PUSHING THROUGH

Market Review **NOVEMBER 2018**

October was a grueling month for US stock market participants. The S&P 500 nearly lost 10% between September 20th and October 29th. At its worst moment, year-to-date gains flipped from being positive to being negative. The S&P 500 has since recovered from the October 29th lows and now holds a slight gain for the year.

So, what exactly fueled the stock market correction? Well, there are many ideas being thrown around. One of the more rational thoughts is that earnings have peaked for US stocks. This year's manufacturing and service indexes as well as industry surveys somewhat support the earnings-peak logic. There are three consistent themes that continue to surface: input costs are rising, delivery times are delayed, and qualified labor is scarce. Those types of constraints can have a powerful pull on the rerating process that goes into stock prices.

The Federal Reserve's (Fed) policy to elevate interest rates has also received some criticism. Some argue that the Fed is beginning to move too fast. The Fed last moved its key target for inter-bank lending higher in September. Another rate hike is scheduled for December. Additionally, the Fed has refrained from new US treasury bond purchases. US treasury holdings on their balance sheet have fallen about $140 billion this year. Consequentially, the yield on the 10-year US treasury bond rose 0.75% this year to about 3.15%.

Higher US treasury yields are a systemically important feature in stock markets. US treasury yields are the safest yields on the planet and are used as a basis for pricing stocks. When US treasury yields rise, stocks generally fall, all else being equal.

Another explanation for the selling hysteria is less about valuations and more about price technical-indicators. Wall Street is purportedly filled with trading algorithms that all look at the same factors. The 200-day moving average is a prime example. When stock markets recede below a well-watched indicator, the reaction by the algorithms is to indiscriminately sell. In previous stock market declines, selling often may stop at the 200-day moving-average. However, when the 200-day moving average was tested in October, the stock market finally caved and sold stocks straight through the 200-day floor. The next test level for the S&P 500 became 2,600. The index almost reached it, but has since begun to crawl back up to the 200-day moving average. This technical indicator is by no means foolproof but illustrates the evolution of the many factors contributing to market changes.

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Sometimes a temperature for US stocks can be taken by looking into US corporate bond markets. After all, bond-traders are often said to be smarter than stock-traders. Well, year-to-date performance in corporate bonds hasn't been pretty. On average, prices of high-quality and low-quality corporate bonds have respective losses of about 6% and 5% this year.

Of course, some of the losses in corporate bond markets are due to rising interest rates. For example, prices of intermediate US treasury bonds have recorded losses of about 2.25% this year. If the losses on treasury bonds were backed out of the corporate bond losses, investors would find that this year's performance in corporate bond markets is marginally worse than stocks. Although not so determinately worse that stock-markets should be in greater jeopardy.

In reality, stock market participants get to participate in the growth of companies whereas bond investors do not. Now that third-quarter earnings season has opened up, the stock market receives a confirming look into how companies are actually doing. In fact, most companies are beating analysts' expectations on revenues and earnings. That doesn't mean the peak earnings argument is discredited. After all, the latest cycle has been in existence for about ten years now. However, until the economy becomes so overly utilized (which hasn't been the case yet), there is no reason why stocks can't recover from here.

Market Movers

The month of October offered nowhere to hide from global selling trends. Most asset categories experienced losses brought on by sellers. Marginal gains were made on the price of gold and provided some protection for investors. However, October was a perfect example of how portfolio diversification can work so well for investors who benefit from less than perfect correlations among asset-classes. While major US stock market indices experienced losses around 10%, the Core Fundamental Allocation portfolio only experienced a fraction of that loss. Year-to-date, the Core Allocation portfolios continue to outpace their benchmark, the Morningstar's World Allocation category average. This year's total returns on the Core Allocation portfolios are marginally down and these portfolios have offered much lower risk compared to global stocks over this time period.

Asset Categories	*Monthly*	*YTD*
US STOCKS	-8.46%	-1.56%
FOREIGN STOCKS	-8.68%	-13.45%
US BONDS	-0.99%	-0.84%
FOREIGN BONDS	-1.23%	-4.13%
HARD ASSETS	-3.37%	-1.42%
HYBRIDS	-3.48%	-0.02%

*DATA USED IS SOURCED FROM MORNINGSTAR®. DATE ENDING OCTOBER 31, 2018.

US STOCKS nearly finished October in correction territory. Buyers stepped back in at the end-of-the month to lift the broad-averages out of the month's deepest troughs. Large-caps closed the month with an almost 7% loss. Small-caps fell nearly 10% in the same period. On-the-year, large-caps hang on to marginal gains while small-cap are now slightly negative.

FOREIGN STOCKS spilled into a correction during the year-to-date time period according to the technical definition of a correction (which is defined as losses in excess of 10%). Developed large-caps sunk over 8% last month whereas, emerging-markets took-off almost another 8% since the beginning of the year bringing total year-to-date losses to around 16%.

US BONDS experienced mild losses in October as the broad-category average fell slightly. The greatest losses were experienced in inflation-protected securities and US high-yield bonds, but these losses were marginal (especially relative to equities). Bank-loans, on-the-other-hand were flat and still hang on to year-to-date gains of around 3%. The diversified stance in the Core Allocation portfolios' bond allocation has offered powerful risk management through this time of heightened volatility.

FOREIGN BONDS fell marginally more in comparison to domestic bonds. Emerging market fixed income has been relatively weak compared to foreign developed country bonds. In October, emerging-market bonds had losses of around 1.5%, which now totals their year-to-date losses to almost 6%. Annual losses by foreign bonds have begun to decelerate which may be an early sign of a bottom. The Core Allocation portfolios an underweighted allocation in this market segment which has been positive for investors.

HARD ASSETS slipped minus just over 3% in October. Gold saw gains of roughly 1% last month but is still down over 9% this year. Energy's category-average fell almost 7% in October, but leads in the category-average with an almost 11% gain for the year. Energy's contribution has limited the year-to-date losses in the category.

HYBRIDS sunk to by over 3% last month, and was weighed down by an approximate 5% loss in preferred-stocks. Convertible-debt only dropped by around 2%. For the year, the hybrid category is basically flat. Being that the asset-classes in the category-average are linked to stocks, mild-losses in hybrids could act as a confirmation for an oversold US stock-market.

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