August 17, 2017

What Happened in the Markets?

- The S&P 500 fell 38 points, or 1.5% today, to close at 2430; The Nasdaq Composite fell 1.9% while the Dow Jones declined 1.2%.
- Increased uncertainty over Washington's ability to pass pro-growth policy and the tragic events in Barcelona likely contributed to the decline in US equities today. All 11 S&P 500 sectors finished the day in the red with Technology, Financials, and Industrials leading the market lower.
- Treasury yields fell around 5 basis points throughout the day with the 10-year Treasury falling from a high of 2.24% to 2.19%. Other safe-haven assets rallied slightly with gold up 0.4% and the yen appreciating by 0.6%.
- European stocks also ended the day lower with the Euro STOXX 50 falling 0.3% in USD terms.

Catalysts for Market Move

Today was the S&P 500's third 1% move in the past week as the market appeared to focus on the viability of President Trump's pro-growth policies and questioned his ability to work with Congress to pass legislation, including tax reform. Additionally, there was speculation that members of his cabinet may resign following the dissolution of both President Trump's Manufacturing Council and Strategy & Policy Forum yesterday. The tragic terror attack in Barcelona likely contributed to the selling pressure as well. There also could be some profit taking in certain sectors such as Technology where the S&P 500 tech sector reached a new all-time high yesterday.

As it relates to political concerns, uncertainty is likely to remain high around the policy debate, budget and debt ceiling in Congress, or any number of potential reforms markets are hoping for out of Washington. While we do not minimize the risks posed by politics, and acknowledge that these are serious issues that bear watching, ultimately, experience tells us that in the intermediate and long term, earnings and economics will have a greater impact on the direction of markets, and to that end the fundamental picture remains strong.

Given the extent of the market's recent run and the near record-low volatility experienced alongside the rally year to date, questions surrounding market complacency are not unfounded. However, in the view of our Global Investment Committee (GIC), the rally in stocks, and the low volatility experienced this year, is not in itself cause for concern given investor skepticism and positioning levels remain neutral and far from euphoric levels. Further, the strong market performance in the first half of 2017 has been a result of equally strong fundamentals; with second quarter earnings season now largely complete in the US, large-cap US companies are on track to post their fourth consecutive quarter of profit growth. To this end, in the first half of the year, S&P 500 companies have seen profits grow 12% versus the first six months of 2016, the strongest half for profits growth we have seen since 2011, which was very early in the post-crisis recovery.

The Global Investment Committee's Current Outlook

The GIC continues to recommend equities over fixed income given their constructive view on accelerating global economic and earnings growth, supportive financial conditions, the potential for global fiscal stimulus and cheap relative valuations. Within equities, the GIC prefers global stocks with allocations to the US, Japan, Europe, and Emerging Markets, which have all performed well so far this year on the strongest global earnings results and equity market breadth since 2Q 2009. Throw in the possibility for US corporate tax cuts and less regulation and this is likely to remain a very favorable cocktail for equities. The GIC advocates a barbell of positioning within equity portfolios—consider deep cyclical stocks, Financials and reasonably priced growth stocks. The GIC expects high valuation and ultra-defensive/low-volatility strategies to underperform as global growth and pro-cyclical company earnings surprise to the upside. For income, they favor dividend growth over dividend yield. Risks to the GIC's bullish outlook include: 1) The Fed is further along in its rate cycle than markets acknowledge; 2) Commercial real estate and auto financing problems create larger credit problems; 3) Oil prices roll over again and move toward $40; and 4) ECB decides to taper asset purchases sooner and/or more aggressively than expected causing global interest rate spike—Taper Tantrum II.

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.

Euro STOXX 50 Index: Provides a blue-chip representation of supersector leaders in the Eurozone.

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.

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International investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies.

Investing in foreign emerging markets entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks.

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.

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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Companies paying **dividends** can reduce or cut payouts at any time.

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.

Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies.

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

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