Market Commentary

Portfolio Managers Commentary – Q1 2018

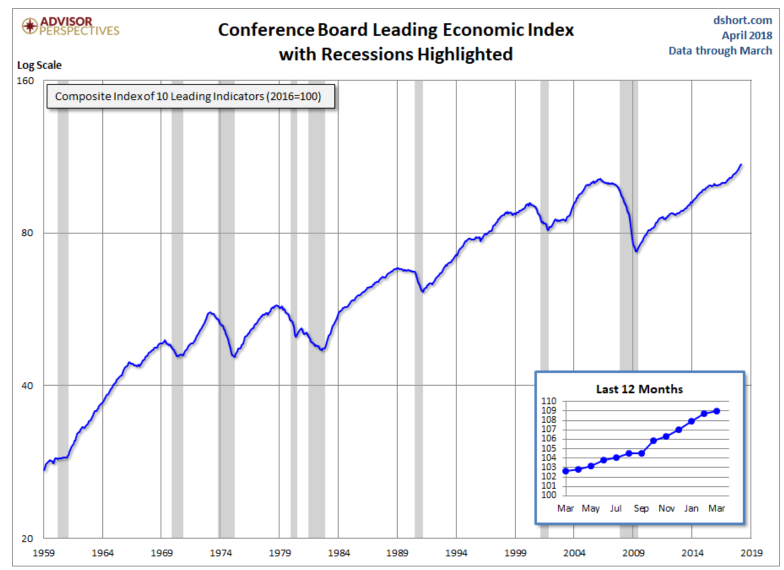
"A 10% decline in the market is fairly common—it happens about once a year. Investors who realize this are less likely to sell in a panic, and more likely to remain invested, benefitting from the wealth building power of stocks." – Christopher Davis

Volatility is back

Last year, stocks marched higher with only minor pullbacks. When the year ended, the largest peak to trough decline for the S&P 500 Index was just under 3%. It was a year that lacked turbulence and one that rewarded diversified investors.

Since the beginning of February, volatility has returned. It's a reminder that periods of relative tranquility don't last forever. In my opinion, it's something that the long-term investor should look past, though I recognize it can create uneasiness among some investors.

If we were facing serious economic problems, something that might be signaling a recession, it would be a cause for concern. Right now, I don't believe we are.



Let's review some key supporting factors for stocks.

Thanks in part to the U.S. tax cut, corporate profits are forecast to rise nearly 20% this year.

Weekly first-time claims for unemployment insurance recently touched a level not seen since the late 1960s. It's a concrete sign that companies don't want to lose employees. If business conditions were deteriorating, the opposite would be true.

The Conference Board's Leading Economic Index (designed to detect emerging trends in the economy), just hit a new high. I know we are facing some challenges (we always will), but the economic fundamentals are solid right now.

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Coupled with rates that remain at historically low levels, the fundamentals have cushioned the downside, in my view, and remain supportive of stock prices.

Shorter term, however, headline risk continues to whipsaw sentiment.

Causes of volatility

Two issues have surfaced that have stirred up volatility, in my view.

Last month President Trump announced he will impose steep tariffs on steel and aluminum imports, fueling concerns over protectionism and the potential impact on the economy. His apparent goal: Pry open foreign markets to U.S. exports.

Before I go on, let me say that it is not my role as your financial advisor to offer up opinions on political issues. However, it is incumbent upon me to analyze and share my thoughts on headlines that are influencing shares. It's not a political statement. It is a commentary on events viewed through the narrow prism of the market.

Investors viewed the corporate tax cut and the paring back of regulations favorably. Trade tensions, however, have created uncertainty.

Most economists support free trade. It's a net benefit to the U.S. and global economy. But "net benefit" means there are both winners and losers.

Losers–those whose jobs disappear amid a flood of cheaper imports. Winners–consumers who pay less for various goods, and those who work in export-oriented industries. In 2017, U.S. exports totaled $2.3 trillion. Yes, that's trillion with a "T."

Free trade versus fair trade–it's a highly debated topic.

U.S. manufacturers are consumers of steel and aluminum, including farm and construction equipment, aerospace, and pipelines and drilling equipment in the energy industry.

At the margin, it may modestly boost inflation and could force some U.S. manufacturers to put projects back on the shelf or move production offshore.

Additionally, U.S. tariffs may invite retaliation, pressuring exporters, jobs and profits in globally competitive sectors. It could also spark a tit-for-tat trade war that hurts everyone.

As the month came to a close, Trump announced he is set to raise tariffs on Chinese imports. In return, China announced new barriers to some U.S. goods, though the response was measured.

While the odds of a major trade war remain low, all this has injected uncertainty into market sentiment.

Meanwhile, troubles popping up in the tech sector have added to volatility. For example, Facebook is embroiled in a controversy over privacy and data sharing. More recently, Trump has set his sights on Amazon, expressing his displeasure in several tweets.

Yes, they are only two stocks, but both have performed admirably, leading the tech sector higher. And, they have a combined market capitalization of $1.1 trillion.

Perspective

I provided an explanation for the recent volatility because I believe one is in order, but let me caution you not to get lost in the weeds. Day traders care about minute-by-minute swings in stocks prices. Long-term investors sidestep such concerns.

So, let's step back and gather some perspective by reviewing the data.

According to LPL Research—

- The average intra-year pullback (peak to trough) for the S&P 500 Index since 1980 has been 13.7%.
- Half of all years had a correction of at least 10%.
- Thirteen of the 19 years that experienced an official correction (10% or more) finished higher on the year.

- The average total return for the S&P 500 during a year with a correction was 7.2%.

These bullet points are an evidenced-based way of saying turbulence surfaces from time to time. Patient investors who don't react emotionally have historically been rewarded.

I understand that some degree of risk is inevitable. But our recommendations are designed to minimize risk, and they are designed with your long-term goals in mind.

I hope you've found this review to be educational and of value. Once again, let me emphasize that it is my job to assist you! If you have any questions or would like to discuss any matters, please feel free to give me or any of my team members a call.

Thank you very much for the trust and confidence you've placed in my team and my firm.

Sincerely,

Brent Woyat, CIM, CMT
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