

Market Outlook – April 2018

Deer in the Headlights as the Fog Gets Thicker

Many investors feel this way and are confused. We encourage clients to stay focused on a positive and steady direction.

Stock markets have behaved much differently in the last two months as compared to the previous year. Increased volatility, however, does not mean the end of the bull market but it is certainly becoming a more challenging environment. The U.S. economy shows few signs of slowing down but risks to growth are rising as trade issues emerge and the Federal Reserve continues its tightening campaign. The global wall of worry is building but positive corporate earnings news should continue to help markets climb that wall. Conversely, trade protectionism remains a significant threat to global growth and could negatively impact the markets.

With all the focus on tariffs, trade, and the FAANG stocks; lost among those headlines is perhaps a more important fundamental reversal in financial conditions. Tightening financial conditions alongside tighter monetary policy have been less-discussed reasons for heightened volatility and weakness in stocks this year, but they will remain an important fundamental backdrop for equities. One of the implications of tighter financial conditions is that investors generally become more discerning, which leads to more frequent sector rotations and lower sector correlations. We have preemptively positioned our clients well for sector rotation as diversification and staying on top of emerging trends is rapid and matters even more.

As has been our mantra for several quarters now, volatility is likely to remain high this year and investment discipline remains essential. Sticking with a long-term plan is typically harder to do when the market is not going straight up. Valuations were quite extended as we entered 2018 and have retreated somewhat – due to both the correction in prices but also strength in earnings. Corrections are always unnerving, especially because they tend to be processes over time as opposed to condensed moments in time. Traditional stock market fundamentals remain supportive of an ongoing bull market. The U.S. economy does not look to be near a recession, which has historically accompanied bear markets. The Index of Leading Economic Indicators rose again in March, continuing a robust uptrend.

The late cycle U.S. economy should have a tailwind that is just beginning due to the tax cuts that many Americans are now incorporating into their budgets. We can also put worries of another government shutdown to bed, as the new spending bill should add to near-term growth. Recall that government spending is one of the significant contributors to GDP growth. Throughout all these positives, however, we want to remind clients that:

- Increased government spending leads to increased government debt;
- This increases inflation and ever-increasing interest rates;
- Tax cuts are temporary and will have impact in 2018 but will likely fade down in 2019;
- We may enter a recession in 2019; and
- Global politics contribute greatly to the uncertainty that drives volatility.

So, what is our outlook?

We continue to find developed and emerging international markets more attractive than the U.S., currently. Dramatic volatility in the market is unnerving but is likely to continue for a while. We have become used to extremely low volatility over an unusually long period and we are paying for that comfort now. We continue to believe the economic and earnings environment should support a continuation of the bull market, albeit with more volatility, some elevated risks, and likely moderate returns going forward. We maintain absolutely committed to diversification within each client portfolio and ensuring that the risk profile of the portfolio fits the unique risk tolerance and time horizon of each of our clients.

Please do not hesitate to reach out to us with any questions or concerns about your portfolio or other financial matters. Like the volatile markets, we are experiencing very changeable weather in the north country of Vermont and New York....snow flurries one day and the tips of day lilies the next. We patiently await true spring!

Our very warm regards,

Priscilla and Joyce

Excerpts from Schwab Market Perspectives by Liz Ann Sonders, Jeffrey Kleintop, and Brad Sorensen. March 2018; April 2018. www.schwab.com