

# INVESTMENT REPORT



**LYNCH FINANCIAL GROUP LLC**  
— Retirement Wealth Management —

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[www.LynchFinancialGroup.com](http://www.LynchFinancialGroup.com)

## Investment Review and Outlook

### Benchmark and Mutual Fund Performance

**In 2018 there were negative returns across almost every major asset class.**

**U.S. stocks were down 4.5% in 2018.**

**Developed international markets and emerging markets both down over 14% year to date.**

**A strong rally in Treasury bonds in December helped the core bond index avoid a negative return for the year; it ended flat.**

*We welcome questions or comments regarding this newsletter at [jlynch@lynchfinancialgroup.com](mailto:jlynch@lynchfinancialgroup.com). Lynch Financial Group provides Retirement Wealth Management Services to individuals within 15 years of retirement, retirees, and surviving spouses. We also provide specialized assistance to professionals, fiduciaries and heirs in wealth transfer situations.*

The box below contains benchmark (capital market and investment style) performance results. The performance results of our recommended mutual funds and their benchmarks are shown on page 4. Equity markets suffered sharp declines during the quarter while high quality bonds performed well. Most client portfolios (except the lowest risk) outperformed their benchmarks during the quarter.

### Fourth Quarter 2018 Key Takeaways

From a return perspective, 2018 could largely be considered the year that wasn't. Despite a few half-hearted rallies leading into the closing day, global financial markets ended December with the worst annual returns since the great financial crisis.

Larger-cap U.S. stocks dropped 9% in December and fell 13.6% for the quarter (its worst quarter in seven years). For the year, U.S. stocks were down a more modest 4.5%. The negative year broke the S&P 500's remarkable nine-year run of positive returns. Smaller-cap U.S. stocks fell more sharply, losing 20% in the fourth quarter and 11% for the year (iShares Russell 2000 ETF). Foreign stocks struggled as well, with developed international markets and emerging markets both down 14% (Vanguard FTSE Developed Markets ETF and Vanguard FTSE Emerging Markets ETF). However, their underperformance versus U.S. stocks came earlier in the year. In the fourth quarter, emerging-market (EM) stocks beat U.S. stocks by seven percentage points, while developed international stocks matched the U.S. market's return.

In addition to the equity market declines, what stands out about 2018 is the breadth of negative returns across almost every type of asset class and financial market, whether bonds, equities, or commodities. (And don't forget cryptocurrencies: Bitcoin plunged 72% for the year.) A study done by Deutsche Bank in mid-November noted that 90% of the 70 different asset classes

#### Benchmark Returns (Periods Ended 12/31/19)

	Quarter	12 Months
<b>Large-Cap Benchmarks</b>		
Vanguard 500 Index	-13.6%	-4.5%
Russell 1000 Growth iShares	-15.9%	-1.7%
Russell 1000 Value iShares	-11.7%	-8.4%
<b>Mid-Cap Benchmarks</b>		
Russell Midcap iShares	-15.3%	-9.1%
Russell Midcap Growth iShares	-16.0%	-5.0%
Russell Midcap Value iShares	-14.9%	-12.4%
<b>Small-Cap Benchmarks</b>		
Russell 2000 iShares	-20.2%	-11.0%
Russell 2000 Growth iShares	-21.7%	-9.3%
Russell 2000 Value iShares	-18.7%	-12.9%
<b>Other Benchmarks</b>		
Vanguard Developed Mkts Idx	-13.1%	-14.6%
Vanguard Emerging Markets	-6.3%	-14.7%
Vanguard REIT Index	-6.5%	-6.1%
Vanguard Total Bond Mkt Index	1.6%	-0.1%
Credit Suisse High Yield Index	-2.0%	0.2%

## Investment Review and Outlook (Cont.)

they track were posting negative returns for the year. This was the highest percentage of losers in the study's 100-year history. Our chart below shows the year's performance of sixteen different asset classes.

Core bonds, which typically perform well when stocks do poorly, had losses through November (Vanguard Total Bond Market Index). But a strong rally in Treasury bonds in December resulted in a flat return for the year. Only the U.S. dollar index and U.S. Treasury Bills (T-Bills) had a return above 1%. And after adjusting for inflation, T-Bills' real return was negative as well.

Simply put, it was extremely difficult to make money in the financial markets last year.

### A Consistent Focus

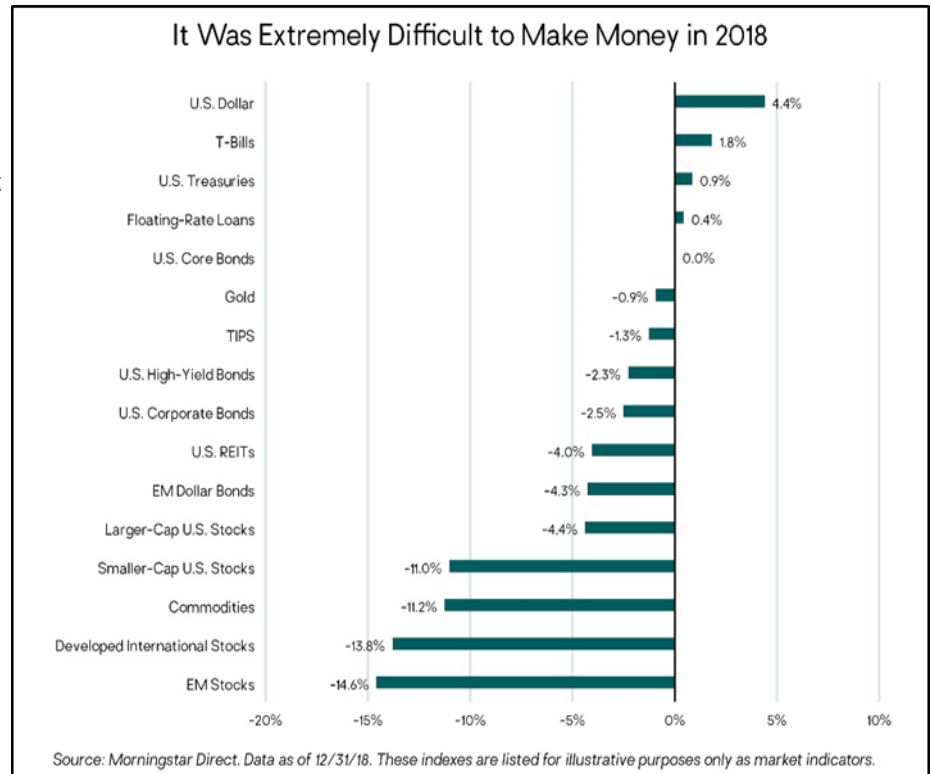
Throughout the history of our firm, we've succeeded on behalf of our clients by emphasizing the importance of having a long-term perspective. With a long-term perspective comes the necessity of discipline and patience in sticking to your investment process and executing it consistently over time rather than being subject to swings in investor sentiment and market consensus, which more often than not detracts from returns versus enhancing them.

While today's headlines may be filled with distress signals and warnings of market weakness, it's worth remembering that just one year ago those headlines boasted 20%-plus global equity gains and historically low market volatility. In fact, most investment strategists expected 2018 would bring a continuation of the synchronized global economic recovery. The sharp market pullbacks witnessed this past year only reinforce our view that no one can consistently predict short-term market moves.

Over the next year, the range of potential equity market outcomes is just as wide as it was going into the 2018. Our approach and preparation remain the same. We construct and manage portfolios to meet our clients' longer-term return goals, which means successfully investing through multiple market cycles, not just the next 12 months. Given our current investments, we are confident our portfolios are positioned to perform well over the medium to long term and to be resilient across a range of potential shorter-term scenarios.

If the current recession fears are overdone, we expect to generate strong overall returns with outperformance from our foreign equity positions, active managers, and flexible bond funds. On the other hand, if U.S. stocks slide into a full-fledged bear market, our portfolios have "dry powder" in the form of lower-risk fixed-income and alternative strategies that should hold up much better than stocks. We'd then expect to put this capital to work more aggressively; for example, by increasing our exposure to U.S. stocks at lower prices and valuations implying much higher expected returns over our medium-term horizon.

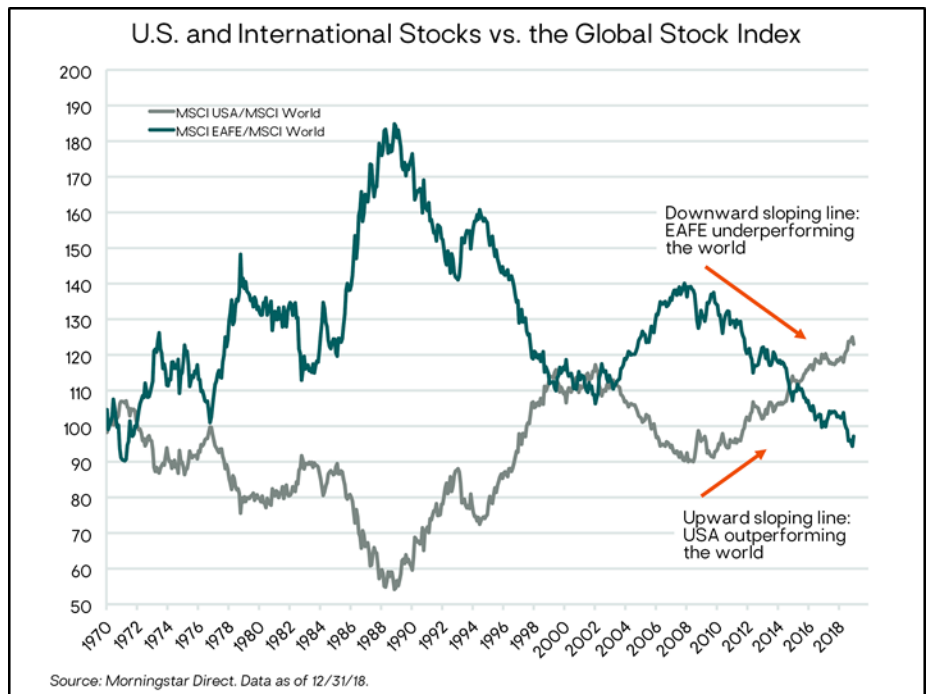
Speaking of U.S. stocks, in the period since the financial crisis, there has seemingly been little need to own anything other than U.S. stocks. But it should be particularly clear after this year (and this past quarter) that



## Investment Review and Outlook (Cont.)

isn't a sound long-term approach. The multiyear period of U.S. stock market outperformance versus the rest of world is reaching an extreme relative to history. The results of the past 10 years are not sustainable, and they won't be repeated over the next 10 or 20 years.

Even after their fourth quarter declines, U.S. stocks are still expensive. However, many markets elsewhere are oversold, strengthening their appeal for long-term, value-seeking investors like ourselves. Europe is historically cheap, with a lot of the worries (e.g., Brexit, Italy's political and debt concerns) likely already priced in. And the selloff in Asia has been particularly severe. Here again the market seems to be overreacting to potential risks (e.g., a slowdown in China) rather than reflecting the true value of emerging markets—a vast investment opportunity set that continues to expand at a faster rate compared to developed markets. Despite the risks we see over the short term, we have high conviction that our investments in European and emerging-market stocks will earn significantly higher returns than U.S. stocks over the next five to 10 years.



Our allocations to foreign stocks also provide our portfolios with diversification away from the U.S. dollar. After the dollar's strong performance the past several years, a U.S. budget deficit not seen outside of recessions or war, and the overvaluation we see in U.S. stocks, we believe the U.S. dollar is a risk factor that investors would be prudent to diversify away from.

### In Closing

Successful investing is a process of consistently making sound, well-reasoned decisions over time, and across market and economic cycles. Our goal is never to track or beat a particular benchmark from one year to the next, but rather to provide our clients with the optimal return for the environment we're given and the risk profile of their particular strategy. Given this approach, it is normal, not unusual, for us to go through periods where we will look out of sorts with the broader market. As we continue to execute our approach with discipline and patience during the inevitable periods when it is out of favor, we will continue to achieve successful and rewarding long-term results for our clients, as we have over the life of our firm.

As always, we appreciate your trust in us and welcome questions.

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## LFG Recommended Mutual Funds

### Performance Results for Funds and Benchmarks

Fund Name <sup>1</sup>	Benchmark (BM) <sup>2</sup>	% Returns For The Periods Ended December 31, 2018							
		3 Months		12 Months		3 Yrs Annlzd		5 Yrs Annlzd	
		Fund	BM	Fund	BM	Fund	BM	Fund	BM
Baron Emerging Markets <sup>3</sup>	Vanguard Emerging Markets Index	-6.2	-6.3	-18.5	-14.7	+6.1	+7.6	+2.0	+1.2
Parametric Emerging Markets <sup>3</sup>	Vanguard Emerging Markets Index	-5.9	-6.3	-13.8	-14.7	+7.2	+7.6	-0.2	+1.2
Schwab Fundamental Emerg Mkts <sup>3</sup>	Vanguard Emerging Markets Index	-7.7	-6.3	-10.0	-14.7	+14.5	+7.6	+1.6	+1.2
Tweedy Browne Global Value	Vanguard Developed Markets Index	-8.8	-13.1	-6.7	-14.6	+4.4	+3.4	+2.6	+0.7
Artisan International	Vanguard Developed Markets Index	-11.3	-13.1	-10.9	-14.6	+1.8	+3.4	+0.1	+0.7
Litman Gregory Masters Select International	Vanguard Developed Markets Index	-16.5	-13.1	-20.2	-14.6	-2.0	+3.4	-2.9	+0.7
Harbor Capital Appreciation	Russell 1000 Growth iShares	-16.4	-15.9	-1.0	-1.7	+10.2	+11.0	+10.3	+10.2
Jensen	Russell 1000 Growth iShares	-10.0	-15.9	+2.4	-1.7	+12.4	+11.0	+10.1	+10.2
BBH Core Select	Vanguard 500 Index	-10.4	-13.6	-7.4	-4.5	+6.3	+9.1	+4.8	+8.3
Schwab Fundamental US Large Co <sup>3</sup>	Vanguard 500 Index	-13.9	-13.6	-7.3	-4.5	+8.1	+9.1	+6.6	+8.3
Dodge & Cox Stock	Russell 1000 Value iShares	-13.6	-11.7	-7.1	-8.4	+10.1	+6.8	+7.1	+5.8
Vanguard Windsor II	Russell 1000 Value iShares	-13.9	-11.7	-8.6	-8.4	+6.6	+6.8	+5.4	+5.8
FPA Crescent	60% Russell 2500 Index; 40% Vang Tot Bd	-10.5	-10.5	-7.4	-6.1	+4.1	+5.2	+3.3	+4.0
PIMCO All Asset	Barclays TIPS Bond iShares	-3.3	-0.5	-5.0	-1.4	+7.1	+2.0	+2.5	+1.6
PIMCO All Asset All Authority	50% S&P 500/50% Barclays TIPS Bond iShares	-1.9	-7.0	-6.1	-3.0	+6.2	+5.5	+0.6	+5.0
Westwood Income Opportunity <sup>3</sup>	25% S&P 500, 25% NAREIT All Equity, 25% Citigroup Treasury Bill 3 mo., 25% Citigroup Treasury 10 Yr	-6.3	-3.8	-4.9	-1.3	+4.0	+4.0	+3.7	+5.2
Osterweis Strategic Income	Vanguard Total Bond Index	-3.2	+1.6	-0.7	-0.1	+5.3	+1.9	+3.2	+2.4
Doubleline Total Return	Vanguard Total Bond Index	+1.8	+1.6	+1.8	-0.1	+2.6	+1.9	+3.3	+2.4
PIMCO Total Return	Vanguard Total Bond Index	+1.4	+1.6	-0.3	-0.1	+2.5	+1.9	+2.6	+2.4
Vanguard Intermed Tax-Exempt	Vanguard Total Bond Index	+1.7	+1.6	+1.3	-0.1	+1.9	+1.9	+3.2	+2.4
Loomis Sayles Bond	1/3 CSFB HY, 2/3 Vang Tot Bond	-3.7	+0.4	-2.9	-0.0	+4.3	+3.6	+2.0	+3.0

<sup>1</sup>Funds were selected using the LFG Proprietary Mutual Fund Rating System<sup>SM</sup>. This system is based on extensive research using both quantitative and qualitative factors. The system seeks to identify top funds in each asset class and investment style. LFG typically combines 8 to 10 funds in client investment portfolios.

<sup>2</sup>iShares exchange traded funds were used where available and respective Russell indices were used for the other periods.

<sup>3</sup>Funds which were not recommended for entire 5 year period.

The above table reflects past performance and should not be considered indicative of future results. The results contained in this schedule were obtained from sources we believe to be reliable. We cannot, however, guarantee the accuracy of this information.