risk, but not to recession levels. And, the Fed's monetary policy (raising its Fed Funds rate from zero to 2.25%) has probably contributed to this measure of risk. Since WW2, there have been 14 bear markets (defined as an Index decline of 20% or more). Seven of these were <u>recessionary</u> bear markets, with declines averaging 37%. The other seven bear markets occurred during economic expansions; these were swift and shallower, with declines of about 20%. These "bears" turned out to be corrections in a bull market.

This year, on January 4, the Labor Department reported strong employment for December, with higher wages. This was not a recessionary report! On the same day, Jerome Powell acknowledged that the Fed could afford to be more patient in raising interest rates. Modest growth, low inflation, discounted stock prices – this looks like another opportunity to buy our quality mid-cap growth stocks in this extended bull market.

There were no material changes to our firm brochure (SEC Form ADV, Part 2A); however, if you would like a copy free of charge, please let us know. Please call us with questions or comments, or if there are changes to your financial goals, investment time horizon, or risk tolerance.

We are excited to announce the hire of Nathan C. Oakley, CFA as an investment adviser. A Boise native, Nate will provide wealth management advice to clients and will work closely with our research team to provide qualitative company research. Nate has almost 20 years of experience in institutional investment management, and we are glad to have him as part of our team. This announcement reflects Mountain Pacific's commitment to the continued growth and expansion of the firm's wealth management team and services.