Market Summary – November 26, 2018

For the week ending November 23

This summary is provided by BMT Wealth Management.

Equity Markets in Correction Mode

When equity markets reprice, it is never a pleasant experience, and it seems to last longer than most investors think or certainly wish it should.

Since early September for U.S. small-cap stocks, and since later that month for their larger-cap brethren, the road has been quite bumpy for most equities. That said, it is important to place corrections in an historical context, understand some of the reasons for the volatility, and reaffirm long-term objectives as they relate to risk and return.

The recent bout of equity market volatility has been difficult to watch, but investors should be aware that 10%+ corrections are not that uncommon (see the table below). They even occur during periods when there is no recession or bear market.

Market (S&P 500 Index)
Corrections of -10% or Greater
Absent a Recession or Bear Market

Start	Through	Correction Magnitude	Duration (Months)	Return 3 Months After
10/7/1997	10/27/1997	-10.8%	0.7	10.5%
7/17/1998	8/31/1998	-19.3%	1.5	21.6%
9/23/1998	10/8/1998	-10.0%	0.5	32.9%
7/16/1999	10/15/1999	-12.1%	3.0	17.5%
11/27/2002	3/11/2003	-14.7%	3.4	24.6%
4/23/2010	7/2/2010	-16.0%	2.3	12.1%
4/29/2011	10/3/2011	-19.4%	5.2	16.2%
5/21/2015	8/25/2015	-12.4%	3.2	11.8%
12/29/2015	2/11/2016	-12.0%	1.4	12.9%
1/26/2018	2/8/2018	-10.2%	0.4	3.5%
9/21/2018	11/19/2018	-7.87%	?	?

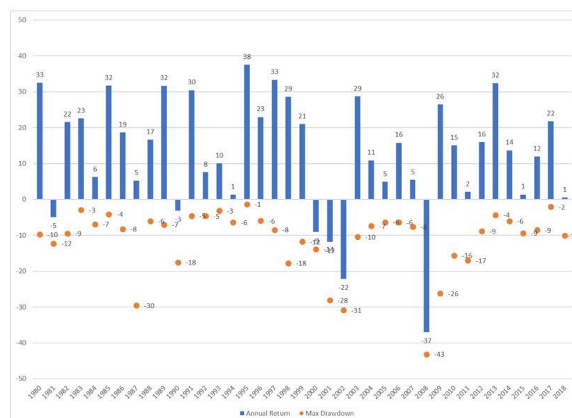
Source: Strategas Research

Another way to view corrections in the context of history is reflected in the graph below. It depicts annualized returns for the S&P 500 by year since 1980. Blue bars above the zero line are positive annual returns, while those below are negative returns.

There are many takeaways from this data, but two to keep in mind are:

- Annualized market returns are more often positive than negative
- Even in years when the market does well, the market may experience significant drawdowns

S&P 500 Annual Returns and
Max Drawdowns:
1980 – 11/20/2018



Source: Morningstar Direct

Economic Backdrop

Economic data in the United States has shown no visible signs of slowing. We have yet to see deterioration in business and consumer sentiment measures, economic leading indicators, or employment data, which typically (but not always) precede recessions and often accompany more significant declines (-20%+) in equity markets.

In addition, corporate profits, based on data compiled by Strategas Research, are up approximately 23% on a year-over-year basis as of the end of the third quarter of 2018. Corporate profits typically start falling before a recession commences.

Equity Markets

Over the first nine months of 2018, domestic equities moved higher (+10.56%). While most sectors within the S&P 500 were in positive territory (see the table below), it was the Technology sector that did the heavy lifting (+20.62%) with respect to powering the Index higher.

Technology and a handful of Communication Services names had benefited from robust earnings growth and the "high price momentum" trade being in vogue, which took many names to valuations that looked rich by our work.

Since the end of September, the Technology sector has declined by -14.92% (through Nov. 23). It was adversely impacted by a combination of high valuations, slight earnings growth deceleration, and lower guidance from some bellwether names in the tech space that recently reported earnings.

Similar to late 2015/early 2016, more defensive sectors (such as Consumer Staples, Health Care, and Utilities), larger-cap securities, and lower beta (less volatile) equities have outperformed, as the market adjusts to the near-term prospect of lesser growth.

Sector Performance Sorted by Worst to Best (Middle Column)

Name Report Currency: Base Currency	1/1/2018 - 9/30/2018 (Last Year End Return (Cumulative)	10/1/2018 - 11/23/2018 (Last Quarter Return (Cumulative)	1/1/2018 - 11/23/2018 (Last Year End Return (Cumulative)
Unclassified			
S&P 500 Sec/Energy TR USD	7.46	(15.68)	(9.39)
S&P 500 Sec/Information Technology TRUSD	20.62	(14.92)	2.63
S&P 500 Sec/Cons Disc TR USD	20.64	(14.38)	3.28
S&P 500 Sec/Commun Services TR USD	0.75	(11.25)	(10.59)
S&P 500 Sec/Industrials TR USD	4.84	(11.06)	(6.75)
S&P 500 Sec/Materials TR USD	(2.73)	(8.16)	(10.67)
S&P 500 Sec/Health Care TR USD	16.63	(5.77)	9.90
S&P 500 Sec/Financials TR USD	0.09	(5.74)	(5.66)
S&P 500 Sec/Real Estate TR USD	1.67	1.04	2.73
S&P 500 Sec/Cons Staples TR USD	(3.34)	1.28	(2.10)
S&P 500 Sec/Utilities TR USD	2.72	2.74	5.53
Benchmark 1: S&P 500 TR USD	10.56	(9.39)	0.19

Source: Morningstar

The Federal Reserve and Fixed Income Markets

The Federal Reserve (the Fed) will meet for its last meeting of the year in mid-December. Although investors have dialed back their expectations, it is still likely that the Fed will increase the federal funds target range an additional 25 basis points (0.25%).

Looking ahead into 2019, investors are pricing in only one rate hike in mid-2019. The outlook has changed over the past couple of weeks given the pickup in volatility, the widening of credit spreads, and the increased uncertainty about global economic growth.

Interestingly, inflation expectations have remained well anchored to the Fed's target of annual inflation at 2.0%. The soft inflation readings provide the Fed with more time to remove accommodative monetary policy from the system.

Given the cautious approach the Fed has been taking during this rate-hiking cycle, we believe it will continue to monitor economic and financial market developments and adjust its policy actions accordingly.

In fixed income, U.S. Treasury yields have declined across the yield curve, as investors have readjusted their thinking on ongoing global economic growth and the expected path of further rate hikes. Credit spreads continued to widen out, coinciding with increased risk aversion in the equity markets.

BMT Investment Process

By design, Bryn Mawr Trust's investment process leads us to select equities, credits, and externally managed funds for our clients' portfolios that are reasonably valued, defensively postured, and with conservative balance sheets. As a result, our equity strategies have outperformed during this recent volatile period.

During the better part of the runup in the markets since March 2009, stocks of good companies but with very high valuations (e.g., "FAANG" stocks) represented a great deal of the upside and, in our opinion, skewed returns for the markets. They created a challenging environment for wealth managers with the intention of delivering very good long-term risk-adjusted returns.

While it is too early to tell if the high-growth/high-price momentum trade is rolling over, the recent underperformance of "aggressive growth" has been beneficial to our designed strategies.

Summary

Asset allocation is a key factor in risk and return, and we continue to stress that it should remain a prime focus over the long term. Given the current volatility, it is equally important not to use short-term events to shape long-term allocations. However, it is vital to develop a plan beyond the current level of volatility that is consistent with one's risk tolerance and return expectations.

While the markets could clearly fall further, we would not be surprised to see stocks rally to some degree, assuming there is even a minor compromise between China and the United States over trade-related issues. That said, we do not think it is prudent to make drastic changes from an asset allocation standpoint at this time.

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