18 AM US Passive Ethical Equity Highlights

The 18 AM US Passive Ethical Equity Portfolio provides clients the S&P 500 return +/- the return of stocks prohibited by the client's Investment Policy Statement. The portfolio is customized, using a separate account, to each client's specific ethical prohibitions. This report highlights the portfolio's representative account, which prohibits exposure to Alcohol and Tobacco stocks.

For Q4, in $US, the 18 AM Portfolio's return was -13.51% versus -13.52% for the benchmark. For 2018, the portfolio returned -4.16% versus -4.38% for the S&P 500. In Q4, the Canadian dollar slid 5.4%, from $0.77 to $0.73 $US. In Canadian dollars, the portfolio's Q4 return was -8.61% versus -8.62% for the S&P 500. The portfolio's zero exposure to Alcohol and Tobacco stocks had a slight positive effect on the return. During Q4, Alcohol and Tobacco company returns ranged from -5.5% (Brown-Forman) to -25.1% (Constellation Brands).

Market Overview

The S&P 500's Q4 total return was -13.52%. At its lowest, on Christmas Eve, the S&P 500 was down almost 19% for the quarter before a small holiday rally. Several factors contributed to the US market decline: escalating trade tensions between the US and China, the threat and then actual occurrence of government shutdown over the border wall dispute and a sharp drop in oil prices after the murder of a Saudi-American journalist. As to stocks, 85% of stocks in the index had Q4 losses. Only 15% had positive returns. In Q4, winning stocks were led by Red Hat (computer software), which was up 28.9%. SCANA Corp (Natural gas public utility) enjoyed a 23.2% Q4 gain. Newmont Mining Corp (Gold producer) was up 15.2% for the quarter. Notable losers were led by NVIDIA Corp (computer chips), Newfield Exploration (oil exploration) and PG&E Corp (Natural gas public utility) which were down 52.4%, 49.2% and 48.4%, respectively.

As to industry sectors, 10 of the 11 industry sectors in the S&P 500 experienced declines in Q4. The Energy sector was hit the hardest (down 23.8%), followed by Industrials (down 17.4%) and Information Technology (down 17.3%). Only one sector had a positive return, Utilities, which managed a 1.4% gain for Q4.

Despite the market turmoil, underlying fundamentals such as Earnings growth remain strong in the US. Q3 operating earnings (reported in October and November) for the S&P 500 of $41.38 were the highest quarterly earnings level ever recorded. This was the sixth record-setting quarter in a row. These quarterly earnings represent a 32% increase versus levels achieved in Q3 2017. Earnings in the last four reported quarters are up over 27% versus the earnings of the preceding four quarters. S&P 500 earnings for Q4 2018 (to be reported in January and February) are forecast to be $40.39, a retreat from record-setting levels, however, still the second-highest quarterly earnings ever recorded. Wall Street analysts are expecting a 9% increase in earnings for fiscal 2019 over 2018.

There are oft cited concerns about the market's valuation levels. However, the S&P 500 is trading at a price to earnings ("PE") multiple of 15.6 times using 2018 expected earnings and 14.3 times using 2019 expected earnings. These valuation levels compare favourably to the 25-year average PE for the S&P 500 of 16.1 times, suggesting that the market is not critically overvalued at present levels.

Performance is shown gross of all fees. Performance data is historical and not indicative of future performance. Returns are annualized for periods greater than 1 year. The benchmark for the fund is the S&P 500 Total Return Index. This document is for information purposes only. Data sources: Thomson Reuters, Standard and Poors and 18 AM.