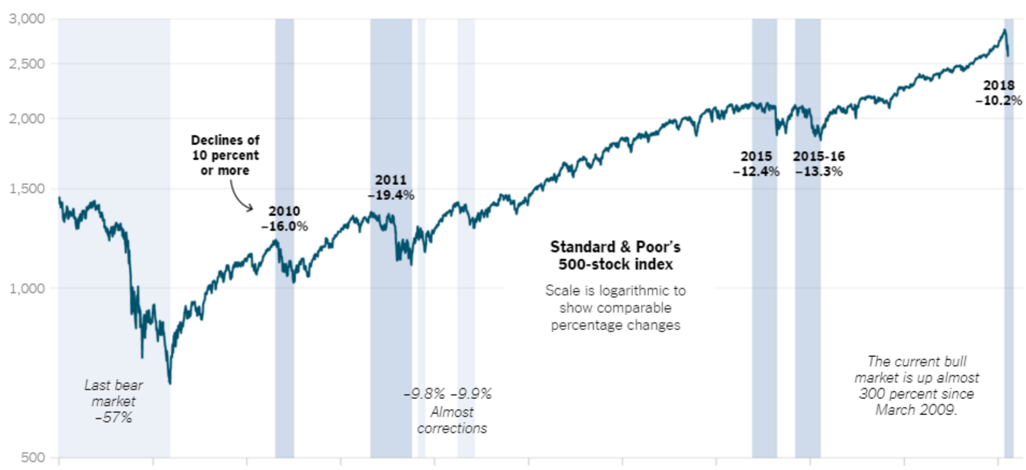
APRIL 2018

MARKET AND ECONOMIC REVIEW & OUTLOOK

AN UPDATE FROM THE ADVISORS AT GASKIN ASSET MANAGEMENT ***CHARLOTTE, NORTH CAROLINA***

On February 2nd, the prognosticator of prognosticators made a dire prediction. This ominous forecast did not come from Warren Buffet, the "Sage of Omaha." Rather, it was made by the "Sage of Punxsutawny". Dressed in a fine fur coat for the cloudy and extremely cold weather, Punxutawny Phil arose from the comfort of his warm and comfy den in Punxutawny, PA to make his annual prediction while in the company of more than 1,000 witnesses. To the disappointment of those in attendance, Mr. Phil is alleged to have seen his shadow thus predicting six more dreadful weeks of winter. We would never accuse our furry prognosticator of perpetrating "fake news" or personal bias but it has been noted that he and his ancestors have predicted six more weeks of winter in 100 out of 132 predictions.[i] In spite of global warming, the odds as indicated by Mr. Phil are clearly in favor of more cold weather each year even though he was clearly wrong this year in the Southern climes. Some might find his prediction questionable given the cloudy weather on the day of his viewing. We wonder if the prolonged winter prediction is not just an attempt on his part to be left alone to slumber for six more weeks undisturbed. Then again, maybe he was just irritated and not in the mood to delight the crowd. After all, who would want to be awakened from a deep sleep by a bunch of grinning old bearded men in top hats?

The Dow Jones Industrial Average (DJIA) was not feeling particularly positive on the day of Phil's gloomy prediction either. The market posted its worst percentage decline since Brexit of 2016 and the worst single-day point decline since the financial crisis of 2008 on February 2nd.[ii] Like Phil, it appeared that the market might be ignoring the obvious signs and reacting in a way that seemed unjustified. While Phil rather oddly saw his shadow on a cloudy day, the market plunged just as wage growth was accelerating, unemployment was declining and productivity and earnings were increasing. Again, there is probably more to this story than what meets the eye. Since the Groundhog Day gyrations, stock market volatility, as measured by the CBOE Volatility Index (VIX) has traded at levels similar to those of the financial crisis according to Jeff Cox of CNBC.com.[iii] As noted in the chart below, the S&P 500 Index** officially entered "correction" territory on February 8th.[iv]



Sources: New York Times, Thompson Reuters, Yardini Research by Kari Russell February 8, 2018

The market volatility we saw in early February persisted through March – and has now continued into the start of April. Since the S&P 500 peaked on January 26, the index moved at least 1% on a daily basis on half of the 43 trading days through the end of March. John Bogle, the founder and former CEO of Vanguard, recently stated during a live

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CNBC interview, "I have never seen a market this volatile to this extent in my career." Bogle commented further, "now that's only 66 years, so I shouldn't make too much about it, but you're right: I've seen two 50 percent declines, I've seen a 25 percent decline in one day and I've never seen anything like this before."[v] Interestingly, Bogle went on to state that he sees the volatility as primarily "noise" to be largely discounted.

"This contrasts to only one move of greater than 1% during 2018 prior to that peak and is a far cry from the calm seen in 2017, when the S&P 500 produced a 32-year volatility low with only eight days with moves of at least 1% for the full year," shared Raymond James Managing Director of Equity Portfolio & Technical Strategy Michael Gibbs.

However, a healthy backdrop for the U.S. equity markets exists amid all the recent market noise – and U.S. economic conditions remain quite healthy. In a recent Federal Open Market Committee (FOMC) press release, the Fed highlighted strengthening of their economic outlook. Growth in the remainder of the year is expected to be relatively strong, with an unclear impact from fiscal stimulus such as corporate tax cuts and increased spending.

Having raised short-term interest rates again on March 21, Fed officials are split in their expectations of whether there will be two or three more hikes this year. "Since December of 2015, including this month's hike, the FOMC has raised rates six times for a total increase of 1.75%. Over the same time frame, the 10-year Treasury has risen only 0.55%, and we saw the Treasury yield curve flatten during the month," explained Doug Drabik, senior vice president, Raymond James Fixed Income Services Group.

The Fed expects inflation to drift gradually higher, while the unemployment rate is anticipated to fall to nearly a full percentage point below what it considers a long-term sustainable level in 2019 and 2020. However, the risks of a monetary policy error are increasing.

While well-intentioned, tariffs raise input costs, invite retaliatory tariffs on U.S. exports, disrupt supply chains and increase global investment uncertainty. "The bigger concern has been the reaction of our trading partners, which, to date, has been muted – giving rise to the hope the worst-case fears about a trade war are more likely not going to be realized," according to Raymond James Washington Policy Analyst Ed Mills. The financial markets have responded to a one-step back, one-step forward set of trade policy decisions.

	12/29/17 Close	3/29/18 Close	Change YTD	% Gain/Loss YTD
DJIA	24,719.22	24,156.41	-562.81	**-2.28%**
NASDAQ	6,903.39	7,062.66	159.27	**2.31%**
S&P 500	2,673.61	2,641.60	-32.01	**-1.20%**
MSCI EAFE	2,050.79	2,005.67	-45.12	**-2.20%**
Russell 2000	1,535.51	1,529.75	-5.76	**-0.38%**
Bloomberg Barclays U.S. Aggregate Bond Index	**2,046.37**	**2,016.48**	**-29.89**	**-1.46%**

Performance reflects price returns as of 4:00 ET on March 29, 2018.

Here is a look at what's happening in the economy and capital markets, as well as key factors we are watching:

Economy

- Real GDP growth was likely at around a 2.5% annual rate in 1Q18 (advance estimate due April 27), with slower growth in domestic demand, but expectations of growth for the remainder of the year remain strong.
- Job growth has remained strong, but the pace should eventually slow as the job market continues to tighten – the labor market and inflation continue to be areas of focus for the Fed.

- The Federal Open Market Committee raised the federal funds target to 1.50% – 1.75%, and officials are split in their expectations of whether there will be two or three more rate hikes this year.
- "The risk of a more substantial trade war has been a main financial market concern," explains Raymond James Chief Economist Scott Brown.

Washington Policy

- Fear of trade wars and possible missteps dominated D.C. this past month. "There is solace in the hope that the bark may be worse than the bite and tough announcements get negotiated down toward more workable outcomes," outlined Ed Mills, Washington policy analyst.
- The threat of a government shutdown has been removed until October 1, as Congress finally passed a FY18 spending bill almost six months late. This bill adds another round of fiscal stimulus (on the back of the tax cuts) coming out of D.C. – boosting both domestic and military budgets. Included in the deal were a number of policy items, including new gun regulations, but avoiding any changes to healthcare policy (which likely signals a near-term truce on healthcare fights).
- The largest overhaul of the Dodd-Frank Wall Street Reform Act cleared the Senate on a 67–31 vote, signaling momentum for the deregulation of community and regional banks. "We anticipate a bill signing before August that should provide a boost to bank lending, profitability and flexibility," shared Ed Mills.

Equities

- Behind March's market volatility is a healthy backdrop for the equity markets.
- "Longer term we continue to embrace the theme that the secular bull market has years left to run," according to Raymond James Chief Investment Strategist Jeff Saut.
- Valuations for U.S. equities are more favorable after the recent price decline. Managing Director of Equity Portfolio & Technical Strategy Michael Gibbs states, "We favor strategically buying into sectors and, more specifically, shares of individual companies exhibiting the most favorable fundamentals."
- The S&P 500 P/E, on a forward-looking 12-month basis, is now 16.1x, in line with its five-year average.
- Earnings growth is strong on a global basis, with U.S. earnings growth expected to reach the upper teens this year and the low teens next year.

International

- International equity markets exhibited volatility during March with trade war concerns impacting both Europe and the emerging markets, according to Raymond James European Strategist Chris Bailey.
- In Europe, the formation of the German government buoyed hopes that ongoing European economic reform could be forthcoming, which would benefit the region, although the results of the Italian general election results were inconclusive.
- The risk of a "cliff-edge" Brexit instability period was reduced when the U.K. and European Union agreed to a 21-month transition period after the initial two-year period elapses at the end of March 2019.
- Beyond trade tensions, China's commitment to significant change was reinforced by the conclusions of the most recent National People's Congress. By contrast in Japan a continuing property-related corruption scandal impacted even the senior political ranks in Japan.
- The fall in the U.S. dollar during the month combined with a further lessening of diplomatic tensions around the Korean peninsula continued to encourage global inflows into the emerging markets.

Fixed Income

- While the siren call for a bond bear market continues, Treasuries are rallying. Post the Fed's recent move that raised interest rates, the yield curve is flattening.
- A bond bubble exists – not in low-risk assets like high-grade municipals or Treasuries – but in lower credits and highly leveraged companies, such as Tesla.
- Cracks in credit, widening spreads in LIBOR-based instruments, and a flattening yield curve suggest a conservative risk posture in debt investing, according to James Camp, CFA, managing director of Fixed Income, Eagle Asset Management.
- Regarding the Treasury yield curve, the 2-year to 10-year spread has narrowed. "The long end of the curve has fallen in yield, while the short end of the curve has ticked up," stated fixed income strategist Doug Drabik.

Bottom Line

Inflation and interest rates remain low from a historical standpoint, but are likely to move higher over the course of the year, potentially causing additional bouts of volatility. Given the strong economic and earnings backdrop, pullbacks should be normal in nature and viewed opportunistically. As always, a well-diversified portfolio in line with your long-term goals should allow you to participate in upside potential as well as serve as a ballast for any short-term volatility that may arise in the coming months.

Thank you for taking the time to read through this newsletter. We welcome your calls or emails and look forward to speaking with you again soon.

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[i] Shannon, Joel (2018, February 2) "Groundhog Day 2018: Punxsutawny Phil Predicts 6 More Weeks of Winter", USA Today Network. https://www.usatoday.com/story/news/nation-now/2018/02/02/groundhog-day-2018/1088175001/

[ii] Egan, Matt (2018, February 2) "Dow Plunges 666 Points –Worst Day since Brexit", CNN Money. http://money.cnn.com/2018/02/02/investing/stock-market-today-dow/index.html

[iii] Cox, Jeff (2018, February 16) "The stock market correction two weeks later: How it happened, and if it can happen again", CNBC.com. https://www.cnbc.com/2018/02/16/the-stock-market-correction-two-weeks-later.html

[iv] Phillips, Matt & Hsu, Tiffany (2018, February 8) "Stocks Plunge as Markets Enter 'Correction' Territory", NYTimes.com. https://www.nytimes.com/2018/02/08/business/stock-market-activity.html

[v] Frank, Thomas (2018, February 6) "Jack Bogle says he hasn't seen a market this volatile in his 66-year career", CNBC.com. https://www.cnbc.com/2018/04/05/jack-bogle-says-he-hasnt-seen-a-market-this-volatile-in-his-66-year-career.html