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Wetherby NEWS

Our perspective on recent market volatility

In the past quarter, the U.S. equity market has experienced substantial volatility. Investor sentiment, which was remarkably resilient to various major events in 2017, is now reacting to a myriad of current events[1]. Economic signals vary; while corporate earnings and the Fed's outlook indicate a solid economic future, softening housing markets and flattening yield curves add uncertainty to this mix.

We caution against being too reactive in a market environment that reflects significant fear or trying to time short-term market swings. Our investment philosophy remains resilient in such market conditions: maintain a long-term horizon, diversify across multiple asset classes and maintain a disciplined approach to rebalancing portfolios to reduce the risk of asset allocations becoming unintentionally skewed by significant price swings. While it often tends to feel the worst when there is opportunity in the markets, volatility can also create attractive valuations for long-term investors.

Following is a brief overview of some recent major market events:

> ***The Fed Raises Interest Rates:*** The Federal Open Market Committee ("FOMC") announced a fourth increase in interest rates this year, from 2.25 to 2.5 percent. Fed Chairman Powell represented a dovish, or softened, stance on future rates, expecting to raise rates only twice (rather than three times) in 2019 and maintain a 'data dependent' approach to future changes. Regardless, investors hoping for a pause in the Fed's program of reducing its balance sheet were disappointed, resulting in a single-day S&P 500 drop of 1.5% on December 19th. Amidst the volatility, there are sufficiently solid underpinnings to economic growth and corporate earnings to support this less accommodative monetary stance.

> ***Flattening Yield Curve:*** 3-year Treasury yields climbed slightly higher than those of 5-year Treasuries in early December. Many investors fear the beginning of a broader inversion of the overall yield curve, which has preceded recessions in the past. However, traditionally it is an inversion of the 2- to 10-year yields that is considered a meaningful indicator. While futures markets imply a continued flattening of the overall yield curve in the near-term, they do not suggest a fully inverted curve which historically has raised concerns of an imminent recession.

> ***Investor Sentiment & Market Volatility:*** Investor worries about U.S.-China tensions, a flattening yield curve, weakening oil prices, softening housing data and uncertainty regarding Brexit negotiations, have all contributed to the S&P 500 declining 14.5% since September, with most global equity indices now in negative territory for 2018.

> ***Attractive Valuations & Investor Opportunity:*** The S&P 500 is now trading at a 17.1x price-to-earnings multiple, reaching valuation levels not seen since early 2016, with certain sectors (such as some tied to energy) trading at valuations not seen since the Great Recession ten years ago. However painful in the near-term, the current correction can be looked upon as an important depressurizing of the momentum-led rally that lead to elevated valuations, suppressed and unsustainably low levels of volatility, and significant investor complacency.

As advisors, we hold our client's trust in highest regard and are always available to discuss market conditions. Please reach out to your Wetherby team with any questions.

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[1] The standard deviation of S&P 500 daily prices fourth quarter to date was 25.54, compared to 8.04 for the entire year of 2017 (data from Morningstar).

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