



2018: A Volatile Year in Review

US Equities: A Wild Ride

After an eerily calm 2017, the increased volatility of 2018 came as a shock to many investors. The S&P 500 index entered “correction” territory twice last year (defined as a drop of 10% or more from a peak). The first was a sharp drop from late January to early February, with a loss that clocked in right around 10%. The market quickly recovered, and the middle part of the year was marked by new highs and strong gains across the domestic stock market. Going into the fourth quarter, the S&P 500 index was up 11% for the year to date, but 2018’s second correction, sharper and more persistent, pushed the index into negative territory for the year.

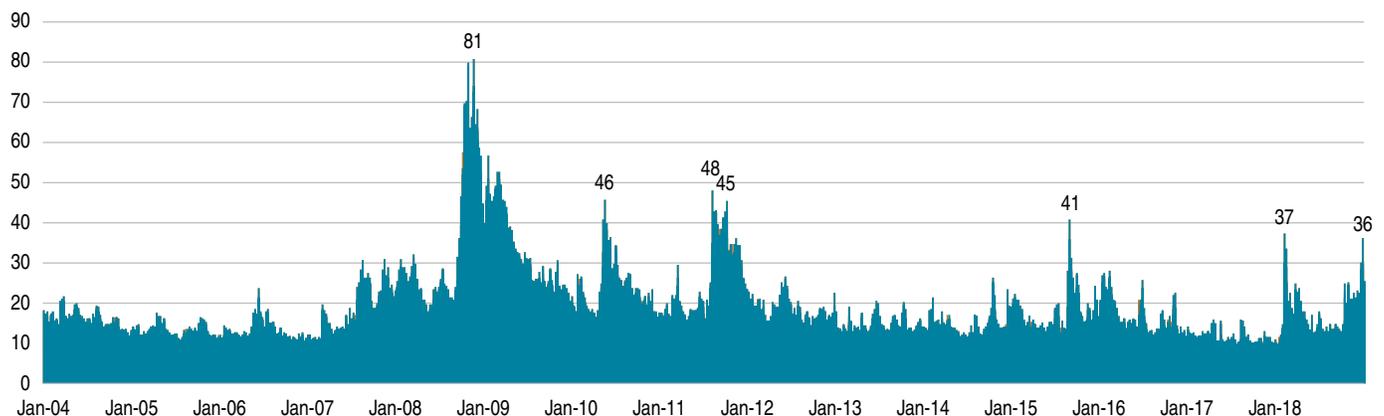
The last quarter started off poorly with the S&P 500 dropping 7% in October; it bounced back in November with a 2% gain, but spent much of December on the defensive, ending the month down 9%. From peak to trough (September 20 to December 24), the S&P 500 dropped 19%, narrowly missing bear market territory (defined as a drop of 20% or more) before posting modest gains in the last few trading days of the year. The index ended the year down nearly 4.5%, the worst calendar year since the 2008 financial crisis.

Though unsettling, investors would be wise to put this volatility into historical context. The chart below shows the closing price of the CBOE Volatility Index (VIX), a commonly referenced measure of domestic market volatility, from 2004 through 2018. Looking back since the 2008 financial crisis, the VIX shot much higher on several occasions including the European sovereign debt crisis in late 2011 and during the collapse of oil prices in 2015.¹ Volatility is always unsettling for long-term investors but coming off 2017—a year of unusual calm—made last year’s ups and downs seem relatively worse than they were.

Bonds Aren’t Boring

Far from boring, bonds (and the Treasury yield curve) captured headlines all year as market pundits debated the significance and likelihood of a yield curve inversion, and the markets alternatively cheered and jeered the Federal Reserve’s interest rate policy. With low unemployment and low inflation, the Fed maintained its “data-driven” mind set and hiked short-term interest rates four times last year. The final hike in December, though largely anticipated, proved the most dramatic as markets awaited Fed Chairman Jay Powell’s comments on future rate hikes. Thanks to increased volatility during the fourth quarter the market lowered its

VIX Closing Price



Source: Chicago Board of Options Exchange

¹ Cboe Volatility Index® (VIX® Index) measures the market’s expectation of future volatility. The VIX Index is based on options of the S&P 500® Index, considered the leading indicator of the broad U.S. stock market. The VIX Index is recognized as the world’s premier gauge of U.S. equity market volatility.

expectations for interest rate hikes in 2019 to zero from two just a few months earlier. During the December meeting, however, the Fed signaled two more rate hikes in 2019 (down from their previous forecast of as many as four) which disappointed the market, despite the more dovish tone compared to previous Fed statements.

Trouble Brewing Across the Pond

The international stock markets took a beating as the U.S. dollar continued to climb and news from overseas seemed to get worse by the day. The prospects of a “hard Brexit” became more likely by the end of the year, political protests in France shut down the city for several days, Venezuela slid deeper into crisis, and several other developed and emerging markets countries saw growth slow more than expected. The MSCI EAFE index posted negative returns in eight months last year while the MSCI Emerging Markets index posted negative returns in nine. The S&P 500, by contrast, was down in just four months last year.

Perhaps most unsettling to investors last year was that most major asset classes closed down for the year. The Bloomberg Barclay’s Aggregate Bond index spent much of 2018 in the red, but took gains during the fourth quarter, ending the year flat. Corporate bonds sold off precipitously

during the fourth quarter, ending the year with a 450-basis point loss. Small cap stocks (as measured by the Russell 2000) posted double-digit losses for the year and dropped 20% in the fourth quarter. The table below shows returns for major indexes through 2018 over various time periods.

Looking Ahead

Going into 2019, investors should expect heightened volatility to be the norm as the markets attempt to navigate several important issues, the outcomes of which are murky at best. Trade wars, or the resolution of trade wars; a slowing Chinese economy; the possibility of a hard Brexit; and the divergence of the Federal Reserve’s stated rate rising path and the market’s expectations of what the Fed should do are just a few. Each of these issues has the potential to move markets considerably in either direction. Given that many of them may come to a head sooner rather than later (the Brexit deadline is March 29 and the Fed will have its first meeting of 2019 at the end of January), investors should brace themselves for a rocky first quarter. That said, investors who have a long-term investment plan and an allocation that is appropriate for that plan and their risk tolerance should not worry about day-to-day changes in the stock markets. The market goes up and it goes down in the short run but a diversified portfolio wins over the long term.

Calendar Year Returns 2007-2018

Index	Q4 2018	1 Year	Total Return (%)		
			3 Year	5 Year	10 Year
Equities					
S&P 500 (Large Caps)	-13.52	-4.38	9.26	8.49	13.12
Russell 2000 (Small Caps)	-20.20	-11.01	7.36	4.41	11.97
MSCI EAFE (Intl Equity)	-12.54	-13.79	2.87	0.53	8.02
MSCI Emerging Markets	-7.47	-14.58	9.25	1.65	6.32
Fixed Income					
Bloomberg Barclay’s US Aggregate Bond	1.64	0.01	2.06	2.52	3.48
Bloomberg Barclay’s US Corporate High Yield	-4.53	-2.08	7.23	3.83	11.12

Data as of 12/31/2018. Source: Morningstar

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The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value-weighted index with each stock’s weight in the index proportionate to its market value. The Russell 2000 Value invests in stocks in the Russell 2000 Value Index, a broadly diversified index predominantly made up of value stocks of small U.S. companies. The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. and Canada. The MSCI Emerging Markets Index is an index designed to measure equity market performance in global emerging markets. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded. Mesirow Financial refers to Mesirow Financial Holdings, Inc. and its divisions, subsidiaries and affiliates. The Mesirow Financial name and logo are registered service marks of Mesirow Financial Holdings, Inc. © 2019, Mesirow Financial Holdings, Inc. All rights reserved. Some information contained herein has been obtained from sources believed to be reliable, but is not necessarily complete and its accuracy cannot be guaranteed. Any opinions expressed are subject to change without notice. Advisory Fees are described in Mesirow Financial Investment Management, Inc.’s Form ADV Part 2A. Mesirow Financial does not provide legal or tax advice. Advisory services offered through Mesirow Financial Investment Management, Inc. an SEC registered investment advisor. Securities offered by Mesirow Financial, Inc. member FINRA and SIPC.

To learn how Mesirow can help you,
please contact Cara Esser at 312.595.8458
or cesser@mesirowfinancial.com.

