JANUARY 2019 COMMENTARY

As we kick off 2019, markets continue to be volatile. The fact that investors are nervous about trade wars, Fed policy, global economic growth, and other concerns hasn't changed. However, what also hasn't changed is that, over the long run, staying invested and diversified are the best ways for investors to achieve their financial goals. This is no different today than at any other point in the market cycle.

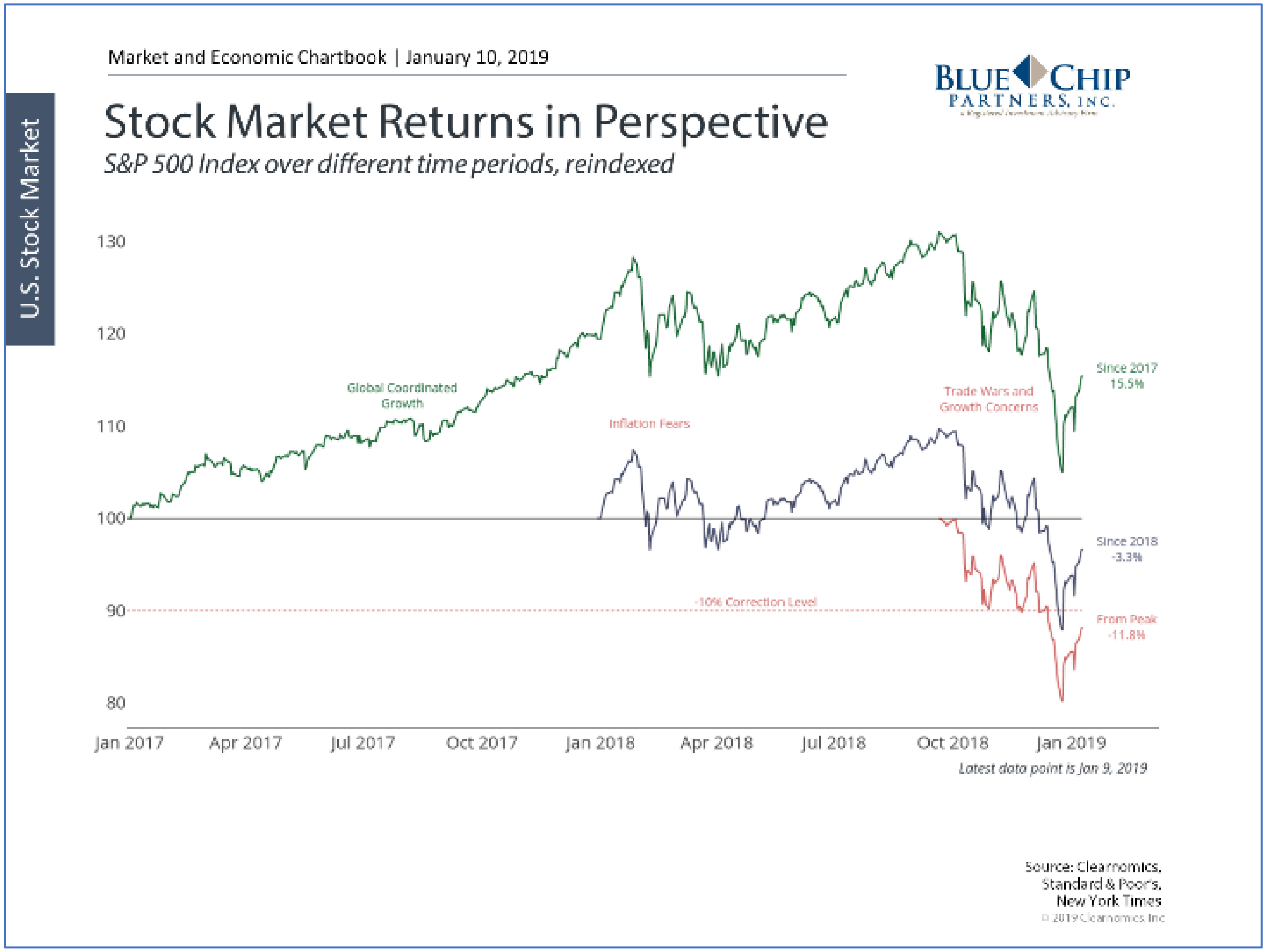
One of the biggest challenges for long-term investors is keeping market concerns and volatility in perspective. Unfortunately, it's easier to see what's happening in the markets today than how they've evolved over years and decades, let alone the underlying economic factors. This requires looking beyond recent market patterns and concerns.

The reality is that the past two years have seen both ups and downs centered around global economic growth, corporate earnings, and investor expectations. Beginning in late 2016, markets behaved as if nothing could go wrong. Today, the market is behaving as if nothing will ever be right again. Just as investors were too optimistic in 2017, they are probably too pessimistic today.

Most headlines have focused on the fact that 2018 was the worst year since 2008. While this is true, it would be difficult in any other situation to compare a year that was down -6% (-4% with dividends) to one that fell -38% (almost -50% intra-year). The fact that 2018 is compared to 2008 speaks more to how spectacular stock returns have been over the past decade. Those who stayed invested over that period are closer to achieving their financial goals, even if the most recent quarter was negative.

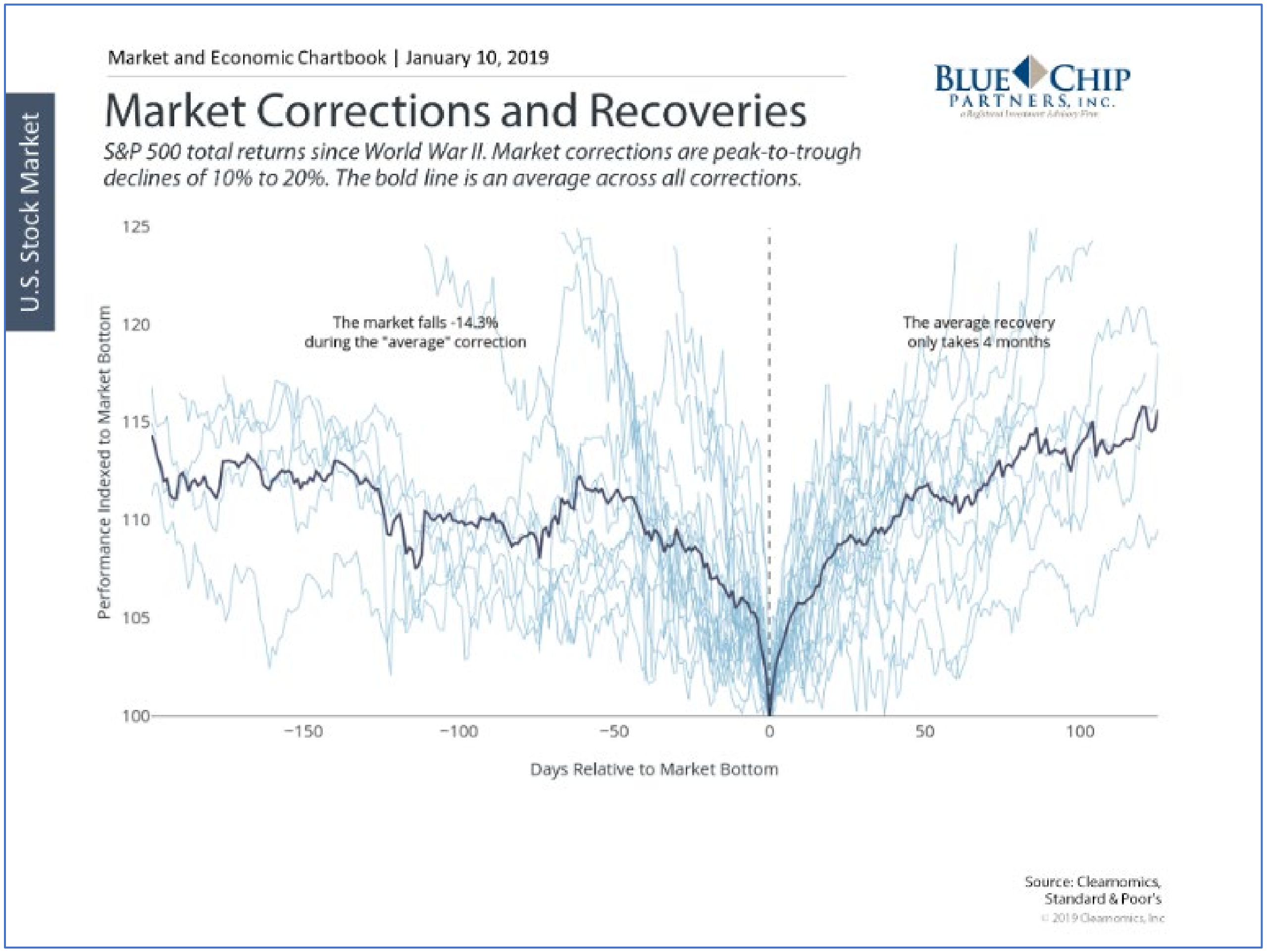
For long-term investors seeking to protect and grow wealth over many years, it's clear that widespread market timing is often counterproductive. The goal isn't to swerve around every pothole. Not only is this dangerous, but some bumps are entirely unforeseen or unavoidable. The goal is to set yourself up for a balanced ride, regardless of the terrain. Staying invested across time, over both the ups and the downs, requires composure. Diversifying across asset classes that do well in different market environments requires discipline. These are principles that will help long-term investors in 2019 - no different than in any other year.

1. It's important to keep markets in perspective



Keeping market volatility in perspective requires looking past short-term trends. While markets were down in 2018, the exact opposite was true in 2017. Over the past two years, the S&P 500 rose 14%, before dividends. This is a solid return over this timeframe no matter how you slice it. Staying invested and taking the good with the bad is a key principle to achieving long-term goals.

2. Market volatility is normal



Another way to maintain perspective is to remember that market volatility is normal. Since World War II, there have been two dozen market corrections between -10% and -20%. The average market decline during these periods is -14%, resulting in investor nervousness all along the way.

However, if the market and economic conditions are right, markets can rebound swiftly as well. On average, the market fully recovers in four months. This most recently occurred during the market corrections of late 2015 and early 2016. While these recoveries don't occur over days or weeks - and certainly each correction is different - patient investors are often able to ride out the storm.

Thus, market volatility is a reminder for investors to stay disciplined and to ensure that their portfolios match their risk tolerance and objectives.

3. The path of Fed rate hikes is uncertain

As has been the case throughout the past ten years, one of the market's biggest concerns is the Fed. It would be an understatement to say that central bank monetary policy has played a role in the global economy and markets. With markets continuing to be volatile, many are worried that the Fed will make a policy error in 2019.

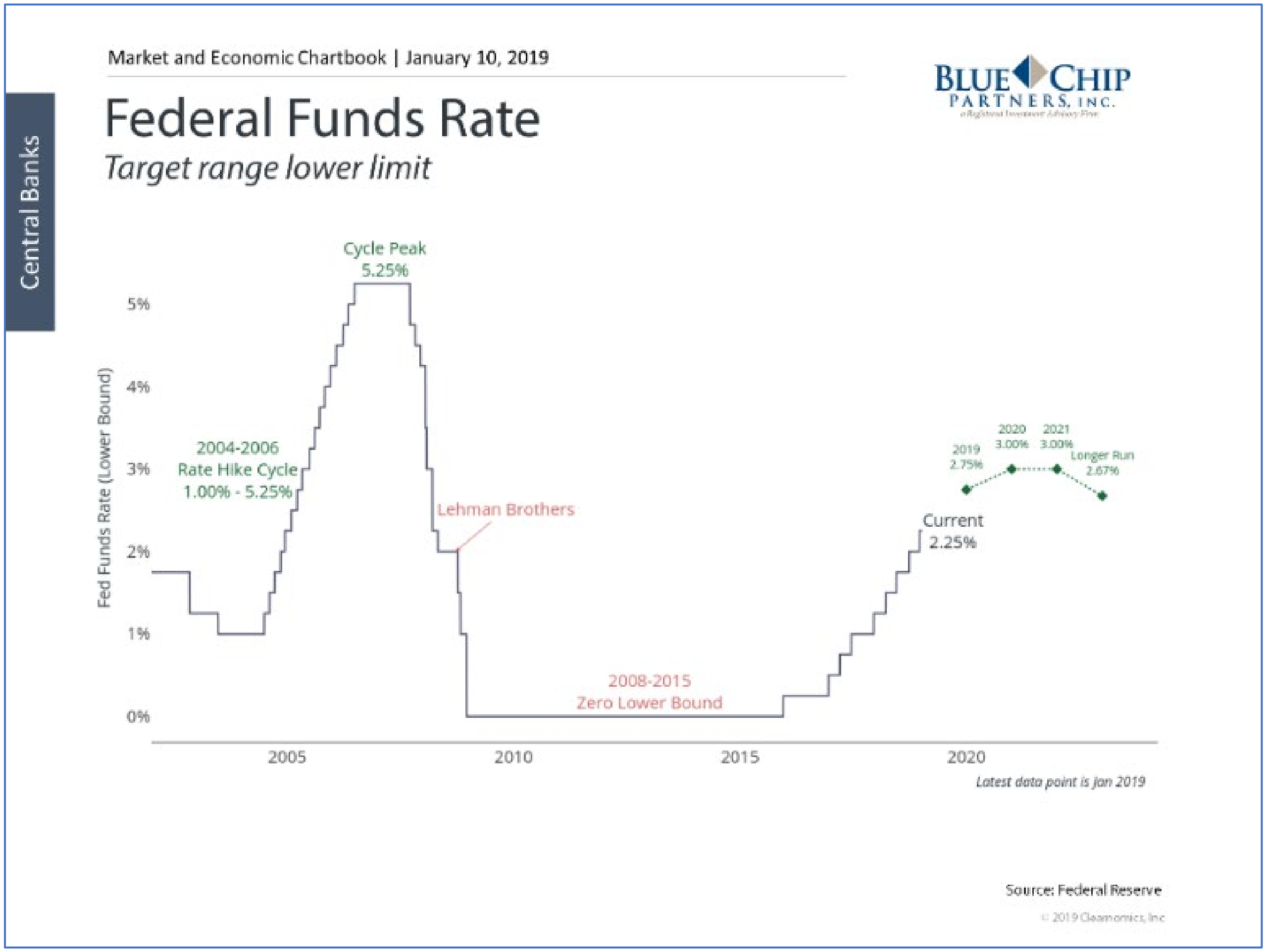
This is a case of investor expectations versus reality. Investors, in a difficult market environment, expect the Fed to pause its rate hikes in 2019. At the moment, fed funds futures are predicting zero rate hikes in 2019 and the possibility of rate cuts in 2020.

The reality is that, from the Fed's perspective, the pace of rate hikes has been exceptionally slow compared to history - and may have slowed even more on its own so as to not fully invert the yield curve. In December, the Fed attempted to bridge the gap in expectations by decreasing the pace of rate hikes to two in 2019, after having raised rates four times in 2018. This wasn't enough to calm investors, although more recent comments by Chairman Powell suggest greater flexibility in the path of monetary policy.

Why are investors concerned about this? It's undeniable that many historic recessions have either coincided with or have been directly caused by over-tightening of interest rates by the Fed. Famous examples are the Great Depression, when the Fed was too tight with the money supply, and the 1970's recession when Paul Volcker intentionally tightened policy to snap runaway inflation. More recently, low interest rate policy likely helped to fuel the housing collapse during the mid-2000's as well.

The Fed, of course, does understand this history. So why does it continue to raise interest rates? The answer is simple: because they still judge the economy to be healthy by most broad economic measures. Case in point: last week's jobs report showed that the economy added 312,000 jobs - a very strong number - alongside rising wages. The unemployment rate is still very low at 3.9%, and rose slightly only because workers rejoined the labor force, a positive sign. (These numbers don't yet include the impact of the government shutdown)

For most investors, it's important to have perspective on the economy and proper expectations regarding Fed policy. After ten years of expansion, we are in the later stages of the business cycle, increasing the potential risks to the economy and reducing the margin of error. However, the economy is still healthy with a strong job market and inflation only slowly rising. As always, it's important to stay balanced in this environment to take advantage of long-term investment opportunities.



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Although investors are concerned about a possible Fed policy error, they should not overreact to gradual monetary policy tightening. Today, after nine rate hikes, the federal funds rate is only in the range of 2.25-2.50%, as shown in the chart above. This is roughly half the pace of previous rate hike cycles, and on an inflation-adjusted basis, the fed funds rate is still near zero.

The Fed is raising rates because it judges that the U.S. economy is healthy. Unemployment is still at a multi-decade low of 3.9% and most measures of inflation are at or beyond the Fed's target of 2%. Still, the Fed reduced its forecast of rate hikes to two in 2019, and has the flexibility to reduce it further if warranted by the economic data.

The bottom line? Having the right long-term perspective on markets is even more important at this stage in the business cycle. The best way to stay focused and disciplined in 2019 is to maintain a balanced portfolio.

Sincerely,

Robert | Dan | Matt | Jonathan

Robert K. Steinberg, JD, CPA, CFP® | Daniel E. Seder, CFA, CFP® | Matthew Mondoux, CFA, CFP®, CMT | Jonathan A. Johnson, CPA

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38505 Country Club Dr., Suite 150, Farmington Hills, MI 48331
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