Economic & Market Overview

as of March 31, 2018

Volatility is back. U.S. equity market performance began the first quarter in stellar fashion, leaping 7.5 percent out of the gate through January 26th, as measured by the S&P 500 Total Return Index. Expectations for strong earnings growth aided by tax reform, improving underlying GDP growth, low inflation, and continually low interest rates led investors to ramp up their price targets. However, this enthusiasm was quickly tempered in late January and early February when the initial Q4 GDP report and the subsequent January employment report signaled inflation pressures may be building. The S&P 500 Index dropped 10.1 percent in the nine trading days following the initial Q4 GDP report. The speed and magnitude of this decline was potentially exacerbated by one-sided bets in low volatility funds that were forced to unwind their positions quickly. February economic data was mixed, and the index rallied through mid-March, before again selling off later in the quarter, fueled in part by trade tensions. The S&P 500 Index finished the quarter down 0.8 percent on a total return basis.

Interest rates also exhibited increased first quarter volatility. The U.S. 10-year treasury yield, which ended 2017 at 2.4 percent, climbed for most of the quarter to a multi-year closing high of 2.97 percent on February 21st before sliding back to 2.74 percent by quarter-end.

We believe the increased volatility in stocks and bonds likely signals that the “Goldilocks” scenario for markets, which dominated 2017, has probably ended. Under Goldilocks, economic growth was improving, but not so fast as to ignite inflation. Good economic news was good for markets because it signaled that earnings growth would be better, and bad news wasn’t necessarily bad because the Federal Reserve would continue to keep rates low and support markets. Now, good news could be bad news for markets because economic growth could be too hot leading to accelerating inflation. Bad news could be bad news as the Federal Reserve is less likely to reverse course and support markets unless economic data were to significantly worsen. This narrowing of potential positive market outcomes decreases the risk/reward trade-off in assets and understandably has led to pressure on prices. Going forward, markets are likely to be more sensitive to economic news than they have been throughout much of this business cycle with heightened sensitivity to inflation gauges. Investors will need to weigh this against still positive near-term earnings and GDP growth outlooks.

We continue to manage your portfolios with a focus on our strict valuation discipline, portfolio diversification, and liquidity.