

Atherean

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Dear Atherean Wealth Management client:

Enclosed is your portfolio summary report for the quarter ending December 31, 2018, as well as an investment advisory fee statement for the first quarter of 2019. The portfolio summary report shows the holdings in your accounts as well as an overview of the portfolio asset allocation as of the close of the fourth quarter of 2018. It also provides a summary of your investment objectives, time horizon, and risk tolerance as per our records.

Quarter and year in review: Equity Market Performance

The fourth quarter of 2018 was one of their worst performing quarters for U.S. equity markets since the 2008 financial crisis. The S&P 500 index was down 14.3%, the Russell 2000 small cap index was down 19.5%, and the MSCI EAFE (Europe, Asia and Far East) index was down 13.6%. For the 2018 calendar year, the S&P 500 index was down 6.35%, the Russell 2000 index was down 12.2%, and the MSCI EAFE index was down 16.4%.

As we have been stating in our recent quarterly updates, the focal points of U.S. equity markets over the past few quarters have been interest rates, trade, and corporate earnings. Interest rates in particular have been of major concern as growth stocks drove much of the market rally throughout 2017 and early 2018 (see our Q3 and Q4 2018 letters for further discussion). The fear of rising interest rates continued to create market turmoil in the fourth quarter. This fear peaked at the December 19 Fed meeting, when Fed chairman Powell made hawkish comments, exacerbating the December market slide. The downward trend in U.S. equity markets continued through Christmas Eve, the day after Treasury Secretary Mnuchin held calls with the CEOs of the six major U.S. money center banks to discuss their liquidity. Markets had flashbacks of the 2008 financial crisis and the S&P 500 sold off by another 2.6%. These fears did not materialize, however, and on the following trading day (December 26), as the Chicago Board Options Exchange Volatility Index ("VIX") peaked, U.S. equity markets bottomed. The S&P 500 has, as of the close of trading on January 30, recovered most of its December losses. As of the date of this letter, the S&P 500 index is up 7.1%, the Russell 2000 index is up 10.4%, and the MSCI EAFE index is up 6.6% since the beginning of 2019. The Fed Chairman has since struck a more dovish tone and has even walked back some of his previous hawkish comments. The curvature of the U.S. treasury spot rate curve suggests that the market could be pricing in the possibility of decreases in the federal funds rate over the next few quarters.

Equity Market Valuation

As market volatility, fear and uncertainty drove equity markets in the last quarter, we want to provide a discussion of current U.S. equity market valuations within their historical context so that we can gain some rational perspective. For this purpose, we will turn to a equity valuation tool known as the Cyclically Adjusted Price to Earnings Ratio, or "CAPE" ratio. We first began discussing the Shiller CAPE ratio in our second quarter of 2017 letter. The CAPE ratio indicator, developed by Nobel Prize winning economist Robert Shiller, is an equity valuation metric which has equity market prices in its numerator and the 10 year average of trailing S&P 500 earnings in its denominator. Unlike the

traditional trailing twelve month P/E ratio which is so often discussed in the financial press, the CAPE ratio is less susceptible to earnings noise and the effects of short term earnings manipulation by corporate managers. The CAPE ratio has a very strong track record in predicting stock market peaks over the last 130 years.

We are very encouraged by what is beginning to look like a trend in the pull back of the Cyclically Adjusted Price to Earnings ratio from its high in January of 2018. As that time, the CAPE ratio was the highest it had been since the peak of the internet stock bubble and the peak of the 1920's stock market bubble. Since January of 2018, corporate earnings have continued to grow, GDP growth has remained solid, the economy has continued to operate at full employment, and factor productivity has improved. All the while the CAPE ratio has declined steadily. We believe that these factors make a strong case for current equity valuations being more in line with market prices than they were a year ago.

We will continue, as always, to take a long-term view and focus on maximizing the risk-adjusted return of your portfolio with respect to your time horizon, risk tolerance and liquidity needs. Let us know if there are any changes to your financial profile or investment objectives. If you would like to review your portfolio and/or financial plan in greater detail or have any other questions or concerns, feel free to contact me.

Sincerely,



Atherean Wealth Management, LLC