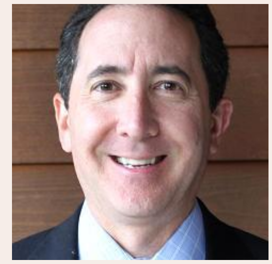
By Peter Boockvar
Chief Investment Officer – Bleakley Advisory Group



Given the recent uptick in market volatility, along with the dynamically changing global economic landscape, we decided to slightly alter our approach to our monthly commentary. This month, we want to offer our perspectives in two distinct pieces. Part I is intended to remind you about what we believe is most important to your success as our client. Part II is intended to provide you with an overview of what's happening in the global economy and investment markets.

Part I – The Financial Plan

While it can be difficult to not to get caught up in the noise created by short-term market swings and the many pieces of economic data reported on a daily basis, we have to continue to remind ourselves that most of this information is not within our own control. For this reason, having a well thought out financial plan to provide ongoing guidance and reference points, along which progress can be assessed and adjustments can be made, is the best place to start. A Financial Plan is a comprehensive evaluation of an investor's current and future financial state by using currently known variables to predict future cash flows, asset values and withdrawal plans.[1]

"The true value of a financial plan is the process focused on a specific purpose to help you avoid making emotional decisions or taking abrupt action that may be detrimental to your long-term financial success"

Generally speaking, the true value of a financial plan is not the written plan itself, but the process that takes place to put the plan together in the first place. This process, when done effectively, creates an opportunity to clearly identify your financial goals and objectives, values, purpose, and priorities. Together, these will be used to make decisions based on deliberate choices with a focus on what is important to you. Further, they will help ensure that your decisions and actions are always directed toward a specific purpose. Most importantly, they will help you avoid making emotional decisions or taking abrupt action that could be detrimental to your long-term financial success.

If you've been paying attention to the stock market during the past few weeks, you may have noticed that the degree to which values are fluctuating has been amplified. In Part II of this commentary we're going to offer our opinion and explanations for what we believe to be the factors causing this volatility. But, before we do that, we feel it is very important to acknowledge that meeting your goals will be much less dependent on where the market closes at the end of October, than where it will be in October 2025, and beyond.

1-wikipedia

Part II – Market & Economic Update

Since the end of the 3rd Quarter, the investment landscape has become more challenging. This is especially true when comparing the recent spike in volatility to the calmer days of 2017, when volatility fell to the lowest level on record. October was a particularly difficult month for equity investors. Domestic stocks, as measured by the S&P 500, were down 6.9% for the month, but are still up 1.4%% year-to-date, excluding dividends. Foreign stocks, as measured by the MSCI ACWI ex U.S. were down 8% in October, and are now down 12.1% for calendar year 2018.[2]

In our opinion, there was a confluence of events that came together in October which pressured markets, ultimately driving them lower. We've outlined several of the most meaningful drivers of the recent market selloff:

Rate Hikes and Inflation Concerns

During a speech in early October, Federal Reserve Chairman Jay Powell reminded markets that the Federal Reserve is still a ways away from getting to a so called 'neutral interest rate,' a level believed to be neither accommodative nor restrictive. Chairman Powell would like to see the fed funds rate about 100bps above the rate of inflation, which is currently running at 2%.[4] This means that we face the likelihood of another 100 bps of rate increases by the Fed, as the current level stands at 2.0% to 2.25%[5].

The Federal Reserve is also in the process of reducing its balance sheet as it winds down its quantitative easing program. This, combined with the government's large-scale issuance of Treasury securities to finance its budget deficit, are driving bond yields higher. The market driven U.S. 10-year Treasury yield finally broke above a multi-year range, reaching a closing high of 3.23% on October 5th.[6] That was a level last seen in May 2011[7].

"The US 10-year Treasury yield reached a high of 3.23% on 10/5/18 – a level not seen since May of 2011."

Trade Tensions and Tariffs

The ongoing tensions between the U.S. and China over trade are causing considerable unrest in markets. The two countries have been implementing – and threatening to broaden – tariffs on a wide variety of imports from each other, and there is no indication that tensions will soon ease.[8] President Trump and President Xi are scheduled to meet at the end of November at the G20 meeting. We have fingers crossed that it is amicable and room is given on both sides to come to an agreement on trade and US intellectual property.

2-6 Bloomberg, 7 - T. Rowe Price; Global Market Volatility; October 2018,

Part II – Market & Economic Update

Corporate Earnings and Inflated Valuations

After bottoming in March 2009, equity markets have been rising for almost 10 years. Over this period of time, corporate earnings growth has been strong and some believe that the high valuations that held throughout most of 2018 may have reflected a view that those current favorable fundamentals will remain for the foreseeable future.[9] As 3Q earnings have been reported, about 75% of companies have reported earnings that beat estimates, but that is about on par with the typical rate.[10] The issue has been that about 1/3 of those companies have missed their revenue estimates.[11] Any further developments that imply a weaker outlook could cause further weakness in equity markets.

Domestic Economic Activity

U.S. economic growth has been relatively strong. 3Q GDP was reported at a 3.5% growth rate, after a solid 4.2% gain seen in Q2.[12] Fiscal spending, tax reform, and deregulation are believed to be the forces that have been driving growth. However, we are in the later stages of this economic cycle with less accommodative monetary policies, higher interest rates, and inflation and labor costs rising amid tighter labor markets[13].

The consumer is a particular bright spot, as personal spending was reported at a solid 4%.[14] Consumers are benefiting from a very strong labor market and an increasing pace of wage increases. On the other hand, we've seen a slowdown in the rate of housing transactions, as higher mortgage rates and multiple years of 5% to 6% annual price increases have resulted in a preference for renting, rather than buying. The important auto sector has also seen a moderation in the demand for vehicles. Here too, higher interest rates and record high car prices have slowed the pace of new purchases.

"Overseas, economic growth has become more suspect. China is growing at the slowest rate since 2009 and the Eurozone growth is expected to be less than 2% in Q3."

Foreign Economic Activity

Overseas, economic growth has become more suspect. Chinese growth has moderated to 6.5%, the slowest rate since 2009, and in the Eurozone it is expected to be less than 2% in Q3 for the first time since 2016.[15] Global trade, generally, has slowed in response to the trade tariffs as the tariffs disrupt supply chains, create business uncertainty, raise the cost of doing business and distort the timing of deliveries.

9-12 – Bloomberg, 13- T.Rowe Price; Global Market volatility; October 2018, 14-15 Bloomberg

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Conclusion

In conclusion, the two main drivers of the bull market in stocks has been an amazing level of central bank easing, both in the US and abroad, along with strong earnings growth and record high profit margins. The former is being reversed and the latter is being tested. We hope the Fed can engineer a soft landing and does not overdue the tightening, but most of the time that is not determined until after the fact because of the lagging influence of rate and balance sheet moves. The U.S. economy should still benefit from the tax cuts, fiscal spending and a strong labor market, but is not immune to softening economic growth overseas, the rising cost of capital, and the impact of tariffs.

It is worth reiterating that having a financial plan is critical. Maintaining adequate liquidity (cash) and balancing your need for asset growth with your tolerance for risk, in a manner that is consistent with your long-term financial plan, is essential to working towards your goals. It is never a bad time to speak with your advisor, but particularly in light of the changing market and economic landscapes, now would be a great time to check in to make sure you're properly positioned for the future.

Have a Happy Thanksgiving holiday!