November 15, 2018

What Happened in the Markets?

- US stocks rallied to snap a five day losing streak heading into Thursday. The S&P 500 gained 29 points, or 1.1%, to close at 2,730. The Dow Jones Industrial Average rose 200+ points and the NASDAQ Composite jumped 1.7%.
- Geopolitical developments were a primary focus during the trading session. US stocks seemed to inflect positively in the afternoon following headlines that US and China were redoubling efforts to reach some kind of trade deal by the G20 summit. Materials and Industrials sectors benefitted from the improved outlook for a trade truce between the world's two biggest economies. Tech also rebounded after falling more than any other sector during the previous five day sell-off, helped by solid earnings and outlook from a major hardware firm. Elsewhere, the pound plummeted against the dollar as Brexit negotiations sent the UK government into turmoil. The Italian budget standoff also continued to weigh on European markets, but neither issue appeared to move global markets in a major way.
- 8 of the 11 S&P sectors ended the day higher. Tech (+2.5%), Energy (+1.5%), and Financials (+1.4%) were the day's best performers. In contrast, Real Estate (-0.9%), Utilities (-0.8%), and Staples (-0.3%) underperformed as defensive areas lagged.
- Outside of US stocks, Treasuries firmed slightly along the curve and the 10 year yield settled near 3.11% as of the equity market close. Oil prices advanced for a second day, but are still down more than 20% since early October. The US dollar index increased slightly as the USD strengthened on balance against its peers. Gold also finished the day modestly higher.

Catalysts for Market Move

US stocks closed higher on Thursday to end a volatile session that saw the S&P 500 fluctuate between gains and losses throughout. The NASDAQ Composite advanced the most among the three major equity indices, rising 1.7%. The S&P 500 gained 1.1% and the Dow increased 0.8%. Eight of the 11 S&P sectors ended the day higher. Tech (+2.5%), Energy (+1.5%), and Financials (+1.4%) were the day's best performers. In contrast, Real Estate (-0.9%), Utilities (-0.8%), and Staples (-0.3%) underperformed. Cyclical stocks outperformed defensives by 1.8%, and growth outpaced value by a modest 0.3% as measured by the Russell 1000 indices.

The catalyst for Thursday's move arrived late in the session when news broke that the US may be considering pausing its implementation of further Chinese tariffs and delaying the planned increase of tariff rates from 10% to 25%. Commerce Secretary Ross and Trade Representative Lighthizer came out and denied the reports, but the rally endured. Before the trade headline came across the ticker, the market was swinging between shallow gains and losses as it grappled with further turmoil in the UK over Brexit. After the EU-supported agreement passed through Prime Minister Theresa May's cabinet, several ministers resigned and a leadership challenge began in Parliament. The tumult and uncertainty sent the pound down as much as 1.9% during the trading day. Despite the headline grabbing political developments out of Europe, US markets appeared to be mostly unfazed.

The day's rally helped push US stocks higher following a challenging October. The S&P 500 has rebounded 3.4% from its recent low on October 29, and is now 2.1% above where it started the year. Even though the market has climbed recently, the pickup in market volatility that began last month has not subsided. The S&P 500 has moved more than +/- 1% on 14 of the last 27 trading days. This follows a stretch of 70+ trading days without a single daily move of that magnitude. We believe volatility will likely remain elevated for the time being as concerns around peaking earnings growth, rising interest rates, Fed tightening, geopolitics, and trade disputes continue to weigh on markets.

The Global Investment Committee's Outlook

Following a strong 2017 characterized by robust global growth and supportive financial conditions, 2018 has presented a significantly more challenging investment environment. Financial conditions have tightened, some economic data have begun to roll over, and interest rates are on the rise. For equities, this has translated into a "rolling bear market," with different regions, sectors, and styles taking their turn at falling out of favor and succumbing to market corrections. US equities, particularly Technology and internet-related stocks, along with small-caps, appeared to be the last large swaths of the market that had yet to correct through the first three quarters of this year. The GIC believes this led to extreme crowding in some of these pockets of the market. The pullback seen in October targeted these prior "safe havens." The GIC reiterates the recommendation it has maintained since August that investors should look to fade strength in US equities, favoring value over growth stocks in the US, and international developed markets over US exposure. With US growth likely peaking and 10-year rates having moved higher alongside a flattening yield curve, the GIC maintains a preference for defensive/value-oriented sectors. In the defensives, the GIC favors Utilities, Staples and Telecom, and on the more cyclical side, the GIC also likes Energy. Within fixed income, the GIC recommends US-only positioning with no exposure to high yield. Additionally, the team suggests an allocation to TIPS as inflation expectations recover further with a stable/weaker dollar, fluctuating oil prices, and a tighter labor market.

Market data provided by Bloomberg.

Dow Jones Industrial Average (DJIA): A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.

NASDAQ Composite Index: A broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.

S&P 500 Index: The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks.

US Trade-Weighted Dollar Index: A weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that circulate widely outside the US.

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Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate. **Bonds rated below investment grade** may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio. **Treasury Inflation Protection Securities' (TIPS)** coupon payments and underlying principal are automatically increased to compensate for inflation by tracking the consumer price index (CPI). While the real rate of return is guaranteed, TIPS tend to offer a low return. Because the return of TIPS is linked to inflation, TIPS may significantly underperform versus conventional U.S. Treasuries in times of low inflation.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Investing in smaller companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity. **Stocks of medium-sized companies** entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more-established companies.

Value investing does not guarantee a profit or eliminate risk. Not all companies whose stocks are considered to be value stocks are able to turn their business around or successfully employ corrective strategies which would result in stock prices that do not rise as initially expected. **Growth investing** does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations.

Investing in commodities entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

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Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.
REITs investing risks are similar to those associated with direct investments in real estate: property value fluctuations, lack of liquidity, limited diversification and sensitivity to economic factors such as interest rate changes and market recessions.

Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies. **Technology stocks** may be especially volatile. **Asset allocation and diversification** do not assure a profit or protect against loss in declining financial markets.

The **indices** are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

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