



#### IN THIS ISSUE

MARKET BRIEF	2
ECONOMY	4
EQUITY	5
FIXED INCOME	6
ALTERNATIVES	7
DISCLOSURES	8

MARKET REVIEW  
FEBRUARY 2019



ATG TRUST  
C O M P A N Y

### ARE WE THERE YET?

Many parents can appreciate the all-too-familiar question "Are we there yet?" We can all picture the children packed in the back seat of the family minivan, anxious to arrive at their destination. Parents, despite their best efforts to placate children with promises of sweets and presents, often fail to stop the barrage of questions.

Perhaps this vignette illustrates attitudes of modern-day investors. "Are we there yet?" is similar to the way in which some investors question when the markets will return to "normal." This phrase can describe the sentiment of investors looking for a reason to change their goal, measure their success, or just simply time the markets. This Market Brief doesn't exactly answer the question, but instead seeks to reframe it more constructively.

### EQUITY MARKETS

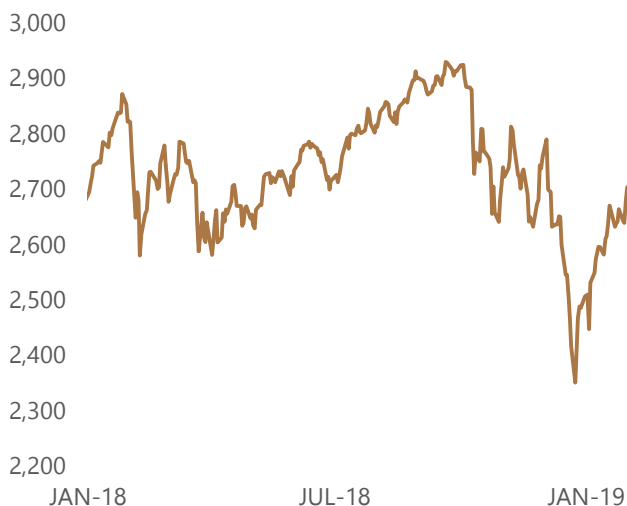
When the stock market declines 15% to 20% over a short period of time, worried investors may lament "When will things get back to normal?" just as the child asks "Are we there yet?" Very concerned investors might even sell stocks if they can't stomach this risk. Historical average annualized U.S. equity market returns are between 10% to 12%. The typical range of returns around this average is about 15% on either side as measured by the variance of annual returns. With return expectations of between 10% to 12% in line with historical data, a typical investor might not worry when markets are down 10%, but become very worried when the decline approaches 20%.

Investors might acknowledge that losses of 15% to 20% are possible, but it's different when they actually see it on monthly statements. To us, this thought exercise might help contextualize investors' yearning for markets to get "back to normal."

The top left chart on page three shows the path of the S&P 500 since January 1, 2018. The pullback in late January and early February was so short-lived that some investors may not have had time to react. In fact, their absence of worry was rewarded by new all-time highs achieved from August through October. However, as the drawdown from the October highs through year end approached 20%, investor reaction was meaningfully negative as measured by data including net equity fund outflows. Though the rally off the December lows has cut the loss in half, investor sentiment may remain poor until stocks recover and then surpass the October all-time highs.

## S&P 500 DAILY RETURNS

JANUARY 1, 2018 THROUGH JANUARY 31, 2019

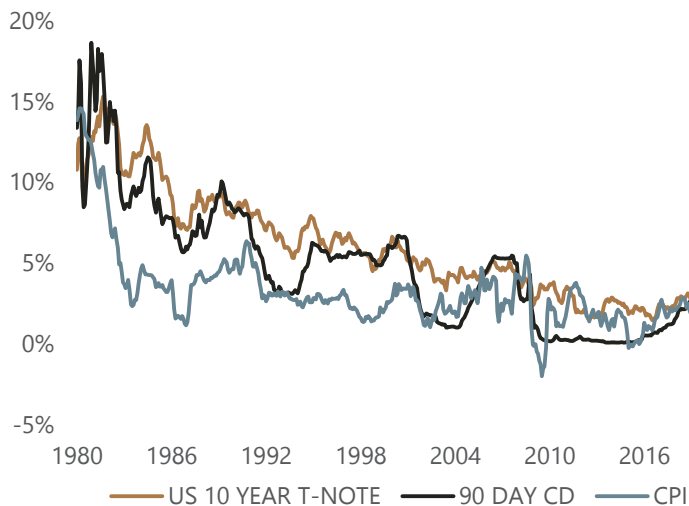


Source: Bloomberg

Past performance does not guarantee future results.

## SELECTED YIELDS

1980 THROUGH JANUARY 31, 2019



Source: Bloomberg

Past performance does not guarantee future results.

### YIELDS AND INTEREST RATES

Stretching our memory a bit, there still are a few investors who pine for the “good ol’ days” of double-digit interest rates on Certificates of Deposit (CDs). We’ll forgive these folks for conveniently forgetting about the double-digit interest rates on home mortgages, and continue with the “Are we there yet?” metaphor.

As shown in the Selected Yields chart (top right), today’s CD rates are minuscule compared to the 15% to 17% commonly available in the early 1980s. However, what’s really important is not what you earn, but what you keep. For yield-hungry investors, the cost of inflation must be considered.

The Selected Yields chart shows the level of inflation as measured by the Consumer Price Index (CPI), yields on 10-year U.S. Treasury Notes (US10) and 90-day CDs. Bond investors “keep” the difference between their yield and CPI, called the real yield. In this respect, the glory days of CD investing actually occurred in 1985 when the difference between yields and inflation was at its widest. After adjusting for inflation, rolling CDs made no money for most of the early 1990s and actually lost money in the early 2000s.

Additionally, investors in US10s were more handsomely rewarded compared to CD rollers. One example proves the point. Consider an investment in US10s and rolling 90-day CDs beginning in the summer of 1981. Sure, the CD yield began at 18% and the US10 yield began at 15%, but that 18% fell to 6% by the last 90-day roll in May 1991, and the bondholder received 15% the whole period.

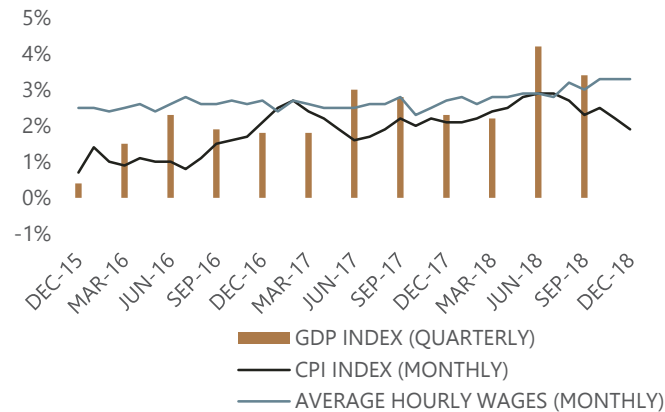
### CONCLUSION AND INVESTMENT IMPLICATIONS

Investment advisors often suggest that clients focus on the long term and ignore short-term swings. Yet, as previously discussed, a 15% to 20% decline in the stock market over a short period of time can cause investor concern and perhaps lead them to overreact by selling a significant portion of their equity allocation.

Advisors can remind clients that investing is a deliberate process, and that the ups and downs of their portfolio value are to be expected. Certainly, drawdowns in a portfolio are unwelcome, as no one enjoys short-term losses, yet any near-term decline in one asset class can often be an opportunity to rebalance. When one asset class has suddenly and sharply declined, often others have held up or gained. The resulting asset allocation drift away from a long-term target can be adjusted, and should provide the opportunity to accumulate shares on the cheap. Disciplined investors who realize the power that rebalancing offers ought not feel the “Are we there yet?” sentiment during declines, but instead view these cheaper prices as an opportunity to better position their portfolio for future gains.

## ECONOMY

### GDP, CONSUMER PRICES AND WAGE INFLATION DECEMBER 2015 THROUGH DECEMBER 2018

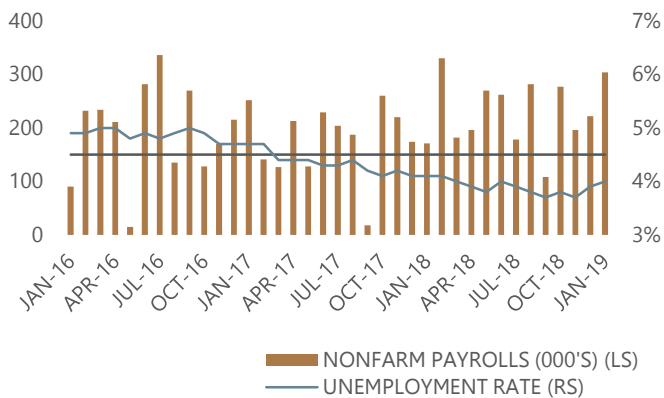


Source: Bloomberg

- The second estimate of annualized third quarter GDP growth was unchanged from its original estimate in October of 3.5%. Growth continues to be driven by tax cuts that have boosted consumer spending and business investment. The first estimate of fourth quarter GDP was delayed until February due to the government shutdown.
- The Core Personal Consumption Expenditure (PCE) price index, the Fed's preferred inflation measure, increased 1.9% year over year in November after rising 1.8% in October.
- The Core Consumer Price Index (CPI), which excludes volatile food and energy costs, climbed 0.2% in December. The year-over-year reading for Core CPI remained steady at 2.2%.

### LABOR MARKET

JANUARY 2016 THROUGH JANUARY 2019

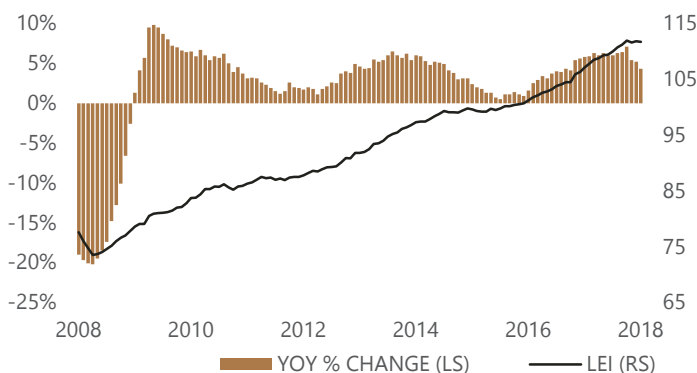


Source: Bloomberg

- Total U.S. nonfarm payroll employment increased by 304,000 in January, crushing estimates of 170,000. December was revised down to 222,000 from 312,000, and November was changed to 196,000 from 176,000.
- The unemployment rate ticked higher to 4.0%, likely impacted by the government shutdown. This is the highest unemployment rate in the past seven months.
- The year-over-year change in average hourly earnings fell to 3.2% in January, a decrease from the 3.3% level in December.

### LEADING ECONOMIC INDICATORS

DECEMBER 2008 THROUGH DECEMBER 2018



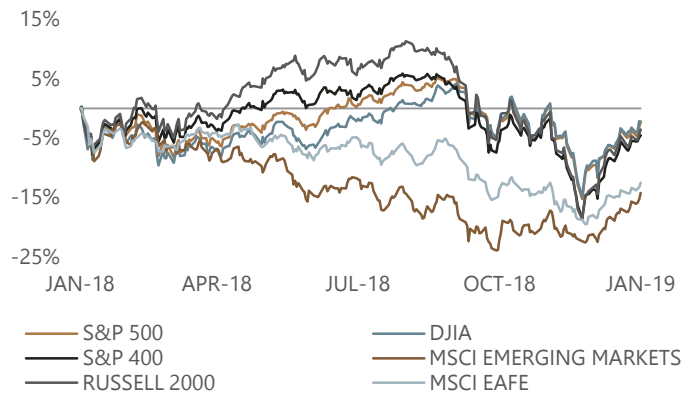
Source: Bloomberg

- The preliminary estimates for the U.S. Conference Board Leading Economic Indicator (LEI) index's year-over-year growth slowed for a third consecutive month to 4.3% in December.
- Stock prices are one of the ten components of the LEI and were among the biggest negative contributors after the historic sell off throughout the equity markets in December.
- Looking ahead, the LEI may rebound due to stock prices recovering about half of their losses since the end of 2018. The recent ISM New Orders index had a significant rebound; however, the trend suggests U.S. economic growth may have peaked and will face a slower pace of growth in 2019.

## EQUITY

### TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, JANUARY 2018 THROUGH JANUARY 2019

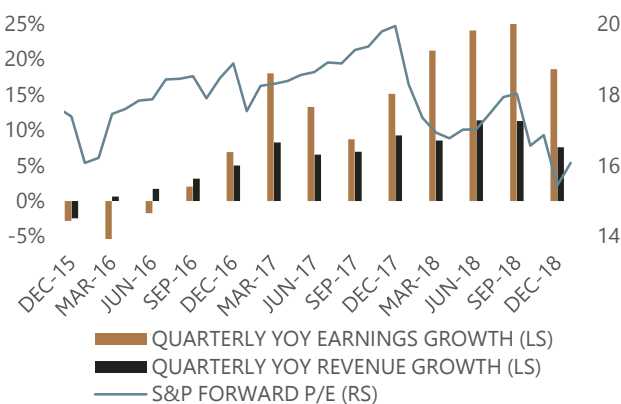


Source: Bloomberg

- Global equities experienced a strong rebound in January following the S&P 500's worst month since 2009 and worst December since 1931. The S&P 500, S&P 400 and Russell 2000 each recorded their best January performance since 1987 with returns of 8.0%, 10.5% and 11.3%, respectively.
- Foreign stocks also performed well as the MSCI EAFE's 6.6% return was the index's best January performance since 1994, and MSCI Emerging Markets rose 8.8%.
- Last month's recovery in sentiment for riskier assets was driven by strong fourth quarter earnings, signals from the Fed that further interest rate increases are likely on hold, optimism for trade talks between the U.S. and China, and new Chinese stimulus.

### S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, DECEMBER 2015 THROUGH JANUARY 2019

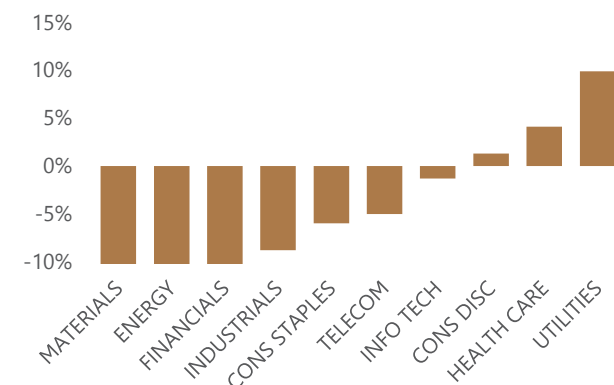


Source: Bloomberg

- Fourth quarter earnings reporting season is nearly half completed. Year-over-year earnings growth is on pace for a slight deceleration to 19.5%, following three consecutive quarters above 20%. The last time the S&P 500 experienced a streak of earnings growth this strong was in 2010-2011.
- Sales growth is also experiencing a modest deceleration to 8.0% on a year-over-year basis after two consecutive quarters above 10%. The last time the S&P 500 experienced two consecutive quarters of above 10% sales growth was 2004.
- Analysts are forecasting deceleration of S&P 500 earnings growth for the full year of 2019 to single-digit levels.

### S&P 500 SECTORS 12-MONTH PRICE RETURNS

JANUARY 2018 THROUGH JANUARY 2019



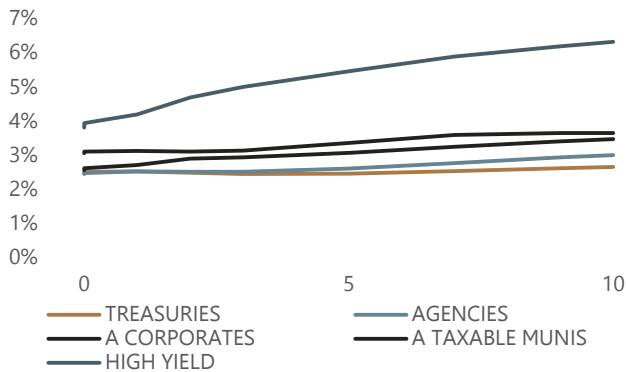
Source: Bloomberg

- Two of the worst performing sectors in 2018, energy and industrials, were the top performing sectors in January with both gaining over 11%. Energy stocks received a boost from the 18.5% rebound in oil after prices declined 38% in the fourth quarter.
- Optimism surrounding U.S.-China trade talks helped the trade sensitive industrials sector. Industrials also benefitted from getting an upward revision in analysts' fourth quarter earnings estimates while most other sectors' estimates were revised lower since mid-December.
- Another reversal from 2018 was January's weak performance of defensive sectors, including utilities and consumer staples, compared to their strong relative returns in the fourth quarter.

## FIXED INCOME

### CURRENT YIELD CURVES

YIELD CURVES AS OF JANUARY 2019

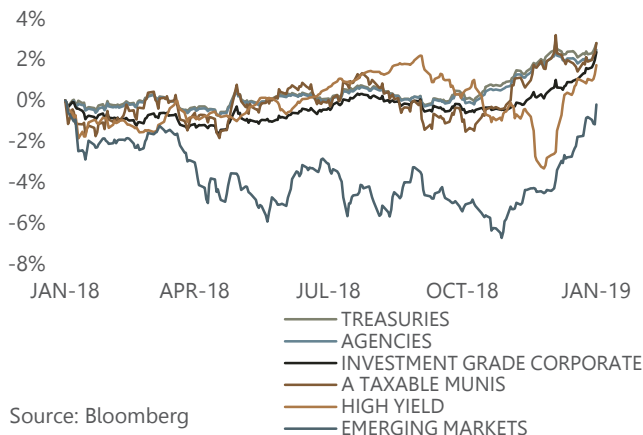


Source: Bloomberg

- The U.S. Treasury yield curve remained flat in January. Part of the U.S. Treasury yield curve between the two year and the five year remained inverted in January after initially inverting in December.
- Members of the Federal Open Market Committee spent much of January preaching patience and Fed Chair Powell said interest rates are “in the committee’s” range of a neutral rate estimate. The Fed’s guidance last year that there would be further rate hikes in 2019 sparked a fourth quarter flight to quality.
- While market-based measures of expected inflation ended January roughly 15 basis points higher than where they started the month, the 10-year U.S. Treasury yield fell 6 basis points during the month.

### 12-MONTH RETURNS, TAXABLE BOND SEGMENTS

JANUARY 2018 THROUGH JANUARY 2019



Source: Bloomberg

- Of the spread sectors we follow, taxable municipal bonds posted the best performance over the last twelve months, recording a return of 2.81% over that time period.
- On the other hand, the emerging market bond category trailed all bond sectors that we follow and was also the only sector to post a negative return over the past twelve months.
- Many investors have noted that emerging market bonds’ recent underperformance might mean that these bonds offer some value at current levels, citing potential dollar weakness as a possible catalyst. While there might be some value in the short-term, dollar weakness seems uncertain as other central banks grapple with their slowing economies.

### SPREAD VS. TREASURY LESS 2-YR MOVING AVG

JANUARY 2016 THROUGH JANUARY 2019



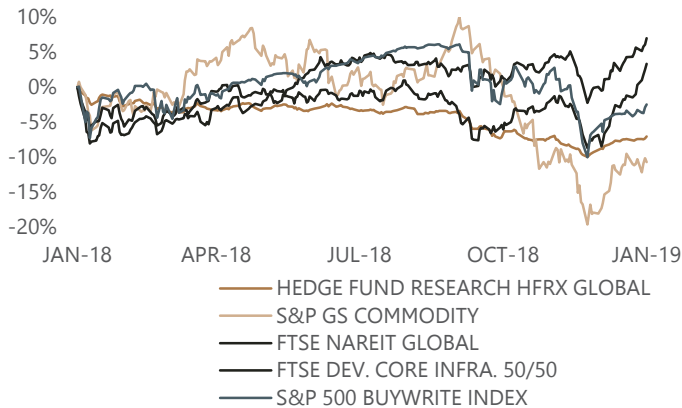
Source: Bloomberg

- A-rated investment grade corporate spreads hit a two-year high of 121 basis points on January 2 and steadily declined the rest of the month to 107 basis points.
- In January, U.S. Agency bonds picked up some spread against their lower quality high yield and A-rated investment-grade counterparts.
- The sharp increase in high yield spreads which began in early October peaked on January 3 at a level of 536 basis points. Spreads tightened rapidly thereafter to 450 basis points by January 11, followed by a slower pace of tightening to end the month at 427 basis points.



## ALTERNATIVES

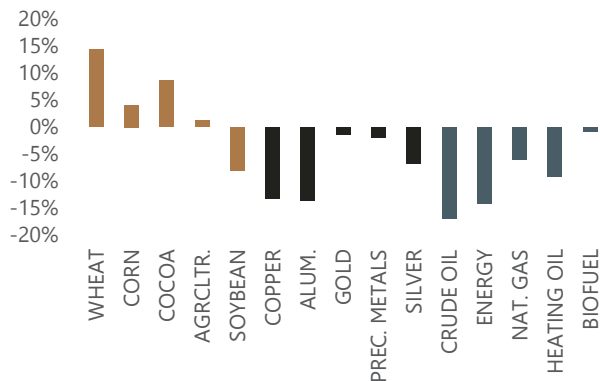
### ALTERNATIVES, 12-MONTH RETURNS JANUARY 2018 THROUGH JANUARY 2019



Source: Bloomberg

- Over the volatile two-month period ending January 31, four of the five alternative asset class indexes shown in the chart at left outpaced the S&P 500's -1.7% total return. The global REIT and developed market infrastructure indexes recorded particularly impressive returns over this period of 5.2% and 3.2%, respectively.
- While the global REIT, global developed infrastructure and hedged equity indexes were reasonably resilient over the twelve-month period ending January 31, the steep decline in crude oil prices from over \$76 per barrel in the first week of October to below \$54 per barrel on January 31 weighed on returns of the broad commodities asset class.

### COMMODITIES, 12-MONTH SPOT RETURNS JANUARY 2018 THROUGH JANUARY 2019



Source: Bloomberg

- Crude oil prices showed signs of stabilizing in January amid OPEC and Russia's December 6 agreement to cut 1.2 million barrels of oil per day from global production beginning in the first week of January.
- Gold prices have climbed 12.5% as of January 31 since reaching an 18-month closing low of \$1,174.16 per ounce on August 16, 2018.
- Despite extreme cold weather across most of the U.S. Midwest in late January, natural gas prices plummeted from \$4.61 MMBtu on November 30 to \$2.81 MMBtu on January 31. Market commentators have pointed to U.S. production that was more robust than expected as a primary driver of the sharp price decline.

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