BOK FINANCIAL

ECONOMIC & MARKET REVIEW

Fourth Quarter 2018

The U.S. equity market had one of its worst fourth quarters ever as the S&P 500 posted a -13.5% return, with small cap stocks down 20.2%. International equities fared little better with the international developed market down 12.5% and emerging markets falling by 7.4%. Bonds did better with the U.S. Bloomberg Barclays index up 1.6%.

Q4 and Calendar Year Investment Performance

	Fourth Quarter	Year to Date
S&P 500	-13.52%	-4.38%
Russell 2000	-20.20%	-11.01%
Barclays Agg.	+1.64%	+0.01%
MSCI EAFE	-12.50%	-13.36%
MSCI EM	-7.40%	-14.25%

Source: Factset Research. As of 12/31/2018

Fears fueled a selloff

Fear gripped the markets in the fourth quarter as a cocktail of worries blended to produce a significant drop in markets around the world. What went into the mix? First, there was Fed Chairman Powell's ham-handed news conference explaining monetary policy in 2019. Add in trade related issues with China plus the increasing likelihood that the Brexit discussion becomes even more convoluted (if that's even possible), and finally, the olive in the martini glass of worries – President Trump's propensity to tweet about *everything*. I list those in the order of impact – at least in my opinion.

Some good news despite the downturn

The market slide aside, let's consider the good news. Consumer confidence, while off its recent highs, remains good. If this correction is to remain just that – a correction and not a bear market foretelling a recession – the U.S. consumer must remain confident as more than two thirds of GDP is driven by consumer spending. One benefit of lower oil prices to consumers is the significant drop in retail gasoline prices, down 22% since October.

Business confidence will be a critical measure in the first quarter

Business confidence also needs to remain solid, as it leads to capital expenditures, new markets, new and expanded factories and additional jobs. A lack of confidence leads to less risk taking and a more timid attitude from business owners. Much of the capital expenditures in the last couple of years have been related to oil and gas exploration and production. I would expect to see a drop in cap ex related to energy as a reaction to the decline in oil prices. This could put a lid on overall capital spending growth in 2019. A lack of confidence is clearly evident from investors. Across the board selling has resulted in sectors that are usually safe havens being hit hard.

At this point, markets are pricing equities as though a recession is happening now. However, at this point, I don't see data that supports that conclusion. There is some thought that algorithmic trading (now 70% of the U.S. volume) is somewhat responsible for market volatility. Algorithmic trading can impact the speed and momentum the markets move but not the direction. As close as I can get to a recession warning light is at what point does the drop in the equity market become a selffulfilling prophecy? While the economic conditions are OK now, the lack of confidence could seep into business and consumer behavior.

What's up with the Fed?

The Federal Reserve raised rates again in December, the ninth rate hike in this cycle dating back to December 2015. Four of those hikes occurred in 2018. On Oct. 3, Fed Chairman Powell said the Fed was "a long way from neutral." The clear implication was that he thought the Fed needed to keep raising rates and would continue this aggressive stance. That was near the peak in the equity market. Then in his press conference following the December rate hike, he said the runoff of securities from the balance sheet would be on "automatic pilot." The rout got worse.

The intent of the Fed-engineered quantitative easing program was to lower interest rates and add additional liquidity to the U.S. economy. You don't need a PhD in economics to understand that reversing that program is tightening liquidity conditions. The Fed made a mistake – especially by implying they didn't care about the impact of their tightening policy on the economy.

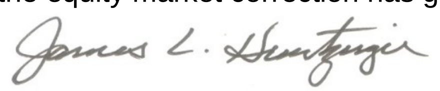
"I'm sorry for the way things are in China…"

The line from the John Denver song has a nugget of truth, as the trade war with China is clearly affecting our economy as well as theirs (China more than the U.S.), but both are feeling the pain. The U.S. and Chinese governments need to announce an agreement on the tariff issues. The Chinese have indicated a willingness to relent on at least some of the forced intellectual property transfers. We'll see. The Chinese recognize the negative impact on their economy from the trade war, and as a result have been easing monetary policy for well over a year. If a deal can be struck, there is hope that their easier policy will begin to positively impact the Chinese economy. If China falls into a recession, the U.S. and the rest of the world will unavoidably follow. Chinese economic growth is still much stronger than the rest of the world. Through September, Chinese GDP was 6.5%, which is down from 6.9% in the summer of 2017. So assuming a trade deal, their economy should stabilize at a lower growth rate and allow stimulus to aid growth.

While weaknesses persist, we're not necessarily in for a recession.

These are the reasons for market and economic weakness. Some self-inflicted (i.e., Fed policy and tone deaf observations from the Fed Chair) and others intentional but necessary (trying to negotiate a fairer trade deal).

Finally, I do not think we are headed for a recession. The unemployment rate remains below 4%, wages are rising, and interest rates are low. The Federal Reserve will stop the rate hike cycle, at least for now, and the U.S. and China will find enough common ground to strike a trade deal. To contemplate otherwise is mutual destruction, which is not in the best interest of any of the parties involved. These assumptions lead me to believe the equity market correction has gone too far.



Jim Huntzinger
Chief Investment Officer
BOK Financial Corporation
January 1, 2019

Disclosures

The information provided in this was prepared by Jim Huntzinger, Chief Investment Officer of BOK Financial Corporation. The information provided herein is intended to be informative and not intended to be advice relative to any investment or portfolio offered through BOK Financial Corporation (NASDAQ:BOKF). The views expressed in this commentary reflect the opinion of the author based on data available as of the date this report was written and is subject to change without notice. This commentary is not a complete analysis of any sector, industry or security. Individual investors should consult with their financial advisor before implementing changes in their portfolio based on opinions expressed. The information provided in this commentary is not a solicitation for the investment management services of any BOKF subsidiary.

BOK Financial Corporation (BOKF) offers wealth management and trust services through various affiliate companies and non-bank subsidiaries including advisory services offered by BOKF, NA and its subsidiaries BOK Financial Asset Management, Inc. and Cavanal Hill Investment Management, Inc., each an SEC registered investment adviser. BOKF offers additional investment services and products through its subsidiary, BOK Financial Securities, a broker/dealer, member FINRA/SIPC, and an SEC registered investment adviser and The Milestone Group, also an SEC registered investment adviser.

Investments are not insured by the FDIC and are not guaranteed by BOKF, NA or any of its affiliates. Investments are subject to risks, including the possible loss of the principal amount invested.

All data presented is as of last quarter, unless otherwise noted.