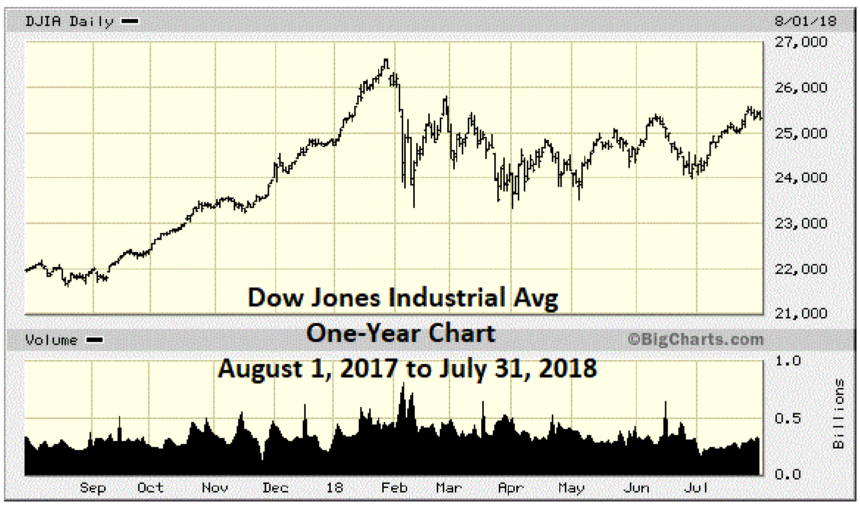
August Update August 1, 2018

Riding the Crest

As we have discussed in recent *Market Comments*, investors have weathered a sea of turbulent and dramatically changing conditions in 2018. First, we had the huge blow-off of stock prices in January when the Dow spiked 1,900 points, or 7.7% in the first three weeks of 2018—after a 25% rise in 2017. That was followed by a much needed, but swift and short, correction into the first week of February. Since that time, stocks have floundered through cycles of optimism and despair with little net change; the Dow is up just 2.8% for the first seven months.



The market simply has not been able to find a compelling driver in the months since the brief correction which started in late January. Geopolitical concerns, slowing global economic conditions, higher interest rates, tariff/trade worries and an aging bull market have subdued investor enthusiasm over phenomenal earnings, continued positive economic conditions, tax cuts and reduced regulation. Any of these issues, and unnamed others, might be enough to move markets decisively in normal times…but this is 2018!

The most generalized description of the opposing forces buffering the market is ***fundamentals*** on one end and ***politics*** on the other. On one hand, escalating trade tensions and the potential for additional tariffs suggest caution may be warranted; on the other hand, robust economic and profit growth support risk assets continuing to climb higher. So far the fundamental forces seem to be winning; as evidenced by the S&P 500's positive year-to-date return. But recent softening in a few economic numbers (although from elevated levels) and slightly lower confidence indicators must be watched closely.

Against this unsettled backdrop, the 2018 earnings season is continuing the streak of ***healthy profit growth*** that began nearly two years ago. With approximately 63% of companies reporting, 84% have beaten earnings estimates and 60% have beaten sales estimates, according to JP Morgan. Analysts from that firm recently increased their estimate for second quarter S&P 500 profit growth to an astounding 28% increase from the prior year's healthy numbers.

While the waves of earnings data, economic statistics, news headlines and *Twitter* feeds can't seem to influence overall market direction, there have been undercurrents providing new risks and opportunities. One of the most dramatic has been the recent crack in previously unstoppable FANG (**Facebook, Amazon, Netflix** and **Google**) and similarly dominant stocks. Just last month, we mentioned how FANG stocks had far outperformed the rest of the market for many quarters but during July two of these stocks (Netflix and Facebook) experienced huge selloffs in response to great—but not great enough—earnings. According to *Dow Jones Data Strategy*, the Facebook decline on the day of their earnings was the biggest drop in market cap ever and the decline was larger than the combined market values of 457 of the S&P 500 companies. It isn't just the FANG stocks; the Chinese counterparts to the U.S. FANG's have also experienced dramatic selloffs while the entire tech-heavy Nasdaq slumped 1.5% on the last Friday in July.

With over a third of S&P 500 companies still to report, the focus in coming weeks will continue to be on earnings but trade tensions, interest rates and global risks are sure to also have an impact on the evolving market environment. It doesn't appear August will live up to its "Dog Days" reputation as far as the stock market is concerned. As always, we will be watching to determine if additional economic, political or market turbulence indicates risk or opportunity.

Best regards,

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