

2018 Capital Markets Review

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Market Madness

The economic backdrop over the first quarter of 2018 generated plenty of headlines as the U.S. stock market narrative abruptly changed. The optimistic market environment throughout 2017, which focused on improving global growth while dismissing anything negative, suddenly shifted in late January with the release of an elevated U.S. wage inflation estimate. As investors were digesting the unexpected inflation scare, growth optimism received a jolt of uncertainty later in the quarter with fears that new tariff announcements could escalate into a broader scale trade war with China. Rising

inflation concerns, combined with escalating trade tensions sent interest rates higher and stock markets lower. The first quarter of 2018 marked only the eighth quarter in the last thirty years both broad U.S. stock markets and broad U.S. bond markets failed to gain ground.

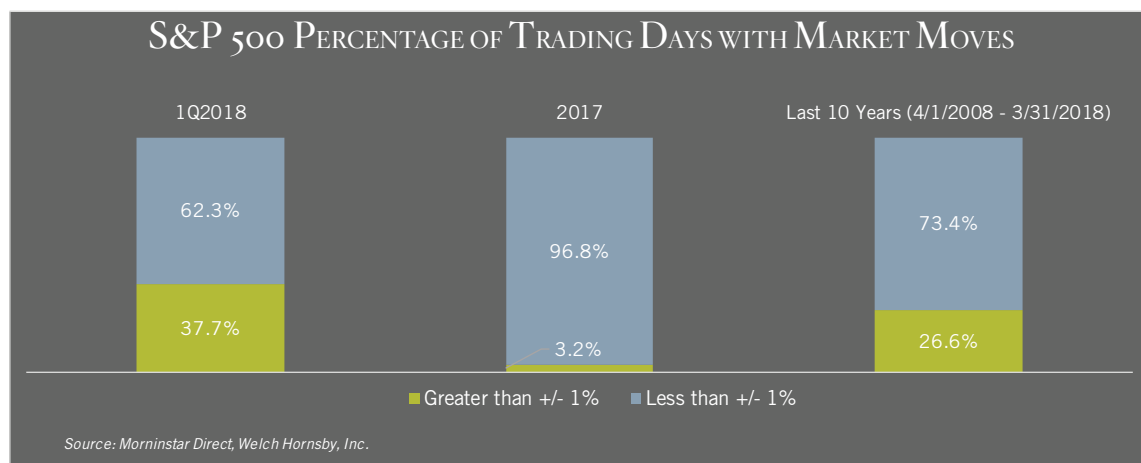
As market sentiment changed, volatility returned. In 2017, the S&P 500 posted daily moves in excess of 1% on only eight trading days (4 up days / 4 down days). During the first quarter of 2018, the S&P 500 eclipsed the 1% threshold twenty-three times (12 up days / 11 down days), or 37.7% of the trading days. While the spike in volatility felt

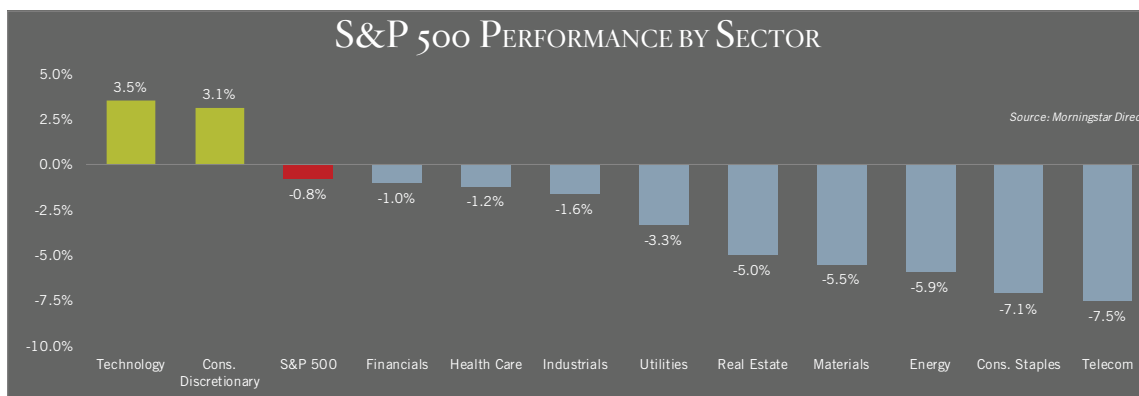
extreme, as the chart below reflects, 2017 was the exception while the start of 2018 is closer to the norm.

Despite the heightened anxiety related to market volatility, I believe a market breather was essential to stabilize the foundation under the current bull market. As we noted in the 4th quarter 2017 capital market review, the market's unrelenting momentum during 2017 felt a bit euphoric with markets potentially accelerating faster than economic fundamentals were improving. My hope is the current market breather, combined with continued improvement in corporate earnings, will improve equity valuation levels, creating a healthier investing environment to sustain the equity bull market. However, we caution this improving foundation may not be strong enough yet to fully survive an inflation surprise or economic growth headwind, two risks that cannot be ignored.

Equity Market Review

The U.S. stock market, as measured by the S&P 500, roared out of the gate; however, the tide turned swiftly in late January and the market's retreat was doubly fast. After peaking on January 29th, up over





7.5% for the year, the S&P 500 collapsed, falling in excess of 10% over the next nine trading days, pulling the year-to-date return down to negative territory. The broad market index bounced around over the second half of the quarter, finishing the period down 0.8% halting the S&P 500's positive winning streaks at fourteen consecutive months and nine consecutive quarters.

Reviewing sector results, the Technology sector, which accounts for nearly 25% of the S&P 500 Index, came under severe pressure in late March due to privacy-driven regulatory concerns. Despite the poor finish, the Technology sector was the top performer for the quarter, gaining 3.5%. The only other area that outperformed during the period was the Consumer Discretionary sector, climbing 3.1%. Amazon was the primary engine pulling the sector higher as the company advanced over 20% during the quarter and accounts for more than 15% of the sector.

These two outperforming sectors represent nearly 60% of the Russell Growth weighting, resulting in continued dominance by the growth style. For the quarter, Russell growth indices outpaced their value counterparts by over 400 basis points, bringing the cumulative 12-month outperformance to more than 13% across the capitalization spectrum.

Outside the U.S., developed markets followed a similar path as U.S. markets, ending the quarter down -1.4%, as measured by the MSCI EAFE Index. Across Europe, stock markets began the year trending higher, but concerns surrounding U.S. interest rates and uncertainty related to global trade weighed heavily on markets in late March. One of the hardest hit markets was the UK, which dropped 7.3% (MSCI United Kingdom Index) in local terms, but the stronger sterling offset approximately half of these losses for U.S. dollar-based investors. In Japan, strong corporate results were not enough to overcome political controversy surrounding Prime Minister Abe, uncertainty over potential disruptions in global trade and a strengthening yen, sending

equity markets lower. However, U.S. dollar investors benefitted from the stronger yen (weaker dollar), offsetting all of the market losses, resulting in a modest 1.0% increase by the MSCI Japan (\$) Index.

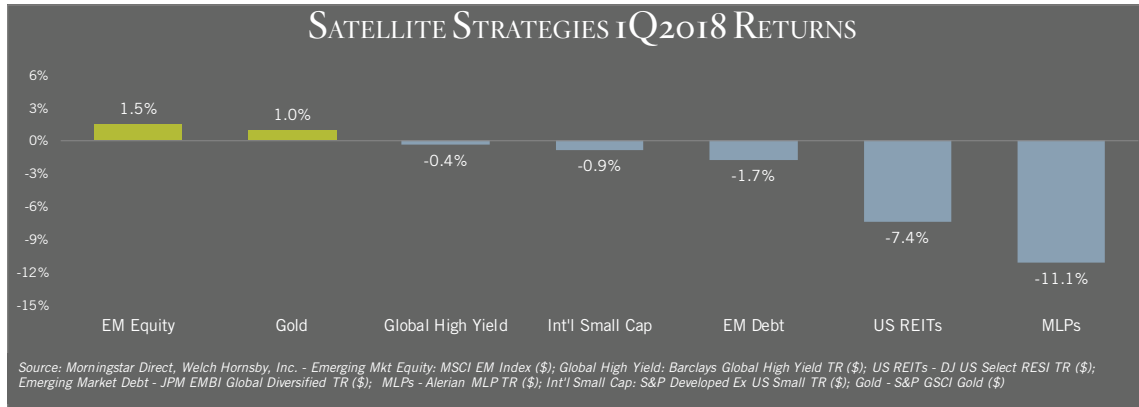
Fixed Income Review

The Fed, led by new Fed Chairman Jerome Powell, raised the Fed funds rate 0.25% at its March Federal Open Market Committee meeting. Additionally, the Fed appears to be increasingly confident that the U.S. economy can withstand higher interest rates, revising upward their guidance for additional rate hikes in 2018 and 2019. This

CAPITALIZATION AND STYLE PERFORMANCE

		1Q 2018	Last 12 Months	
		Value	Core	Growth
Large		-2.8%	-0.7%	1.4%
		7.0%	14.0%	21.3%
Mid		-2.5%	-0.5%	2.2%
		6.5%	12.2%	19.7%
Small		-2.6%	-0.1%	2.3%
		5.1%	11.8%	18.6%

Source: Morningstar Direct, Russell Indices



upward revision combined with the inflation scare in late January, sent yields higher and bond prices lower across the yield curve. The range of quarterly returns for longer duration Treasuries ranged from -0.2% for 2-Year Treasuries to -3.9% for 30-Year Treasuries. Reviewing corporate bonds, a general increase in risk aversion associated with elevated market volatility caused corporate bond spreads to widen, detracting from corporate bond results. In aggregate, the investment-grade taxable bond market, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, declined 1.5% during the first quarter. Outside of the taxable bond market, tax-exempt bonds were not immune from the challenging interest rate environment with the Bloomberg Barclays Municipal Bond Index falling 1.1% for the period.

Satellite Strategies

Finally, reviewing several satellite asset classes, the “head scratcher” award goes to Emerging Market equities. Emerging markets, which are most sensitive to global trade, ended the quarter up 1.5%. Not surprising, Gold was modestly positive as investor “fear” trended higher. On the opposite end of the spectrum, rising interest rates punished REITs and MLPs. Additionally, the Federal Energy Regulatory Commission’s (FERC) revision to disallow an income tax allowance in MLP pipeline rates created additional uncertainty and downside volatility for MLPs.



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