



Montecito  
Bank & Trust®  
Wealth Management

## NOVEMBER 2018 IN REVIEW

December Update | As of November 30, 2018

### ECONOMY: ECONOMIC DATA IMPROVES, TRADE WEIGHS ON BUSINESSES

#### Economic Data

Economic trends generally improved in November, even after strong gross domestic product (GDP) growth over the last two quarters. The Conference Board's Leading Economic Index (LEI), an aggregate of ten leading indicators, increased 0.1% in October and 5.9% year over year. While LEI growth slowed, positive momentum signaled low odds of recession in the coming year.

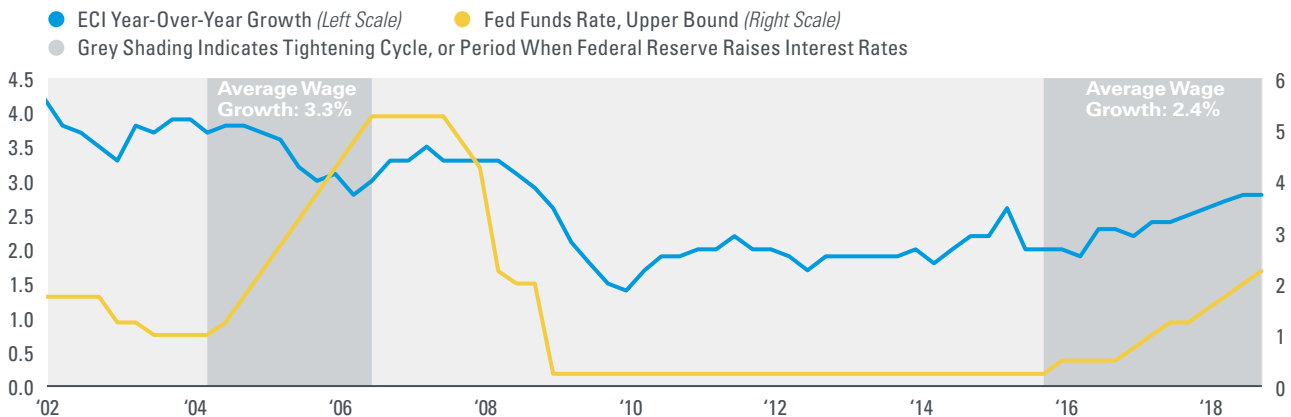
Nonfarm payrolls grew solidly in October, while the unemployment rate stayed at a 48-year low. Average hourly earnings grew 3.1% year over year last month, the first time that measure of wage growth has eclipsed 3% since April 2009. While investors have recently been sensitive to the uptick in wage growth, we think the current pace is sustainable and healthy for the U.S.

economy, especially as labor costs remain relatively low [Figure 1]. Wages represent up to 70% of business costs, so current wage growth shows inflation has yet to reach levels that could weigh on output.

Modestly accelerating wages and fiscal stimulus were a boon to consumer's wallets last month as the quarter of holiday spending commenced. Personal incomes grew year over year in October, near the fastest pace in three years, while personal spending rose near its fastest such pace in four years. Consumer confidence in November fell month over month, but it essentially remained at an 18-year high, signaling strong consumer activity will continue to boost output.

Reports last month showed pricing increases slowed, contrary to expectations that economic growth and tariffs may fuel higher inflation. The core Producer Price Index (PPI), which excludes the volatility in pricing of food and energy components, rose 2.2% year over year in October, slowing from a multiyear-high pace reached in September. Year-over-year growth in the core CPI cooled for a third straight month. Year-over-year

#### 1 CURRENT PACE OF WAGE GROWTH SUPPORTS GRADUAL RATE INCREASES



Source: LPL Research, Bloomberg 10/31/18

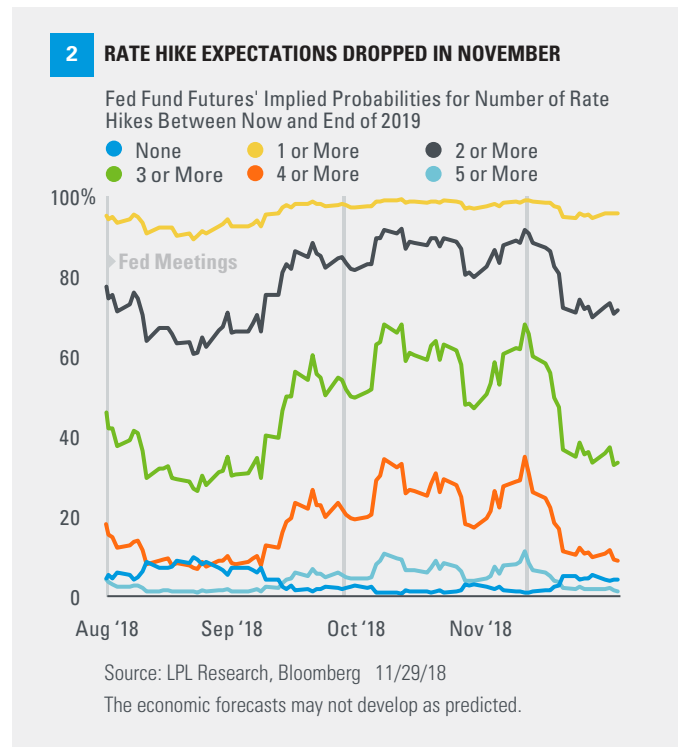
Employment Cost Index (ECI) is a quarterly report from the US Department of Labor that measures the growth of employee compensation (wages and benefits). The index is based on a survey of employer payrolls in the final month of each quarter. Illustration is historical and no guarantee of future results.

growth in Core Personal Consumption Expenditures (PCE), the Federal Reserve's (Fed) preferred gauge of inflation, fell to 1.8% in October, below the Fed's 2% target. Overall, we believe wage and pricing data show inflation remains relatively contained, and inflationary pressures will likely continue at these levels into next year.

However, negative impacts from the U.S.-China trade dispute seeped into leading indicators for business health. Business spending growth continued to cool, concerning investors that trade tensions may be outweighing the benefits of fiscal stimulus for U.S. corporations. New orders for nondefense capital goods (excluding aircraft), our best proxy for future capital expenditures (capex), increased 4.8% year over year in October. The Institute for Supply Management's (ISM) gauge of new business orders fell to the lowest level since April 2017 in October, hampered by steep declines in export orders as overseas manufacturers cut production in preparation for lower demand. Even though recent data on business spending have been discouraging, we see trade tensions as the primary roadblock to capital investment.

Still, U.S. manufacturing health remained solid, even as demand from U.S. businesses waned. ISM's Purchasing Managers' Index (PMI), a gauge of manufacturing activity, rose in October to just below a 14-year high (reached in August). Markit's PMI, which assigns different weights to its survey components, jumped to a fresh five-month high. We are encouraged by U.S. manufacturing strength, especially as global manufacturing activity slows, and we expect fiscal tailwinds and economic momentum to fuel further growth in the sector. The trade dispute has been difficult to navigate for U.S. corporations, and many have opted to put future expansions on hold until there is more clarity on the tangible and intangible effects of tariffs on demand and profits.

U.S. housing demand continued to decline as consumers became more apprehensive about big-ticket purchases and homes became less affordable. While existing home sales grew 1.4% month over month, they fell 5.1% year over year, the biggest decline since August 2014. New home



sales dropped 12% year over year, matching one of the biggest drops since 2011. Year-over-year growth in housing prices, represented by the S&P CoreLogic Case-Shiller 20-City Composite, continued to slow.

### Fed Keeps Rates Unchanged, Expectations Drop

Fed policymakers reconvened in November and announced November 8 that they would leave rates unchanged. Since then, markets have struggled with reconciling the Fed's rhetoric around interest rates and where the neutral rate is with strengthening global economic headwinds. Market-based forecasts of the Fed's policy rate dropped significantly in November as markets increasingly positioned for a slower path of rate hikes [Figure 2].

Fed funds futures' implied probability of at least three 25 basis points (0.25%) rate hikes before the end of next year—including a likely hike in December—slipped to 30% at the end of November (from about 65% on November 8). Futures are pricing in an 80% probability of a rate hike at the December meeting, and a year-end 2019 upper-bound fed funds rate of 2.7%, compared with 2.25% today. The Fed's next rate announcement is scheduled for December 19.

# GLOBAL EQUITIES: STOCKS STAGED A MODEST REBOUND AFTER VOLATILE OCTOBER

## United States

Stocks bounced back in November after a difficult October, as the S&P 500 Index posted its seventh monthly gain in eight months. The S&P 500 returned 2% for the month, bringing year-to-date gains to 5.1%. The Dow Jones Industrial Average (Dow) produced a similar monthly return of 2.1%, while technology weakness weighed on the Nasdaq Composite, which managed only a 0.5% advance. The Nasdaq is still leading the S&P 500 year to date with its 7.3% return, and is ahead of the Dow's 5.6% year-to-date gain (including dividends).

Still solid economic and corporate profit backdrops helped stocks recover from a tough October, including steady job growth, high consumer and business confidence, and an excellent third quarter earnings season. In addition, investors became more comfortable with the primary risk to markets, including midterm elections, United States-China trade talks, and the Fed.

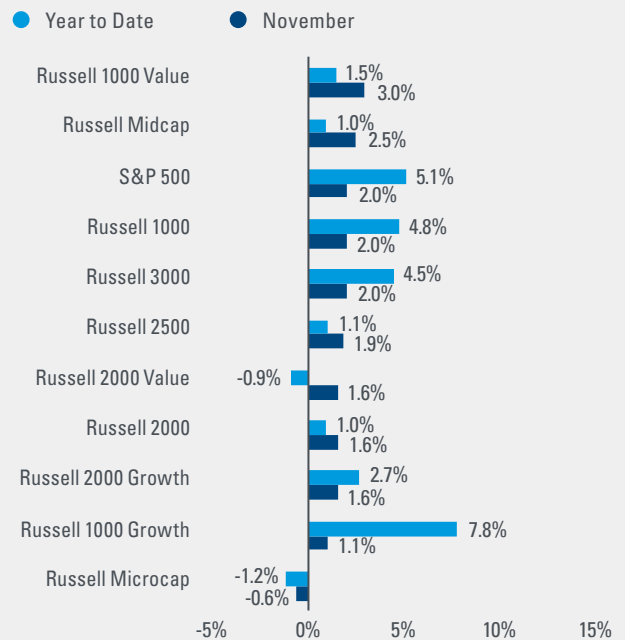
Investors appeared to welcome the outcome of the midterm elections, which was generally in line with consensus expectations. The Republicans held onto their Senate majority, while the Democrats retook control of the House of Representatives. Historically, stocks have done well after the election uncertainty has been removed, while markets generally have thought gridlock is good because it takes out the extremes.

The biggest event in November, which spilled over into December, was the G-20 summit in Argentina, and President Trump's much-anticipated dinner with China President Xi. We will leave the market impact of that meeting to next month's publication, but optimism ahead of that meeting helped support stocks late in November (more on the G-20 [here](#)).

Turning to the Fed: At a speech November 28, Fed Chair Jerome Powell effectively walked back a comment that the market had interpreted as hawkish. Specifically, Powell characterized interest

### DOMESTIC INDEX PERFORMANCE

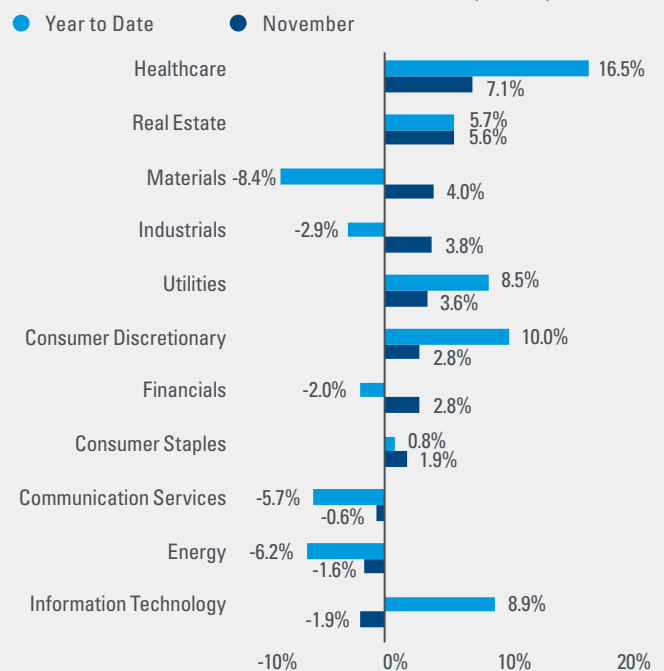
(Sorted by Monthly Return)



Source: LPL Research, FactSet 11/30/18

### S&P 500 SECTOR PERFORMANCE

(Sorted by Monthly Return)



Source: LPL Research, FactSet 11/30/18

Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Stock investing involves risk, including loss of principal.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

rates as “just below neutral,” rather than a “long way from neutral.” The bond market interpreted this wording change as dovish and reduced rate-hike expectations, buoying stock market sentiment.

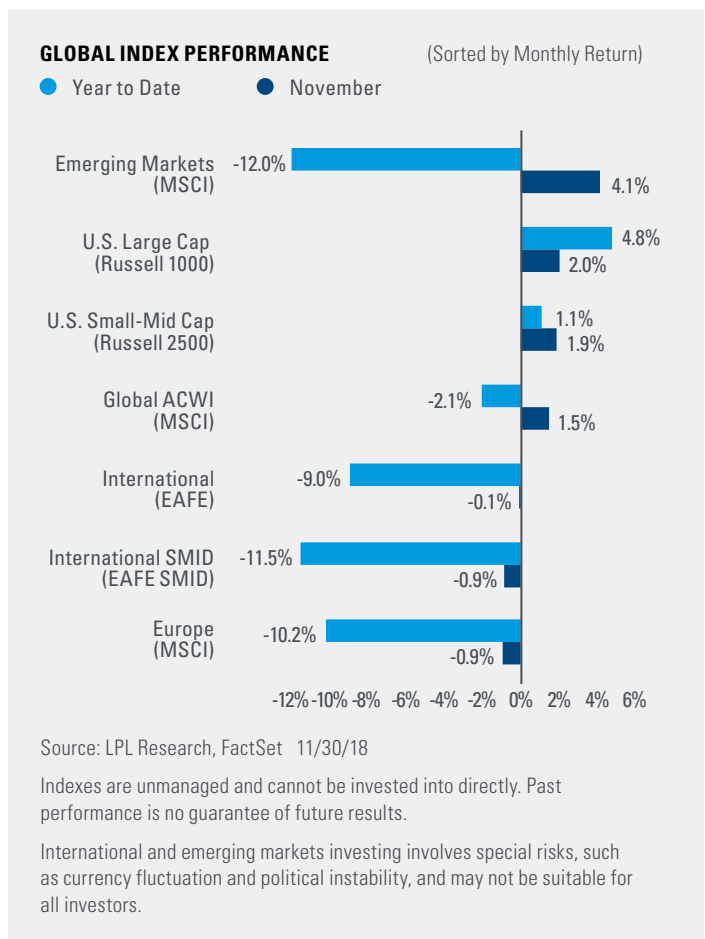
Turning to market leadership, mid cap stocks outpaced large and small caps during November, as the Russell Midcap Index returned 2.5%, ahead of the large cap (2%) and small cap (1.6%) Russell indexes. Widening credit spreads and increasing optimism around trade deals may have helped large caps relative to small and mid cap companies, while small and mid caps may have benefited from attractive relative valuations, economic and market sensitivity, and increased acquisition activity. Year to date, the large cap Russell 1000 Index has returned 4.8%, compared with 1% gains for Russell’s small and mid cap indexes.

Value stocks outperformed growth stocks for the second straight month in value’s first two-month win streak since November–December 2016. The Russell 1000 Value Index returned 3% in November, besting the 1.1% return for its growth counterpart. Technology weakness was the big story, as the growth-heavy sector’s 1.9% loss was last among the 11 S&P 500 sectors. Growth still holds a sizable lead over value this year, as the Russell 1000 Growth Index has climbed 7.8% year to date, well ahead of the 1.5% gain for the value index.

Most sectors were higher in November, led by the defensive healthcare and real estate, suggesting some investor caution even amid gains in the broad market. The three sectors that fell—communication services, energy, and technology—were all economically sensitive, reflecting concerns about mobile phone trends, so-called “FAANG” stocks, and the oil bear market.

**International**

Emerging markets (EM) equities produced a solid 4.1% return in November based on the MSCI EM Index, besting the S&P 500 and the MSCI EAFE Index, the developed international equity benchmark. Slower growth in Europe, particularly in Germany, drove weakness in European stocks.



Hong Kong was the best performing market amid increasing optimism for a U.S.-China trade deal, while Germany, France, and the United Kingdom were the biggest detractors to benchmark performance. Year to date, the MSCI EAFE Index has lost 9%.

Trade-deal optimism and a more dovish Fed rate outlook fueled EM stocks’ gain last month. EM welcomed expectations for more gradual rate hikes and a potentially slower pace of U.S. dollar appreciation that could help reverse tightening financial conditions. China was the biggest driver of the benchmark’s gains with a more than 7% return for the month, while markets in India and South Africa also performed well. On the flip side, markets in Brazil, Mexico, and Russia suffered losses for the month. Year to date, the MSCI EM Index has lost 12.0%.

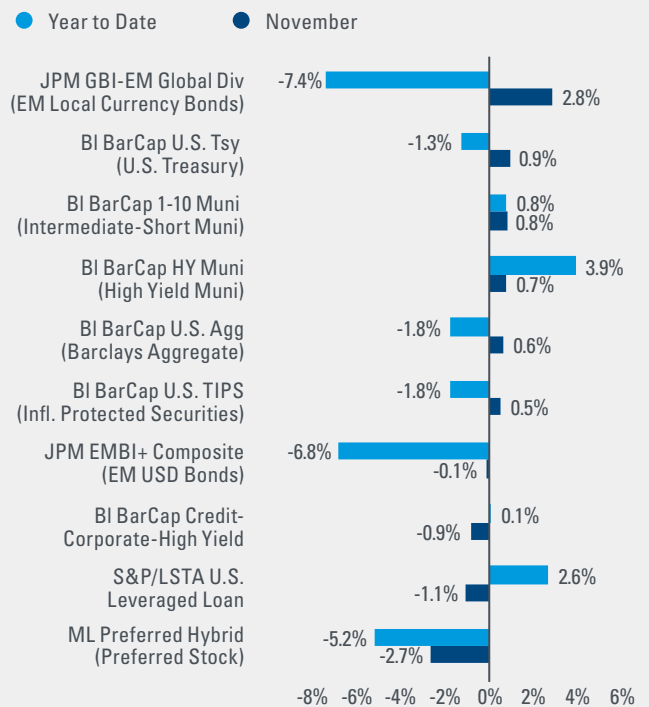
## FIXED INCOME: TREASURIES RISE, RATES FALL AS HEADWINDS STRENGTHEN

Treasury prices rose and rates declined in November as investors positioned for a slower path of rate hikes next year. The 10-year Treasury yield dropped 16 basis points (bps) (.16%) in November, its biggest monthly slide since August 2017. The yield curve resumed its historical flattening, as the spread between the 2-year and 10-year Treasury yields fell to 20 bps (.2%) at the end of the month, near the lowest point of the current economic cycle. The 10-year yield dropped 20 bps (.2%) over nine straight lower trading sessions from November 9 to November 23 as investors reduced their inflation expectations amid trade headlines, geopolitical issues, and softening economic data globally.

Lower rates boosted higher quality fixed income categories, particularly at longer maturities, as shown in the Fixed Income Performance Table. Mortgage-backed securities performed well, climbing 0.9%, their best month since January 2016 (Bloomberg Barclays U.S. Aggregate Securities MBS Index). Treasuries also increased 0.9%, while the Bloomberg Barclays US Aggregate Bond Index rose 0.6%. Investment-grade corporate bonds, represented by the Bloomberg Barclays US Aggregate Credit Index, fell less than 0.1%. Lower quality sectors fared worse as investors turned away from riskier assets in the month. High-yield bonds decreased 0.9% for a second straight month of losses, while bank loans slid 1.1% (S&P/LSTA U.S. Leveraged Loan Index) and emerging markets (EM) debt lost 0.1%.

### FIXED INCOME PERFORMANCE

(Sorted by Monthly Return)



### U.S. TREASURY YIELDS

Security	10/31/18	11/30/18	Change in Yield
3 Month	2.34	2.37	0.03
2 Year	2.87	2.80	-0.07
5 Year	2.98	2.84	-0.14
10 Year	3.15	3.01	-0.14
30 Year	3.39	3.30	-0.09

### AAA MUNICIPAL YIELDS

Security	10/31/18	11/30/18	Change in Yield
2 Year	1.98	1.90	-0.08
5 Year	2.29	2.19	-0.10
10 Year	2.74	2.64	-0.10
20 Year	3.22	3.14	-0.08
30 Year	3.34	3.28	-0.06

Source: LPL Research, Bloomberg, FactSet 11/30/18

Indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

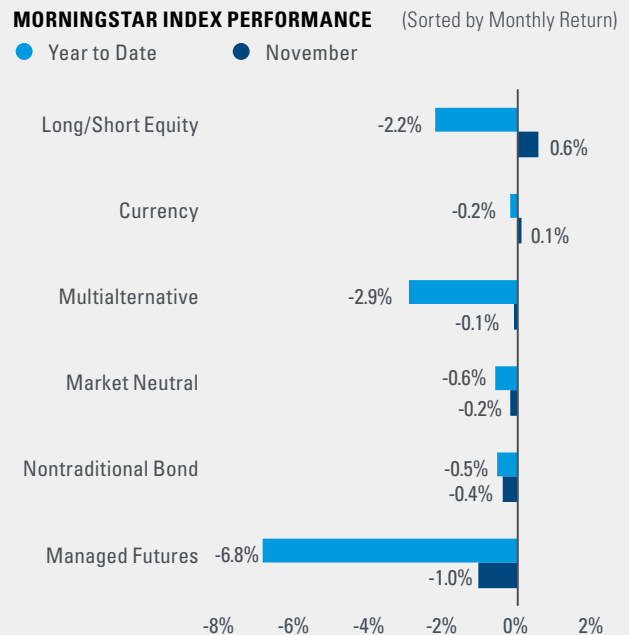
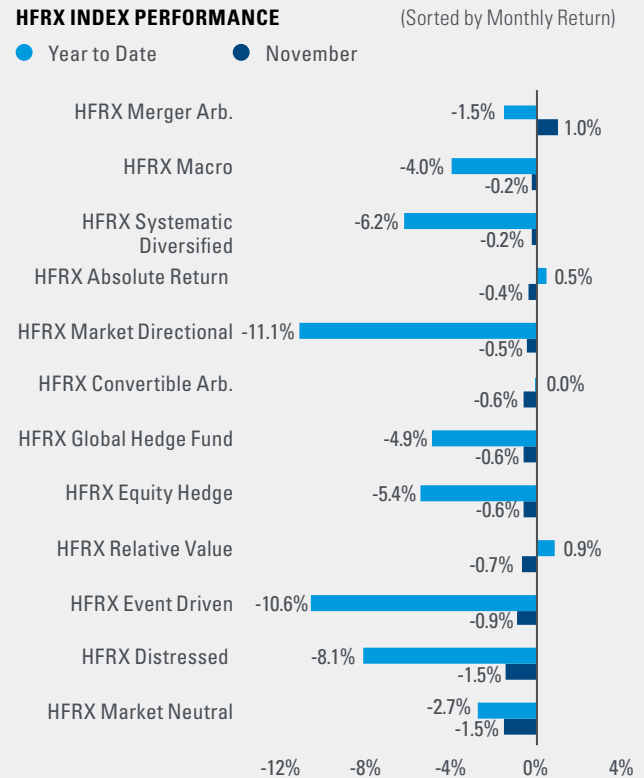
## ALTERNATIVES: MERGER ARBITRAGE STRENGTH CONTINUES

A 4.9% rally in the last week of the month propelled the S&P 500 Index to a gain of 2% in November, as markets initially had a positive reaction to trade negotiations between the United States and China following the G-20 summit.

The HFRX Merger Arbitrage Index led alternative investment gains with a return of 1%, as these strategies benefited from the broader market rally and spread tightening in several high-profile deals. Specifically, Chinese regulators approved a common industry position in a U.S. manufacturing merger and another within the media and entertainment space. China's approval represented the last major regulatory approval required and led to strong price appreciation in the firms being acquired.

The HFRX Distressed Strategies Index (-1.5%) lagged all other strategies, as concerns about weak lending standards and excessive issuance in the bank loan market weighed on the industry. Additionally, positions within the energy sector underperformed due to oil's fall throughout the month. For the year, the index has now declined a disappointing 8.1%.

The managed futures industry also encountered a volatile month, as the HFRX Systematic Diversified CTA Index fell 0.2%. Commodity positions led gains as strategies benefited from the large move lower in oil prices and also from long natural gas exposure. Unfortunately, these profits were offset by short equity exposure in U.S. and Asian indexes. At the end of the month, trend followers predominantly remain short global equities, long the U.S. dollar against European and Asian currencies, and short U.S. Treasuries across all maturities. The index ended the month down 4.0% for 2018.



Source: LPL Research, FactSet 11/30/18

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Alternative strategies may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

## REAL ASSETS: U.S. REITS STOOD OUT

Liquid real assets performance was mostly positive in November, with U.S. and international real estate and global infrastructure posting positive total returns, while commodities and master limited partnerships (MLP) suffered modest losses and trailed global equities.

### Master Limited Partnerships

MLPs fell for the third straight month, losing 0.8% during November. The group was hurt by the sharp drop in oil prices, which overwhelmed any potential benefit from lower interest rates, surging natural gas prices, policy clarity following the midterm elections, and ongoing efforts by the industry to strengthen balance sheets and reduce reliance on external capital. Year to date, MLPs have lost 3.4%.

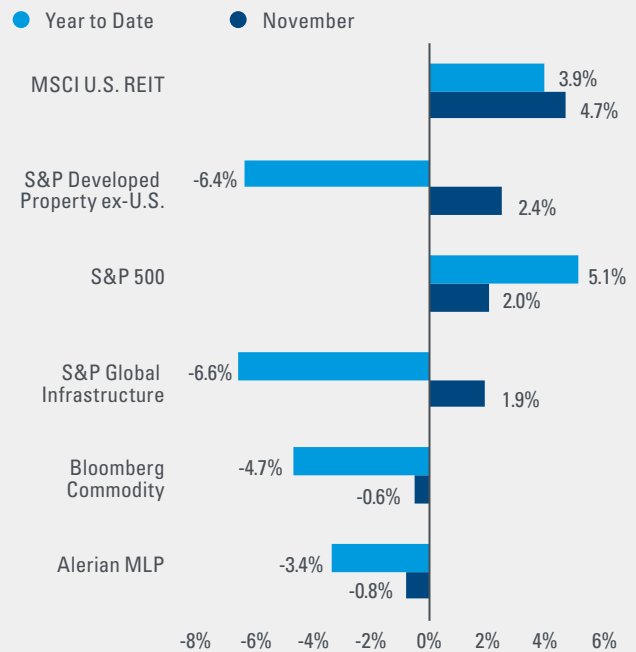
### REITs and Global Listed Infrastructure

Domestic real estate investment trusts (REITs) outperformed the broad U.S. equity markets in November for the second straight month as market interest rates fell and markets favored more defensive sectors. Healthcare REITs, the month's top performer, carried their strong year-to-date performance through the end of November. The lodging/resorts sector trailed the domestic real estate market by several percentage points, while the industrial REIT sector continued its strong performance, as e-commerce tailwinds continued to drive new construction and new investment into warehouses and distribution centers. As with broad equity markets, international real estate has lagged U.S. REITs for the month and year to date.

The S&P Global Infrastructure Index gained 1.9% during November, bringing its year-to-date decline to 6.6%, including dividends. Performance within the utilities and industrial sectors supported the index's performance, while energy-related names were the predominant laggards. Year to date, the S&P Global Infrastructure Index trails the MSCI ACWI Index, a global equity benchmark, by more than four percentage points.

### LIQUID REAL ASSET PERFORMANCE

(Sorted by Monthly Return)



Source: LPL Research, FactSet 11/30/18

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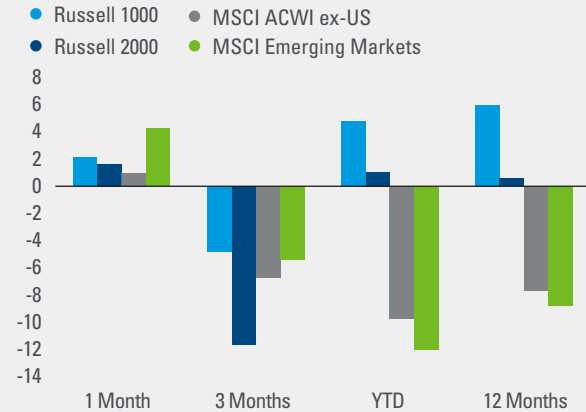
### Commodities

Commodities fell 0.6% in November, as measured by the Bloomberg Commodity Index. The rather muted index-level change belied its components' large price swings, particularly within energy, as natural gas prices surged while crude oil plummeted. Slowing global growth, strong supply, and unexpectedly lenient waivers granted by the United States to buyers of Iranian crude amid new sanctions all weighed on oil. China-sensitive copper rallied in support of industrial metals, while precious metals produced smaller gains. Soybeans traded higher amid trade-deal optimism ahead of the G-20 summit that started at the end of the month, while other major agriculture prices were little changed. The Bloomberg Commodity Index has lost 4.7% year to date.

Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.

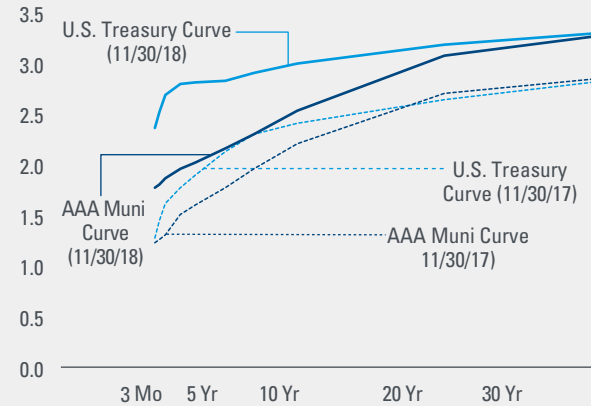
# MONTHLY PERFORMANCE REPORT

## EQUITY PERFORMANCE



Source: LPL Research, Bloomberg, FactSet 11/30/18

## DOMESTIC YIELD CURVE



Source: LPL Research, Bloomberg, FactSet 11/30/18

		1 Mo	3 Mos	YTD	12 Mos
Large Cap	S&P 500	2.04	-4.40	5.11	6.27
	DJIA	2.11	-1.07	5.59	7.62
	Russell 1000	2.04	-4.83	4.76	5.92
	Russell 1000 Value	2.99	-2.15	1.48	2.96
	Russell 1000 Growth	1.06	-7.46	7.75	8.59
Small/Mid Cap	Russell 2000	1.59	-11.62	0.98	0.57
	Russell 2000 Value	1.61	-9.78	-0.88	-1.83
	Russell 2000 Growth	1.56	-13.36	2.69	2.81
	Russell Microcap	-0.64	-14.36	-1.17	-1.64
	Russell Midcap	2.46	-6.66	0.95	1.89
	Russell Midcap Value	2.40	-5.73	-2.00	-0.79
All Cap	Russell Midcap Growth	2.54	-8.00	4.75	5.32
	Russell 3000	2.00	-5.35	4.48	5.53
	Russell 3000 Value	2.89	-2.73	1.33	2.62
International Markets	Russell 3000 Growth	1.10	-7.93	7.36	8.14
	MSCI EAFE	-0.11	-7.22	-8.96	-7.48
	MSCI ACWI ex US	0.96	-6.78	-9.72	-7.67
	MSCI Europe	-0.91	-8.12	-10.19	-8.82
	MSCI Japan	0.40	-5.18	-6.34	-5.67
International Markets	MSCI AC Asia Pacific ex Japan	4.46	-7.53	-11.25	-8.47
	MSCI EAFE SMID	-0.90	-10.64	-11.53	-9.41

		1 Mo	3 Mos	YTD	12 Mos
Int'l - Continued	MSCI ACWI ex US SMID	0.10	-10.11	-12.41	-9.76
	MSCI Emerging Mkts	4.13	-5.40	-11.96	-8.75
	MSCI EMEA	4.53	-0.70	-14.25	-8.24
	MSCI Latin America	-2.17	5.99	-5.53	-1.26
	MSCI Frontier Markets	2.18	-1.47	-13.68	-10.97
Sectors - S&P 500 GICS	Consumer Discretionary	2.81	-7.83	10.04	12.70
	Communication Services	-0.65	-2.37	-5.66	-0.21
	Consumer Staples	1.94	5.37	0.81	3.04
	Energy	-1.65	-10.47	-6.21	-1.63
	Financials	2.80	-4.24	-1.98	-0.06
	Healthcare	7.05	2.82	16.50	15.75
	Industrials	3.84	-5.36	-2.90	-1.06
	Information Technology	-1.88	-10.00	8.93	8.94
	Materials	4.05	-7.77	-8.38	-6.61
	Real Estate	5.57	1.38	5.71	5.17
Utilities	3.58	4.98	8.47	1.81	

Source: LPL Research, Bloomberg, FactSet 11/30/18

(Data continued on following page.)

All data represent total returns, where applicable. Information contained in this report is from sources deemed to be reliable. We cannot guarantee the accuracy or completeness of such information and we assume no liability for damages resulting from or arising out of the use of such information. Further, please note that past performance is not indicative of future results.



	1 Mo	3 Mos	YTD	12 Mos
BI BarCap US Agg	0.60	-0.84	-1.79	-1.34
BI BarCap Muni Inter-Short (1-10Y)	0.80	0.13	0.75	1.29
BI BarCap HY Muni	0.70	-0.95	3.86	5.21
BI BarCap Inv. Grade Credit	-0.17	-1.98	-3.92	-3.04
BI BarCap Muni Long Bond -22+	1.26	-0.79	-1.02	0.51
BI BarCap US Agg Securitized MBS	0.90	-0.35	-0.81	-0.49
BI BarCap US TIPS	0.48	-2.01	-1.80	-0.90
BI BarCap US Treasury Interm	0.69	0.21	-0.09	-0.06
BI BarCap US Treasury	0.89	-0.53	-1.27	-0.96
S&P/LSTA US Leveraged Loan	-1.10	-0.61	2.62	2.95
ML Preferred Stock Hybrid	-2.68	-5.90	-5.21	-4.81
BarCap Credit-Corporate-High Yield	-0.86	-1.90	0.06	0.36
ML US Convert ex Mandatory	1.11	-5.29	5.31	5.32
JPM GBI Global ex US Hedged	0.58	0.72	2.07	2.00
JPM GBI Global ex US Unhedged	0.17	-2.23	-4.20	-4.19
JPM GBI-EM Global Div	2.81	3.41	-7.42	-5.55
JPM ELMI+	1.68	1.61	-3.98	-3.11
JPM EMBI+ Composite	-0.14	0.49	-6.83	-6.25

Fixed Income

	1 Mo	3 Mos	YTD	12 Mos
HFRX Absolute Return	-0.41	-0.87	0.48	0.76
HFRX Market Directional	-0.48	-6.62	-11.12	-9.94
HFRX Convertible Arb.	-0.58	-0.97	-0.03	0.66
HFRX Distressed	-1.47	-2.51	-8.13	-7.29
HFRX Equity Hedge	-0.63	-6.10	-5.41	-4.43
HFRX Market Neutral	-1.54	-3.06	-2.74	-3.44
HFRX Event Driven	-0.88	-5.88	-10.62	-10.27
HFRX Merger Arb.	0.98	-0.92	-1.53	-1.14
HFRX Relative Value Arb.	-0.66	-1.56	0.87	1.54
HFRX Global Hedge Fund	-0.62	-4.37	-4.89	-4.19
HFRX Macro Index	-0.19	-3.44	-3.98	-3.19
HFRX Systematic Diversified	-0.24	-4.42	-6.21	-4.35
Bloomberg Commodity	-0.56	-0.84	-4.68	-1.83
DJ Select US REIT	4.85	-0.61	4.79	4.82
Alerian MLP	-0.83	-10.19	-3.38	1.21

Alternatives

	Latest Mo End (11/30/18)	3 Mos Ago (08/31/18)	Latest Yr End (12/31/17)	12 Mos Ago (11/30/17)
U.S. Dollar Index Value	97.27	95.14	92.12	93.05
USD vs. Yen	113.51	111.07	112.71	112.55
Euro vs. USD	1.13	1.16	1.20	1.19
Gold (\$ per Troy Ounce)	1222.10	1200.80	1302.50	1274.60
Crude Oil (\$ per Barrel)	50.93	69.80	60.42	57.40

Currency

Cmdtys

Source: LPL Research, Bloomberg, FactSet 11/30/18

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