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MARKET REVIEW
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RCB BANK Trust

HISTORICAL PERSPECTIVES FOR MID-TERMS AND MARKETS

During the months of September and October, some news media covering the financial markets attempted to explain stock market performance by asserting prices were reflecting a "typical election pattern." Though the exact phrasing may differ, one often cited explanation for near-term equity volatility by the media was that daily moves in stocks could be attributed to hope or anxiety over the results of the forthcoming election, especially if a presidential tweet recently occurred.

This Market Brief reviews stock market activity for the 17 mid-term election years since 1950 to see if just such an effect exists. Our analysis only focuses on this period to avoid any lingering impact from either World War II or the Great Depression that could overshadow these earlier years.

Truman was elected president in 1948, and his mid-term election occurred in 1950. Every four years after 1950 are mid-term election years. The presidents during those mid-term years are: Eisenhower (1954, 1958), Kennedy (1962), Johnson (1966), Nixon (1970, 1974), Carter (1978), Reagan (1982, 1986), Bush (1990), Clinton (1994, 1998), Bush (2002, 2006), Obama (2010, 2014) and Trump (2018). Our analysis begins by observing the path of stock prices for each of the 68 calendar years since 1950 and compares them to the 17 mid-term years to see if they are similar. Shorter time periods are also similarly analyzed.

Using charts to depict the pattern of stock prices over a year can provide high level observations. For consistency and comparability, each year is scaled to 100. We show the maximum, minimum and average to illustrate the range of performance outcomes.

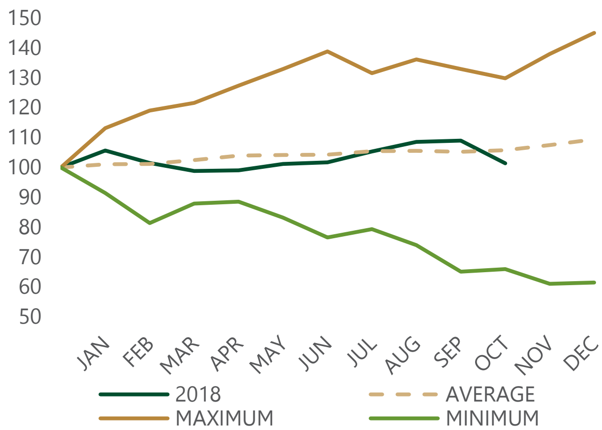
MID-TERMS VERSUS ALL OTHER YEARS

In the chart labeled "S&P 500 Annual Growth of $100," note the wide dispersion of calendar year stock returns. A conclusion that can be drawn is that there is a wide range of outcomes over the last 68 years. Let's add a little math and statistics for further understanding. The average annual price change is 9.1%, with a standard deviation of 16.4%. Excluding dividends, 95% of the time the annual stock performance has been between approximately 41.8% and -23.6%.

The 2018 time period stands out as one of those rare years that stocks are little changed through October. Only seven of the 68 full calendar years since 1950 have experienced stocks changing between -2.5% and +2.5%, indicating that roughly one out of every ten years is flat.

S&P 500 ANNUAL GROWTH OF $100

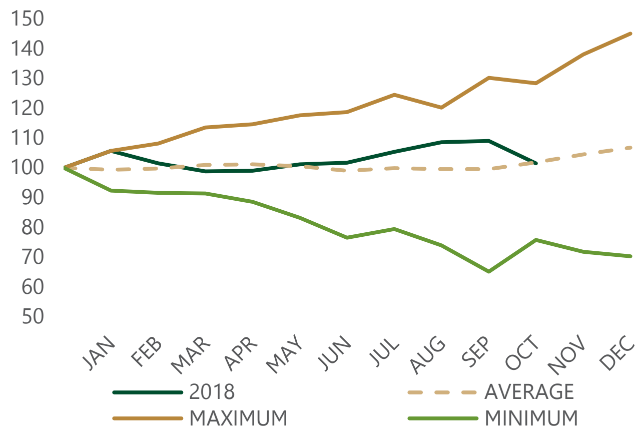
1950 THROUGH OCTOBER 2018



Source: St. Louis Federal Reserve Bank, FRED Database

S&P 500 ANNUAL GROWTH OF $100 IN MID-TERMS

1950 THROUGH OCTOBER 2018



Source: St. Louis Federal Reserve Bank, FRED Database

In the chart labeled "S&P 500 Annual Growth of $100 in Mid-Term Years," a similar level of variation in stock prices is evident. Using a little statistics again, mid-term years are about 18.3% more volatile than the entire set of calendar years from 1950 to 2017. On average, mid-term years rise by 6.7%, with a standard deviation of 19.7%, implying a range of returns between 46.1% and -32.7%, 95% of the time (compared to 41.8% and -23.6% for all years). Based on this observation, it appears mid-term years are moderately more volatile. In three of the 17 mid-term years, markets have moved between -2.5% and +2.5%.

ELECTION ANTICIPATION

Perhaps the election effect has a stronger impact over a shorter period of time. For all years, the price return of stocks through the end of October is 5.5% compared to 1.8% for mid-term years. This observation demonstrates the muted performance of mid-term years, but the variation of market returns through October in mid-terms is greater than other years, with a 15.9% annualized standard deviation versus 13.6% for all years between 1950 and 2017. Considering mid-term years have lower average returns with greater return variation argues against the characterization that in mid-term years the markets twiddle their thumbs until after the election.

Curiously, during the month of October, mid-term years have better results with similar risk. During mid-term Octobers, stocks appreciated on average 2.7%, which is more than three times as much as the 0.8% for all years. The standard deviation of these monthly returns is 5.9% and 5.5%, respectively, indicating similar risk.

However, fourth quarter results are quite compelling. Historically, the fourth quarter has been the strongest performer for stocks, with an average price return of 4.1% and a standard deviation of 7.3%. Mid-term fourth quarters are even more rewarding, up 7.8% on average, and less volatile, with a standard deviation of 6.0%. Perhaps there is some truth to a "sigh of relief rally" after the election.

CONCLUSIONS AND INVESTMENT IMPLICATIONS

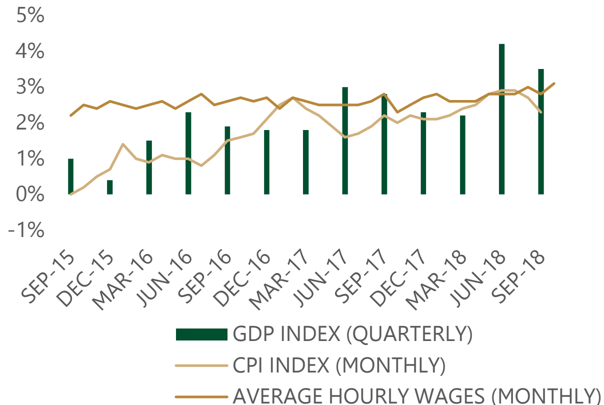
What to make of all these numbers? Stocks do indeed "move sideways" in the months leading up to an election, but in a significantly more volatile manner. It is worth noting that like this year's October return, a loss of 6.94%, only one other large negative October has occurred: the 9.16% loss during President Carter's mid-term election year of 1978.

Investors hoping to time the markets based on a mid-term presidential year cycle are cautioned. The temptation certainly exists, but the historical experience of the last 68 years shows that the ups and downs during mid-term years are more inconsistent than commonly perceived. Instead, investors should broadly diversify and adhere to the targets and ranges for a variety of asset classes that best suit their overall goals. Conversations with your trusted financial advisor can help establish these parameters.

ECONOMY

GDP, CONSUMER PRICES AND WAGE INFLATION

SEPTEMBER 2015 THROUGH OCTOBER 2018

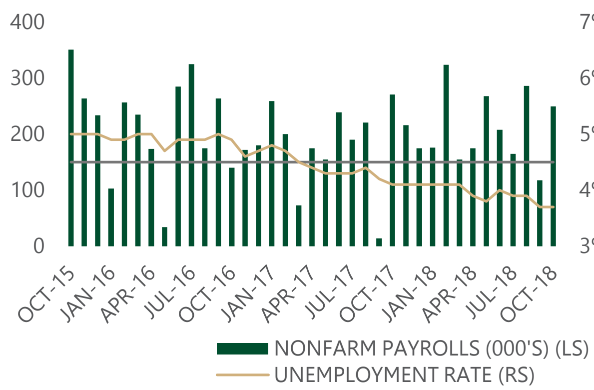


Source: Bloomberg

- Third quarter U.S. GDP grew at a 3.5% seasonally adjusted annualized rate. This was stronger than economists' consensus forecasts for 3.3% growth. Strong consumer and government spending propelled GDP higher.
- The Core Personal Consumption Expenditure (PCE) price index, the Fed's preferred inflation measure, increased 0.2% in September. The year-over-year reading for Core PCE remained at 2.0% for a fifth consecutive month. Core PCE appears to have stalled at the Fed's 2.0% target after accelerating earlier in the year.
- The Core Consumer Price Index (CPI), which excludes volatile food and energy costs, increased 0.1% in September. The year-over-year reading for Core CPI fell to 2.2%, marking the second consecutive month of deceleration.

LABOR MARKET

OCTOBER 2015 THROUGH OCTOBER 2018

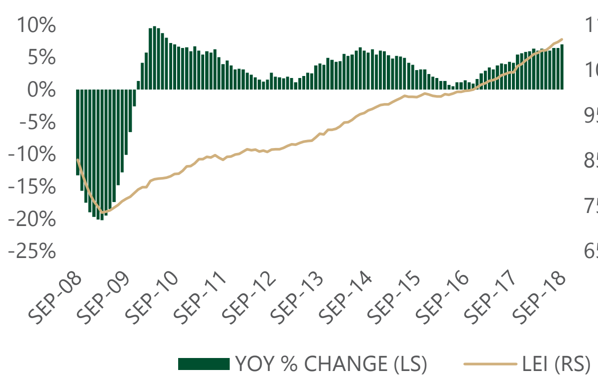


Source: Bloomberg

- U.S. nonfarm payroll employment increased by 250,000 for October. Payroll growth was significantly stronger than economists' consensus estimate of 190,000. September payrolls were downwardly revised by 16,000 to 118,000.
- The unemployment rate remained at 3.7%, the lowest level since December 1969. The Labor Department indicated 198,000 Americans did not work in October due to weather-related reasons, including the effects of Hurricane Michael on Florida.
- Average hourly earnings increased 3.1% on a year-over-year basis. This was the first time wage growth exceeded 3.0% since 2009. The strength of the job market should provide the Federal Reserve with support to continue along their steady path of quarter-point interest rate hikes.

LEADING ECONOMIC INDICATORS

SEPTEMBER 2008 THROUGH SEPTEMBER 2018



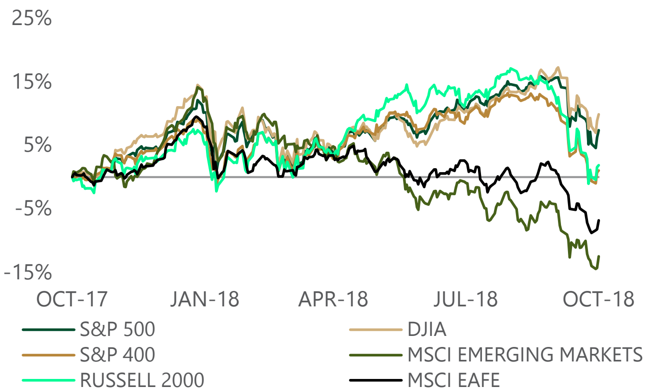
Source: Bloomberg

- The LEI Index increased 0.5% in September to 111.8, following a 0.4% increase in August. The Conference Board LEI Index is comprised of ten economic components, and is considered a helpful gauge for estimating economic activity for the subsequent three to six months.
- Eight of the index's ten indicators were positive in September. Some of the largest contributors were average consumer expectations for business conditions, ISM New Orders Index, and the interest rate spread.
- Optimism for the U.S. business cycle remains strong as the index's year-over-year growth accelerated to 7.0%, the highest rate since 2010. The upward trend suggests economic activity will likely continue to expand at a steady pace in the near term.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, OCTOBER 2017 THROUGH OCTOBER 2018

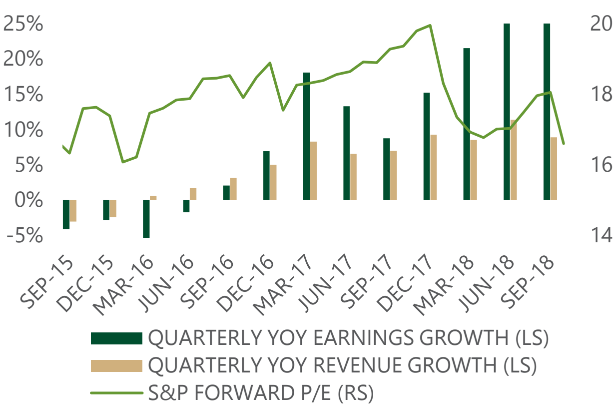


Source: Bloomberg

- A sharp increase in U.S. Treasury bond yields, the impact of tariffs, and concerns about weaker corporate earnings in 2019 contributed to steep declines in global stocks in October.
- Most major stock indexes fell into correction territory and domestic stock indexes experienced their worst monthly decline since September 2011. The S&P 500, S&P 400, and Russell 2000 fell 6.8%, 9.6%, and 10.5%, respectively.
- Strong third quarter earnings and President Trump's comments about reaching a trade deal with China provided support for stocks late in the month. The S&P 500 rebounded 2.7% in the last two trading days of October, raising the index out of correction territory and back to a positive return for the year.

S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, SEPTEMBER 2015 THROUGH OCTOBER 2018

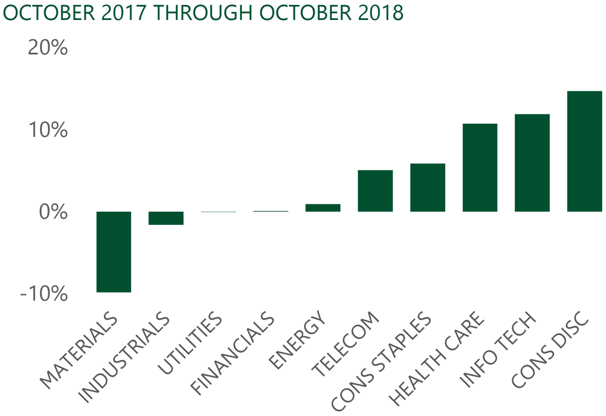


Source: Bloomberg

- Third quarter earnings reporting season passed the halfway mark with results reported from over 300 S&P 500 companies. Earnings growth is on track for a slight deceleration to 22.8% on a year-over-year basis.
- Earnings are on track for logging the third consecutive quarter of growth above 20% for the S&P 500, which is the first time since 2011 the index generated such a streak.
- Lower taxes are not the only factor contributing to strong earnings growth as sales growth is on pace for 8.1%. If sales growth remains above 8.0%, it will be the first time since before the financial crisis that the S&P 500 experienced four consecutive quarters of sales growth above 8.0%.

S&P 500 SECTORS 12-MONTH RETURNS (PRICE)

OCTOBER 2017 THROUGH OCTOBER 2018



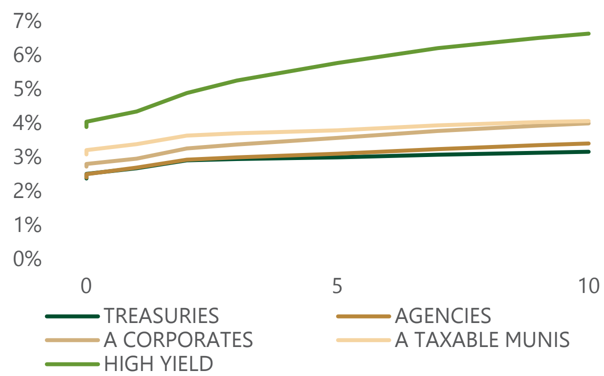
Source: Bloomberg

- Risk off sentiment last month resulted in a rotation out of momentum stocks and into defensive sectors including consumer staples and utilities. Some of this year's best performing stocks before the selloff, including Nvidia, Netflix, and Amazon, declined around 20% or more in the month. Consumer staples and utilities were the only sectors with a positive monthly return.
- The energy sector tied with the consumer discretionary sector for the worst monthly return of -11.3%. The price of crude oil declined 10.8% in October, its worst month since 2016. Concerns about oil market oversupply were exacerbated by another increase in U.S. oil inventory and reduced oil demand forecasts from the International Energy Agency and OPEC.

FIXED INCOME

CURRENT YIELD CURVES

YIELD CURVES AS OF OCTOBER 2018

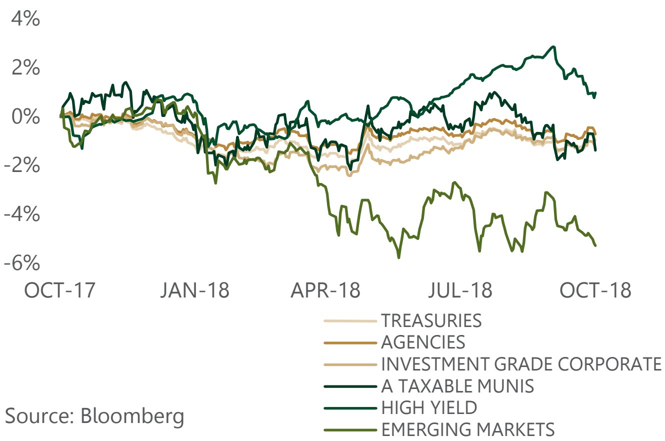


Source: Bloomberg

- The U.S. Treasury yield curve saw a parallel shift higher in October, beginning the month with a 2-Year / 10-Year yield differential of 0.26% and ended the month almost unchanged at 0.27%.
- The U.S. Treasury yield curve steepened to a monthly high of 0.35% in the first week of October before flattening to close the month at 0.27%. The flattening curve was likely signaling the market appears to view current Fed policy as close to, if not, neutral.
- The Fed may become slightly more dovish in 2019 as James Bullard, president of the Federal Reserve Bank of St. Louis, will become a voting member; Bullard is considered to be very dovish on monetary policy.

12-MONTH RETURNS, TAXABLE BOND SEGMENTS

OCTOBER 2017 THROUGH OCTOBER 2018

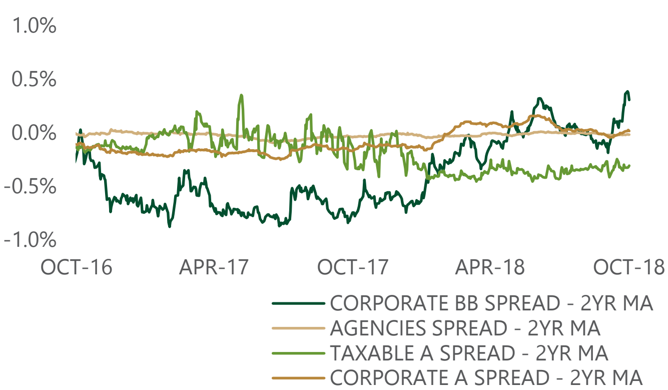


Source: Bloomberg

- Despite a challenging October, high yield bonds continue to lead the pack in taxable fixed income.
- After emerging market bonds recovered somewhat during September, they tumbled again in October as the trade-weighted U.S. dollar climbed higher.
- Intermediate-term investment grade corporate bonds lost 1.27% over the last 12 months and declined 0.45% in the month of October alone.

SPREAD VS. TREASURY LESS 2-YR MOVING AVG

OCTOBER 2015 THROUGH OCTOBER 2018



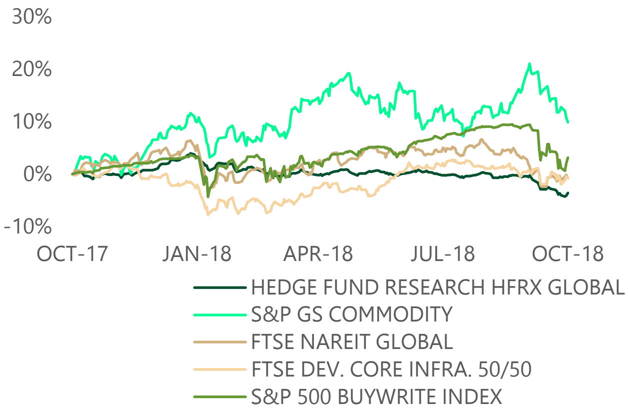
Source: Bloomberg

- As mentioned above, high yield bonds experienced some pain last month. The chart to the left shows a significant spike in high yield spreads relative to their recent trading range, as reduced risk sentiment led market participants to seek safer securities.
- While investment grade corporates suffered losses last month, there was only a modest widening in their spreads, as much of their price movement was driven by the grind higher in rates.

ALTERNATIVES

ALTERNATIVES, 12-MONTH RETURNS

OCTOBER 2017 THROUGH OCTOBER 2018

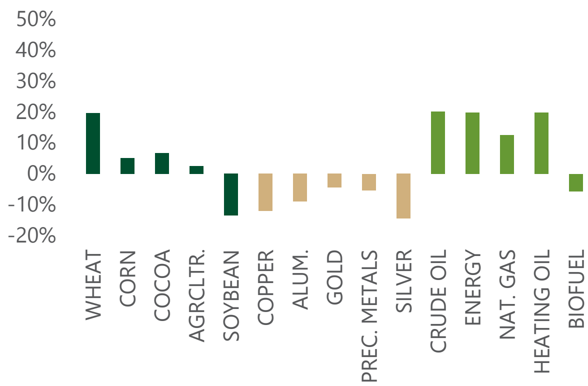


Source: Bloomberg

- All five alternative asset classes tracked in the chart at left provided varying levels of downside protection relative to global equities during a challenging October. The alternatives group was led by the FTSE Developed Core Infrastructure Index's -2.1% monthly decline, which was just 28% of the MSCI ACWI Index's 7.6% drop in October.
- The CBOE S&P 500 BuyWrite (BXM) Index enhanced its core equity holdings with income generated by writing call options on those holdings over the twelve-month period ending October 31. The BXM Index's 3.2% total return over this period outpaced the MSCI ACWI Index and Bloomberg Barclays U.S. Aggregate Bond Index's respective returns of 0.0% and -2.1%.

COMMODITIES, 12-MONTH SPOT RETURNS

OCTOBER 2017 THROUGH OCTOBER 2018



Source: Bloomberg

- Natural gas prices rose nearly 14% over the seven-week period from September 14 to October 31 ahead of the winter heating season. Analysts are expecting a colder-than-average November in the eastern and central regions of the U.S.
- Natural gas inventory drawdowns related to colder temperatures earlier than expected could pressure supply levels, which are at their lowest since 2005.
- U.S. economic sanctions on Iran will take effect November 5, potentially further curtailing Iranian crude oil exports from the current level of about 1.5 million barrels per day. In the final days of October, U.S. WTI was flirting with dipping below $65 per barrel, its lowest level since June.

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