ECONOMIC & MARKET COMMENTARY

December 6, 2018

Recent Market Volatility

The market took another step down with the Dow suffering two (as of this writing) 3% losses on December 4th and December 6th. Due to the market closure in remembrance of George H.W. Bush on December 5th, the downdraft is occurring on consecutive trading days and fear gauges are spiking. The market action is explained by a focus on:

- US China trade relations
- Worries about US growth in 2019
- An inversion of the 2-year and 5-year segments yield curve

At the Wealth Momentum Forum in November, we stated that trade issues and continued Fed tightening had hurt the market in October, but these concerns could be alleviated if the Fed changed its rhetoric regarding rate raises in 2019 and the Trump administration struck a trade deal with China. The Fed did, in fact, soften its rhetoric and markets reacted positively to the news. Trade negotiations at the G20 meeting in Argentina were less conclusive and that news, coupled with the recent arrest of a Chinese Tech executive by Canada, heightened the fears of an all-out trade war between the US and China.

We viewed the October market as a "mid-cycle correction" rather than a secular turning point, marking the end of the bull market. At the time, technical indicators and sentiment signaled that the October correction may not be finished and, as a result, we expected more negative volatility in the short-run.

That is exactly what we are seeing this week. While there are some weak economic indicators, particularly internationally, the economic backdrop for the US is strong. We do not currently see signs that the US is headed into recession in 2019. We see US growth worries as overblown.

Keep in mind the following key points:

- While US earnings growth is slowing, the US has never had a recession with the high level of earnings growth that we currently enjoy.
- We came into 2018 calling for a "blocking and tackling" year for equities following a strong 2017 against the backdrop of a strong economy. We stand by that call.
- The positive effects of any further fiscal policy and/or ongoing regulatory relief will be a tailwind for markets and that impact is currently undervalued.
- European markets are under pressure from Brexit and Italian uncertainty.
- Emerging markets are suffering under the cloud of a prospective trade war. The trend could reverse quickly if progress is made on a trade deal and US dollar strength modifies.
- We do not believe that the technical inversion in the shorter maturity segment of the yield curve is the predictive inversion of the yield curve that we have be watching for as a recession signal. The 2/10 curve has flattened substantially but is still normal.
- We still predict a +/- 3% GDP growth in the US for 2018 and look for a strong year in 2019.

As the Fed normalizes interest rates, expect more volatility in the capital markets. Higher volatility feels unsettling as the recent years of low volatility have made us forget that this kind of market action is far more normal than the lower volatility environment attributable to the extraordinary Fed policies post 2008.

The market dynamic is changing, and we are evaluating the data and ready to adjust our position if the facts change. We will communicate any changes in our outlook as quickly as possible. Please let us know if you have any further questions. Thank you for your continued support and have a pleasant holiday season.

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