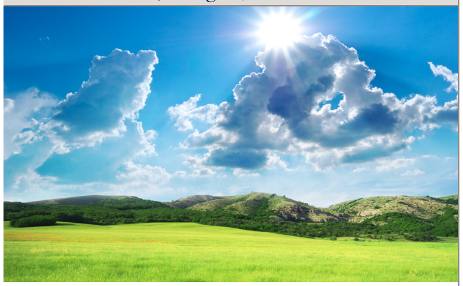
RAYMOND JAMES®

market update

MARCH | 2018

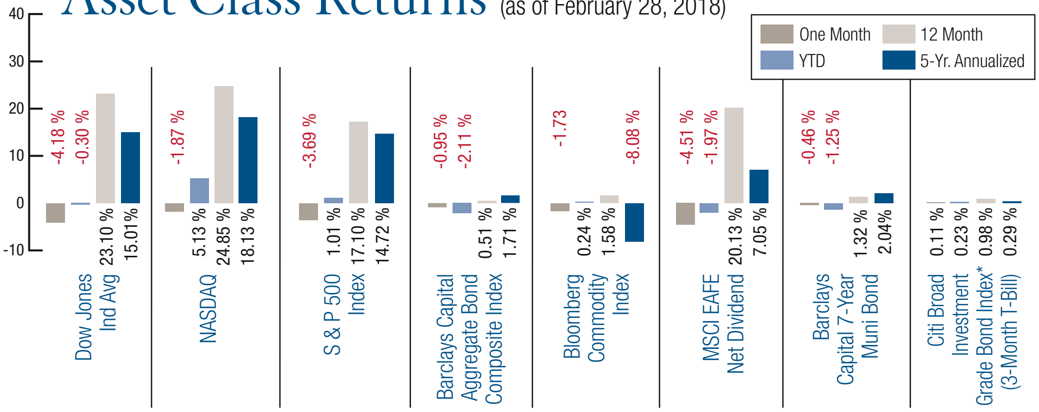
From the Office of:
Jeff Sgroi, CFP®



"Discipline is the bridge between goals and accomplishment."

-Jim Rohn

Asset Class Returns (as of February 28, 2018)



Market/Economic Synopsis

- Washington, D.C. imposed steel tariff raises concerns of looming global trade war
- Bitcoin, other cryptocurrencies, lose luster after parabolic surge through 2017
- VIX reaches multiyear high in February as concerns of higher interest rates and inflation roil equity markets
- Italian voters elect anti-establishment leaders, casting questions on the nation's future role within the European Union
- Information technology carries momentum from 2017 into 2018, leading major S&P 500 sectors through first two months of the year
- 10-Year U.S. Treasury yield rallies to multi-year high, reaching nearly 3.00%

What happened in February?

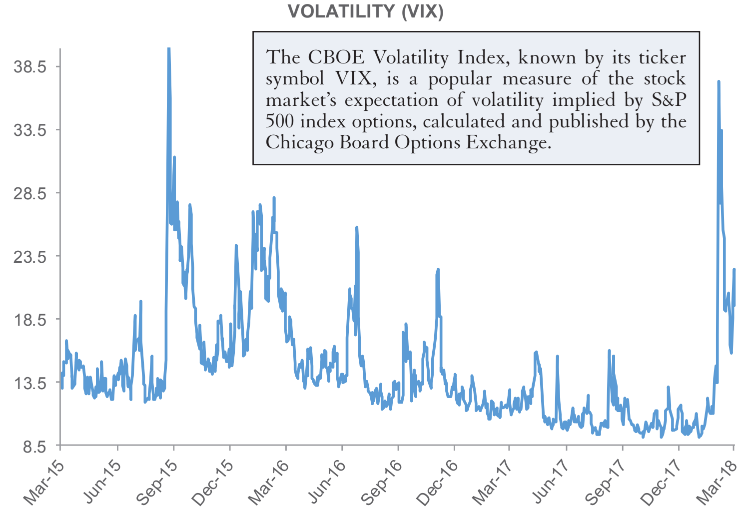
As much as we entered 2018 with a BANG (S&P 500 up 7.55% from 01/01/18 – 01/26/18), we started February with a whimper, with the Dow Jones Industrial Average suffering intraday losses in excess of 1,600 points and closing down 1,175 points on February 5th.

Similar deep losses in recent years have been fairly easy to explain – August 2015 dips were predicated on concerns about China's economy slowing. Dips in early 2016 were by and large based on falling oil prices. Reasons for the February 2018 sell-off are not quite as obvious, though we do have a few reasonable explanations.

1. February 2nd job report – A report showing an increase in wages was likely the primary catalyst to get the selloff started. With higher wages, so go higher inflation, a more hawkish Federal Reserve, and interest rates rising, therefore creating headwinds for the equity markets.
2. A hot equity market – Throughout 2017 and through January 2018, volatility was at a minimum and the risk trade was on. Because of such an extended run up, equity markets were undoubtedly due for a pullback. Eventually, there must be a reversion to the mean.
3. Trading of complex financial instruments – Trading the lack of volatility in the financial markets was lucrative throughout the stable equity environment in 2017. That came to a crashing halt in early February. The loss of value in these volatility-based investments likely cascaded into losses of more traditional, liquid asset classes (i.e. stocks).

As of this writing, equity markets have recouped much of February's losses. However, volatility remains high. The VIX remains elevated, maintaining levels well above those we have seen the past couple of years (see chart below). High VIX levels often present opportunities, though. We will remain on the lookout for them and adjust accordingly!

VOLATILITY (VIX)



Source: Morningstar

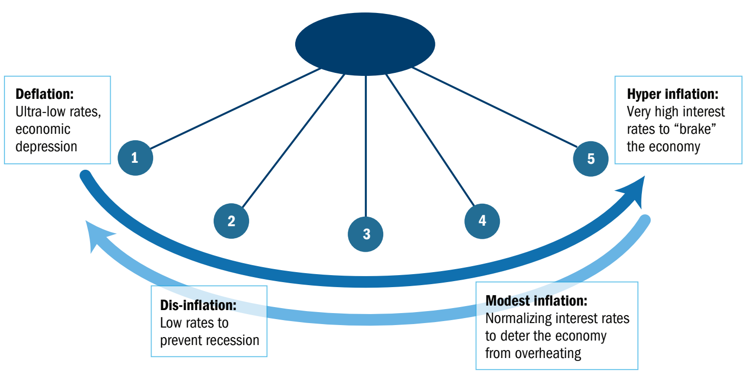
The Inflation Pendulum

Although I typically focus on our market outlook in this section, I believe a deeper focus on recent history, and what likely sparked the sell-off in the equity markets over the past month, is timely.

The Inflation Pendulum (continued)

As we often do, we are leaning on financial professionals from outside of Raymond James to provide additional perspective on current market conditions. Because inflation concerns were the most likely cause of hyperactivity in the equity markets last month, I found a white paper published by our friends at Columbia Threadneedle Investments particularly interesting. It is titled "The Inflation Pendulum", and authored by Colin Moore, Global Chief Investment Officer. Below are a few key talking points from Mr. Moore's piece.

- Earlier this year, U.S. consumer price inflation (CPI) moved above expectations. It heightened the possibility that the Federal Reserve may raise interest rates faster than anticipated if the upward trend in inflation continues.
- Given the importance of bond yields to equity valuation, equity investors are affected by changes in bond yields just as much as fixed-income investors.
- Too much or too little inflation is a bad thing, but trying to get a huge pendulum the size of the U.S. economy to settle in the middle is very difficult. There are just too many forces to assume the whole system can be stable. It inevitably moves through a pendulum's swing, requiring the Fed to adjust the level of interest rates.



Source: Columbia Threadneedle Investments

- How will the Fed and investors react moving forward? The Fed will likely increase interest rates. The debate will heat up on when and by how much the Fed will increase interest rates. Investors will demand a higher yield to compensate for inflation eroding the value of their capital. Uncertainty will increase. The relative attractiveness of bonds will increase as yields rise.

The white paper concludes with the notion that inflationary pressures will likely continue to rise in our current macroeconomic environment. How quickly they do so, and by how much are of key interest. Inflation could be problematic if we see the 10-year U.S. Treasury Note reach 4.0% sooner rather than later.

From the Officefront

Aubrey participated in a three-day "Branch Professional Possibilities" conference offered at our corporate home office in St. Petersburg, FL this past month.

To kick off the conference, RJFS President Scott Curtis addressed the group with opening remarks and an industry update. Sessions that followed covered a variety of topics, including a technology update that offered information on new and upcoming improvements to our client and back office systems. Our Asset Management Services (AMS) department provided tools and ideas on how to better support you, our clients, and demonstrated how to use available asset allocation and investment tools. David Patchen, Senior VP of the Education & Practice Management group, provided numerous tools and ideas to better work with our clients.

From the Homefront

If I may, I'd like to brag for just a moment. All three girls wrapped up their ski school programs this past weekend and, as a final event, competed in a short race with their "classmates". Pictured below is Stella at the starting gate, in fine form. She won her class's race and Dad could not be more excited. I just wonder how many more years I will be able to keep up with her on the slopes.

Hannah and Lily made enormous progress on the hill this year as well. In fact, Tracy and I were surprised to see them, along with their entire ski class, at the top of Buttermilk Mountain a few weeks ago. Although we learned it took them over an hour to complete the top to bottom run, it was nonetheless a solid accomplishment for a group of four-year old skiers.

If you prefer to receive this newsletter via email, please notify us at jeff.sgroi@raymondjames.com.