IdahoTrustBank

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WealthManagement

SOLUTIONS FOR YOUR LIFENEEDS™

Market Insights

A periodic newsletter from Idaho Trust Bank

Global financial markets struggled last year. Volatility levels have increased from much lower levels experienced in the first three quarters of 2018. Uncertainties surrounding the global political landscape have clearly begun to impact the investment environment. The Federal Reserve Bank raised the benchmark Fed Funds rate at its December meeting. The increase came at a time when many have begun to question the resilience of U.S. economic strength in the face of a slowing global economy.

Interest Rates

At the mid-December meeting, the Federal Reserve Bank (Fed) raised interest rates for the fourth time in 2018 (marking the 9th increase in the past 10 years). The target range of the Fed funds is now 2.25% – 2.50%. Domestic economic activity was strong in 2018. However, many forward looking indicators have begun to weaken, which suggests there may be some type of slowdown in the coming months. Fed members currently expect to raise interest rates one or two additional times this year but they have stressed recently that these actions will be dependent on the strength of the economy as well as inflation levels. Many market participants do not believe that the Fed will raise rates this year as they expect that the economy will slow down dramatically from current levels.

Idaho Trust Bank offers total wealth solutions including its LifeNeeds™ investing process. LifeNeeds™ utilizes proven strategies and techniques delivered by a highly trained staff of wealth management professionals.

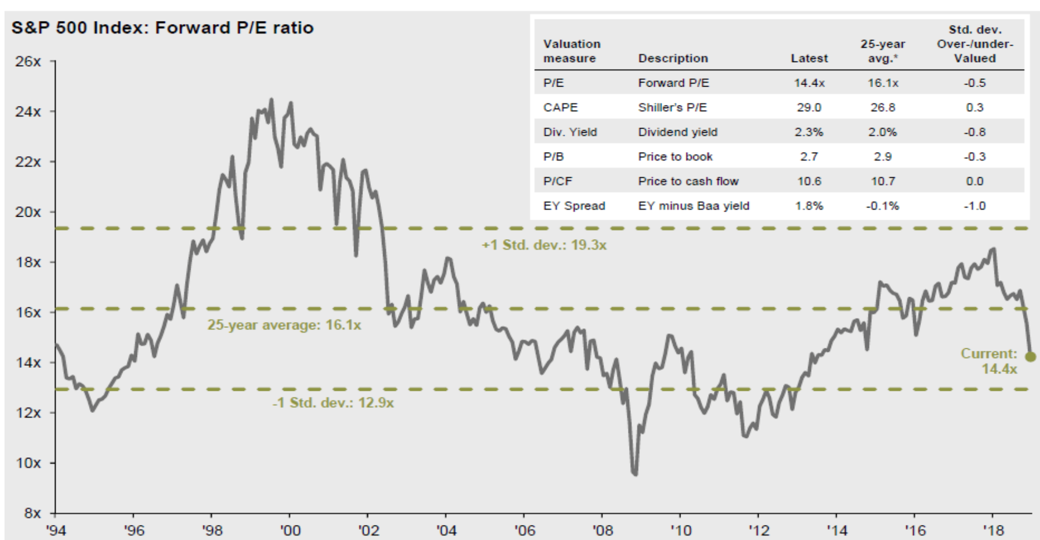
LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust Bank's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.

Gross Domestic Product

The third quarter (3Q) Gross Domestic Product (GDP) was 3.4%, a slight revision lower from the initial reading of 3.5%. The 3Q results, while very solid, represent a deceleration from the torrid pace of 4.2% experienced in the second quarter. Consumer spending rose 0.4%, helped in part by strong employment reports as well as recent changes to tax policy. Over the past 12 months, average wages have increased 3.1%, a level well above recent readings and good news for workers that have not experienced much in the way of wage growth in the past decade. Oil prices have declined which should help boost consumer spending but may well negatively impact corporate earnings this year as lower energy prices typically reduce capital expenditures. Consumer spending accounts for more than two-thirds of U.S. economy; so as long as the labor market remains firm, it should help support economic activity although likely below the levels of 2018.

Year-end Review

During the first three months of 2018, the U.S. indices experienced solid market gains. The S&P 500 index rose 10.6% from January through the end of September. However, beginning in October, almost every major index took a sharp turn lower. The S&P 500 finished the year down 4.4%. Many factors likely contributed to the negative investment performance including an escalation in tariff rhetoric between the U.S. and China as well as the perception of an aggressive Fed policy tightening in the face of decelerating economic activity. International stock indices experienced more challenging conditions, as trade friction as well as the uncertainty surrounding the U.K. leaving the European Union created an unfriendly investment environment.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	14.4x	16.1x	-0.5
CAPE	Shiller's P/E	29.0	26.8	0.3
Div. Yield	Dividend yield	2.3%	2.0%	-0.8
P/B	Price to book	2.7	2.9	-0.3
P/CF	Price to cash flow	10.6	10.7	0.0
EY Spread	EY minus Baa yield	1.8%	-0.1%	-1.0

Europe has struggled with political instability as well as concern that Italian banks hold a rather high portion of non-performing loans on their books. Bonds proved more resilient than equities, recording a nominal 0.01% gain in 2018. Toward the end of the year, credit spreads began to widen, signaling concern for lower liquidity and the overall quality of corporate bonds. As a result, high yield bonds fell 4.5% in Q4.

The S&P 500 trades at about 14.4 times projected earnings for the next 12 months, a reduction from the over 18 times the index traded for at the start of 2018. The reduction represents a healthy discount to the 16.1 times average valuation level over the past 25 years (see chart).

Defensive sectors, such as Health Care, Utilities and Consumer Discretionary were the only areas that made positive contributions to the market returns last year. Economically sensitive areas (Energy, Materials and Industrial) experienced double digit loses as investors worried about a slowdown in domestic economic activity that could happen in 2019. A decline in Commodities prices also suggests that the major factors impacting returns last year was an expectation of slower global growth.

2018 Market Returns

Broad Market Returns	
S&P 500	-4.37%
Dow Jones Industrial Average	-3.48%
Nasdaq	-2.81%
Russell 2000 - small cap	-11.03%
MSCI EAFE	-13.79%
MSCI Emerging Markets	-14.58%
US Bond Index	0.01%
Treasuries	0.86%
Corporate Bonds	-2.51%
Municipal Bonds	1.28%
Foreign Bond Index	-2.26%
Commodities	-11.25%
Domestic Stock Sectors	
Information Technology	-0.29%
Financials	-13.04%
Health Care	6.47%
Energy	-18.10%
Consumer Discretionary	0.82%
Consumer Staples	-8.39%
Industrials	-13.32%
Utilities	4.11%
Materials	-14.70%
Telecommunication Services	-12.53%
Real Estate (REITs)	-2.23%

Conclusion

The total return for the S&P 500 in 2018 was down sharply from the 21.8% gain experienced in 2017. Given the relatively healthy state of the domestic economy last year, the Fed increased rates on 4 separate occasions, which negatively impacted fixed income returns. Therefore, the benefit of portfolio diversification was impacted in 2018. An important variable, in our opinion, will be inflation expectations. If inflation rates begin to accelerate, the Fed will become more aggressive in tightening monetary policy. Uncertainty surrounding this issue could create continued volatility in 2019, until these issues become more clear.

S&P 500 Index

3 Month	-13.81%
Year-to-Date	-4.39%
1 Year	-4.39%
3 Year	9.24%
5 Year	8.48%

MSCI EAFE Net Index

3 Month	-11.98%
Year-to-Date	-13.79%
1 Year	-13.79%
3 Year	2.87%
5 Year	0.53%

Barclays Aggregate Bond Index

3 Month	1.61%
Year-to-Date	0.01%
1 Year	0.01%
3 Year	2.05%
5 Year	2.52%

As of 12.31.2018

Boise Branch
888 W. Broad St.
Boise, Idaho
208.373.6500

Coeur d'Alene Branch
622 E. Sherman Ave.
Coeur d'Alene, Idaho
208.664.6448

Las Vegas Trust Office
2850 W. Horizon Ridge PKWY, Ste 200
Henderson, Nevada
702.430.4747

Info@IdahoTrust.com
www.IdahoTrust.com

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