Rick D. Moulton,
CFA, Portfolio Manager

What a difference a year can make! A sharp contrast is readily apparent when comparing 2018 to 2017. The hallmark of the 2017 markets was a goldilocks-like backdrop. Economic growth was strong, but not too strong. Inflation was present, but not at concerning levels. Investors also embraced record-setting low levels of volatility, with equity markets advancing in a neat, orderly fashion. The recently completed year of 2018 has shattered this placid mold. This past year forced investors to contend with renewed volatility spurred by increased inflationary pressures, a hawkish Federal Reserve, trade wars, and decelerating economic growth. Unlike 2017, when markets regularly established new highs, investors coped with markets that flirted with bear market territory. As we conclude the year, investors are left to ponder whether 2019 will be reminiscent of the idyllic market of 2017 or if they will be forced to relive the headaches of 2018.

The Federal Reserve has been one of two primary stock market maelstroms. Led by new Fed Chairman Jerome Powell, interest rates increased four times in 2018. Since December of 2015, the Fed has increased rates nine times as they attempt to normalize monetary policy from the emergency measures enacted following the 2008 financial crisis. With the robust general economic backdrop, the Fed opportunistically either raised rates or shrunk their balance sheet, which is another anti-growth action. Investors are increasingly concerned the Fed will overcorrect. Some are even concerned these actions may induce a recession.

Numerous trade skirmishes, both threatened and real, were the other market moving hallmark of 2018. During the first six months of the year, stocks adversely reacted to the prospects of tariffs and their potential impact on businesses. As we exit 2018, some companies are reporting the impact of these tariffs and continued uncertainty. The Chinese economy has struggled mightily in 2018, hurt by U.S. tariffs and other factors in that country. Due to their dependence on Chinese economic growth, European and emerging markets have suffered declines. Until the fourth quarter, the U.S. markets seemed somewhat impervious to these international concerns.

As we turn our attention to 2019, earnings will be monitored closely. Investors are expecting a deceleration in growth of earnings following the 20%-plus earnings growth driven by tax cuts. However, the magnitude of this deceleration will be telling. According to IBES data, earnings for the S&P 500 are expected to grow 8% in 2019. Should this figure prove optimistic, the markets will continue to feel pressure. In addition to earnings growth, inflationary pressures will be carefully monitored. With unemployment remaining at a 49-year low, conditions are ripe for wage driven inflation. Modest levels of wage-induced inflation are healthy. Too much of an increase, however, could spur the Fed to enact more interest rate hikes.

Overall, the year 2018 was a decent year for Riverbridge and our investors.

> All our portfolios relatively outperformed their respective benchmarks. Our portfolio companies are less impacted by rising interest rates and borrowing costs because of their ability to internally finance their growth. More importantly, our portfolio companies, in aggregate, had strong fundamental years.

Many strengthened their relative market position. They are also poised to have a strong 2019. Our portfolio companies tend to generate high levels of free cash flow, are not dependent upon borrowing to grow their business, and are generally less economically sensitive relative to the broader markets. This backdrop provides them a good chance to meet success against an uncertain macro backdrop.