Barry Investment Advisors

Navigating Your Wealth Together

Global Market Commentary - February 2018

Volatility has returned. After 15 months of daily returns no worse than a 2% decline, the S&P 500 snapped the winning streak by posting a 2.1% decline on Friday. On Monday, the decrease nearly doubled, with the index posting a 4.1% fall. For many, Monday's action was breath-taking. But it was not extraordinary. Since its inception more than 100 years ago, the Dow has registered a daily decline of 3+% 359 times.

We have been anticipating a correction for more than year and expected more choppy markets in general, as market valuations became stretched with nearly daily increases in stock prices. Rocket-fueled first 18 trading days of 2018 added to our concerns, as the S&P 500 jumped 7.5%, nearly matching its decades-long average annual return.

And then Friday happened. That day, the Department of Labor released a strong payrolls report that had better than market expected results. But with the report, came hard evidence of wage inflation returning. The market interpreted the report as a turning point for inflation. If wages rise too fast, the Fed may accelerate interest rates hikes to head off inflation. And when interest rates rise, as they have been doing more rapidly recently, investors can get temporarily spooked. In addition, rising wages can negatively impact corporate profit margins, slowing earnings growth rates and dampening stock valuations. The S&P 500 gave back January's gains to finish down .92% YTD.

We will continue to monitor economic data as it is released but believe a single payrolls report does not make a trend. We don't see signs of a recession. We are encouraged by the recent corporate earnings reports for the fourth quarter and commentary surrounding expectations for 2018. Following Monday's selloff, the S&P 500 is trading at 17 times 2018 earnings estimates. We project estimates to move higher as analysts have yet to adjust earnings higher to account for lower corporate tax rates in 2018. If earnings and dividend payouts continue to come through ahead of expectations due to the extra tax savings, there is plenty of potential for US companies to resume growth from here.

Over the past year, we have positioned portfolios for a US stock market correction by rotating out of some US names and allocating further to international markets funds. We expect to do more of this in 2018. Our balanced portfolios include inflation-protection positions, a volatility managed fund, and geographic and sector diversifications.

You can see below that for this market selloff, the US (S&P 500) and international markets (EAFE Index) fell in sync (top two lines of the chart). The bottom two lines reflect long-term treasury prices in blue, with the gold price above it.

Source: CapitalIQ

While we expect US earnings to continue to improve, we also think the acceleration of international earnings growth will continue and will look to add selectively as opportunities present themselves. Like with every prior market correction, this one will end.

We appreciate your continuing support. Please do not hesitate to contact us if you have any questions.

The Barry Investment Team