A Message from John M. Silvis, CFA | Chief Investment Officer

Equity markets, including the Dow Jones Industrials Average and the S&P 500 index, saw a continuation today of the declines from last week with both closing the day down more than 4%. The declines from a historic standpoint were some of the largest from the number of points, but well within historic norms as it relates to the percentage of the decline. Here are our thoughts on the equity markets as we expect more volatility in the days ahead:

Positives:

- The S&P 500 Index started the year with a total return of 5.72% in the month of January. This was one of the best starts to the market in several years. It was the 4th best start to the year (first 15 trading days) going back to 1954.
- The global economy remains on firm ground with most data pointing to better growth in the coming months. Unemployment claims continue to fall (came out today), recording the 152nd straight week under 300,000. Consumer confidence remains high and most consumers will see bonuses and lower withholdings in the coming months.
- Earnings so far have been solid. EvercoreISI expects earnings growth for the 4Q (currently half way through the reporting season) of 12.3% versus last year. Revenue growth should be over 6%. Tax reform has lifted expectations going forward and 2018 should see solid growth over last year.
- Equity markets tend to peak after the Fed is done raising rates. The current FOMC projections is for 3 more rate hikes in 2018 with more possible in 2019. So the rally should continue with more choppiness.
- The long term trend of the market remains positive. The slope of the 200 day moving average of the S&P 500 Index, which is a better long term, indicator remains positive.
- From a historical basis, the current rally is defined as a cyclical bull within a secular bull market. According to Ned Davis Research (NDR), there has been 18 occasions since 1900 with the average return of 107% over 1027 days. We have seen an increase of 70% in 715 days through the end of January. So the current expansion should have further upside during the year.

Negatives:

- In the short term, we were overdue for some type of correction in the equity markets. As of today's close, the major indices led by the S&P 500 experienced a 5% decline from the peak early this year of dropping down below 2,730. We could see further declines in the coming days with the next support level at 2,600. A drop below 2,585 would be decline of 10%, officially entering a market correction.
- Yesterday was the last meeting for Fed Chair Yellen. While the FOMC did not raise rates, transitions to new leadership always causes some concern. There has been some speculation that the Fed may have more than 3 rate hikes in 2018, the market is expecting 2.
- We would expect volatility to drift higher in 2018 as measured by the VIX (CBOE Volatility Index). We saw historically low readings in 2017 and the market only experienced a few days with movement over 1% in either direction last year.
- 10 year yields have broken above 2.8%. As we see rates moving higher, the equity markets are adjusting to the fact that the bond bull market may be over and inflation may finally be creeping higher.

Overall, we remain constructive on the equity markets in 2018 and should see further gains as we move into the New Year; however, volatility will likely increase and we will experience some pullbacks along the way.

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