Market Commentary
February 2018

Perspectives on Recent Capital Market Volatility

The goldilocks conditions of broad-based capital market gains accompanied by historically low levels of volatility appeared set to continue into 2018 with global equity markets rising by more than five percent in January, as measured by the MSCI All-Country World Index. As we wrote last month, it was our view that the fundamentals currently supporting global equity markets remained strong based upon the synchronized acceleration in global economic growth and corporate earnings alongside subdued levels of consumer price inflation. However, we also cautioned that the historically low levels of volatility coupled with rising levels of investor euphoria left markets vulnerable to an unexpected return of volatility after an unprecedentedly peaceful period for investors last year. For long-term investors, volatility, while painful in the short-term, is often the precursor to opportunity.

Volatility has returned to capital markets with a vengeance in recent days as the Dow Jones Industrials Average (Dow) declined by more than1,500 points intra-day on February 5 and finished the day down more than 1,100 points (-4.6%), largely erasing the strong gains generated since the beginning of the year (Bloomberg). Identifying the proximate cause of volatility's sudden return is largely speculative due to the complex dynamics driving short-term price movements in markets; however, many pundits point to the recent rise in interest rates and concerns of percolating inflation that could presage further pressure on interest rates to come. During times of heightened investor anxiety, it is important to take a step back and assess the fundamentals as periods of market volatility are typically fraught with fear and the emotional impulses that emanate from it.

From our vantage point, little has changed in the fundamental backdrop that we wrote about last month:

- Corporate earnings remain robust with S&P 500 earnings expected to increase by nearly 15% during Q4 2017 from the same period in 2016. Further, of the 185 S&P 500 companies that have reported Q4 2017 results to date, 80% have reported earnings above analyst estimates and 82% have reported sales above analyst estimates (Thomson Reuters).
- Measures of economic growth remain strong on a global basis, and leading economic indicators suggest the acceleration in global growth is poised to continue. Further, both economic growth and corporate earnings in the U.S. are likely to be further supported by the recent tax cuts that take effect in 2018.
- While concerns about rising inflation have been bubbling, measures of consumer price inflation remain contained with the Headline Consumer Price Index (CPI) rising 2.1% year-over-year in December and the Core CPI rising 1.8% over the same time period (Bureau of Labor Statistics).

We advise investors to maintain discipline during these turbulent times as the fundamental backdrop of accelerating global economic growth, robust corporate earnings, and subdued inflation is likely to remain supportive of equity markets in 2018. We feel that global equity markets were due for a healthy correction after the historically benign risk environment of 2017 to help recalibrate investor sentiment, which had become increasingly extended in recent weeks, regarding the volatility historically associated with investing in equities. We will continue to monitor the market environment closely for both potential risks and emerging opportunities and will continue to communicate with you proactively during this period of heightened uncertainty.

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Authored by the Freedom Capital Management Strategies® Investment Committee

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