Market Update – Special Edition

April 3, 2018

This summary is provided by BMT Wealth Management.

Volatile Markets

Stocks closed out yesterday (Apr. 2), the first trading day of the new quarter, broadly lower, with the S&P 500 Index slumping by -2.23%. As bad as the final figures were, they reflect a meaningful recovery from mid-afternoon, when the Index was lower by just under -3.30%.

Looking at 2018 year-to-date returns, the S&P 500 is now lower by just under -3.0%, a loss that somehow feels much worse given the recent volatility.

In overseas trading last night, Japan's Nikkei Index was lower by a small -0.45%, and Hong Kong's Hang Seng Index rose +0.29%.

Headlines and Earnings Reports: Effects on the Markets

With first quarter earnings reporting season yet a couple of weeks away, the ***headlines dominating the news and influencing the markets now*** are tariffs, possible trade wars, and the specter of increased regulatory encumbrances on select mega-tech companies.

We reiterate the point made when the markets first exhibited volatility in late January/early February of this year: Periods of correction, on average, last four months and often longer.

Many mega-tech companies currently have very high and, in our opinion, unsustainable valuations. ***Our investment process is designed to reduce exposure to valuation risk, and we have been defensive in our approach in constructing client portfolios as it relates to the mega-tech stocks.***

Once quarterly reports are released, the narrative should shift to what management teams say about the underlying strength of corporate profits and, by definition, the U.S. economy. ***While downside volatility is always painful, we continue to believe that corporate profits and the U.S. economy are on sound footing.*** Consequently, our focus for client portfolios remains on consistently profitable companies with sound balance sheets and reasonable valuations.

In fixed income, U.S. Treasury yields trended lower across the curve yesterday as demand for safe-haven assets picked up, coinciding with the drop in the equity markets. The U.S. Treasury curve has resumed its flattening bias, with continued Federal Reserve tightening contributing to rising yields on the short end of the curve and longer maturity yields trending lower.

Given how low yields are across the yield curve and the current flatness between the five-year and 30-year part of the curve (40 basis points, or 0.40%), we believe it does not pay to take on duration risk for the additional pickup in yield.

We do not see a big downfall in the financial markets, but believe we have entered a period of volatility higher than the historically low levels of volatility we have witnessed in recent years.

Our proprietary checklist of recession indicators informs us that a recession does not appear imminent.

Block Out the Noise and Focus on Fundamentals

It is important during times of market distress to look beyond the noise and focus on the fundamentals. It is certainly possible that volatility may continue at elevated levels over the near term, depending on the external news flow. As always, we would urge caution in making long-term portfolio construction decisions based on short-term market issues. Market downturns often present longer-term investment opportunities.

The combination of diversified equity and bond portfolios and client-sensitive asset allocations provides defensive characteristics for our client portfolios.

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