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Market Commentary

WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Basic Concepts

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Last Week's S&P 500 Index:
-4.1%

Key takeaways

- *The recent stock market correction can be broken down into just a couple of basic concepts.*
- *While there are many underlying moving parts, the possibility of the Federal Reserve (Fed) making a mistake and a global growth slowdown are the top concerns, in our opinion.*

Behind the stock market selloff that began in the first week of October, there are many moving parts, but we think investors should focus and break down the last seven or eight days of trading into just a few basic concepts. Let's try to cover these concepts and attempt to get a feel for what the forward path from here might be for the equity market.

First, we believe stock market participants need to put this market correction in the proper perspective. From April 2 to September 20 when the S&P 500 Index hit its all-time record high, the index jumped almost 14% higher with hardly any pauses or minimal pullbacks along the way. The last minor stumble prior to last week came at the end of June. When you have that magnitude of a move in that short of a time, one should expect that at some point the market is going to cough up a portion of those gains, temporarily, if the forward-looking fundamentals are still in place.

As of last Friday's close, the S&P 500 is down just a touch over 5% from the September record high. In the whole scheme of things, and considering what the major equity indices have done over the last six or seven months, that's not bad in our view. This strategist will tell you that in the 35-plus years I have been participating in, analyzing, and trading the financial markets, a 5% move one way or the other is often considered nothing more than "noise." But once again, you have to ask yourself if the outlook for the fundamentals has changed. That is the key.

Our Equity Strategy group over the last 18 months or more has been stating that the two biggest risks in 2018, in our opinion, would be the Fed making a mistake and/or a slowdown in global economic growth. A mistake by the Fed would mean hiking rates too high for the level of domestic growth we expect looking ahead. Both of these concerns have played heavily into the current pullback. But keep in mind, neither of these concerns is new. And neither is part of our base case.

If these concerns are not new, then the natural question is "what was the trigger?" The recent triggers have been, in our opinion, Fed Chairman Jay Powell's enthusiastic assessment of the economy in a number of speeches he gave early in the month and last week's lowering by the International Monetary Fund (IMF) of its global growth forecast based on concerns surrounding tariff implications for China and emerging markets in general. That got the ball rolling.

In addition, some have argued that earnings growth is an issue. This is another topic we have discussed at length this year. 2019 earnings growth is not expected to be anywhere near 2018 earnings growth. But the market has known that for some time. Earnings concerns are largely related to global growth fears and the negative margin effect of higher costs, some tariff related. We need help from foreign economies to hit our earnings forecasts. We look for 7% to 8% earnings growth in 2019 versus probably 20% or so this year.

Understanding the basic concepts driving the stock market is important, especially later in a cycle. Given our fundamental outlook, we believe the S&P 500 Index will be higher 12 months from now.

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