# Market Perspectives | A Glance at How the World Affects You

## *Ending the Quarter – Political Influences & Economic Expansion*

April 18, 2018

Investor confidence of late has been dented but looks to be (generally) holding up. This story may be one of rotation from sectors into areas that appear to have great opportunity. U.S. equities gave back their sizeable January inflows, but flows into non-U.S. developed market and emerging market (EM) equities have more than offset the loss. U.S. investment grade, EM debt and U.S. government bonds have attracted inflows.

For now, Investors remain focused on trade issues where tensions rose near the end of March. However, last week we saw conditions improve as Chinese officials indicated they may be open to negotiating resolutions. In theory, the Chinese government has signaled that it will make some concessions. Such a move would avoid any disruption in the global trade and afford President Trump a political win. Indeed, we see a full-blown trade war as unlikely.

A conducive backdrop

While markets have been choppy in 2018, supportive economic and earnings backdrop remain intact, thus underpinning the reward for risk. Economic expansion continues in spite of recent economic data disappointments. For example, U.S. manufacturing has picked up — and in recent months has been accelerating. The tax overhaul, in our opinion, was a catalyst to the U.S. corporate earnings outlook — earnings momentum appears to be rising across the world. First-quarter U.S. earnings season has started with some solid results and reasonable outlooks. If earnings drive stock prices, and they do, the current environment should support stocks and subsequently mollify concerns about trade tensions and economic deceleration.

Home prices continue to gain and support the growing economy. The home price index from January showed an impressive 6.2% year-over-year, reflecting high levels of consumer confidence and low levels of unemployment. Looking across the remainder of 2018, we expect price hikes to settle in the 5.0%-5.5% range. That may not sound like much, but slow and steady increases tend to be much more sustainable than rapid escalation in home prices seen in years leading up to the credit collapse in 2008.

Business activity is also adding to this positive backdrop. Non-Defense orders for durable and capital goods have made a strong recovery in the past 15 to 18 months. These business decisions to invest have likely been stimulated by a number of factors; President Trump, who promised to stimulate growth and reduce regulations; the decline of the U.S. dollar in the past year, which helped promote a recovery in manufacturing; and the reduction in the corporate tax rate, which lowers the hurdle for investment. These are positive trends that greatly improve economic activity. However, any intimation of trade wars could disrupt this momentum.

So, where should investors consider taking risk? First, every investor should be familiar with their capacity for risk. Our team focuses on this area with every client before choosing a strategy. With that in mind, our opinion favors equities for several reasons, including interest rate risk. Our negative opinion of government bonds is unlikely to change amid tight credit spreads and increasing sensitivity to rising rates. Areas that appear favorable are U.S. and Emerging Market equities along with technology and financials. Furthermore, companies with strong free cash flow and the ability to boost dividends might appeal to defensive investors.

Possible Risks

Inflation represents a possible risk for equities but modest and slow increases with moderate interest rate adjustments shouldn't be enough to derail the long-running equity bull market. In fact, economic growth remains decent with opportunity for growth. Along with strong corporate earnings, equities should do well across 2018 but not without increased volatility. For the next few months, we anticipate markets will remain in a consolidation phase due to economic and political crosscurrents. Nevertheless, a combination of reasonable corporate earnings, fading trade-war fears, and successful tests of recent market (index) lows gives us believe markets may make a run toward the higher end of the current trading range (around 2,750 to 2,800 for the S&P 500). However, downside risks also exist, and it may take some time before equity markets are ready to post new highs.

Technical Perspective

Short-term momentum has improved as the percentage of stocks above their 20-day moving averages has grown to 71.1% from 26.5%. The reading is nearing the YTD high of 81%. However, this indicator has been particularly volatile this year. At a minimum, we want to see this indicator remain above 55% and ideally push past one standard deviation to return to a bullish state.

In the intermediate term, the percentage of stocks trading above their 100-day moving averages has risen to 42.0% from 29.7%. Over the course of 2017, this reading bounced roughly between one standard deviation (near 79.9%) and one negative standard deviation (47.8%). But just after it broke through the one standard deviation mark at the end of January 2018, the market contracted and the reading plummeted to around 33%. It then attempted to recover, climbing up to 64% -- but immediately fell again to new lows. It is now hovering between the negative one standard deviation mark and the negative two standard deviation mark (31.7%).

Looking at highs and lows on a monthly basis, 970 stocks were at one-month highs on Tuesday and 149 were at one-month lows, for a ratio of 651%. Over six months, 233 were at highs and 56 at lows, for a ratio of 416%. Over the past year, 191 were at highs versus 40 at lows, for a ratio of 478%. These indicators point to a market that is gaining strength.

At the current index level near 2,706, the S&P 500 remains above its 200-day trendline of 2,602. If a sell-off ensues, we will look for Initial support around the 50-day moving average, currently at 2,685.

Best Regards,
Phillip L. Clark, RFC
President & CEO