Please find attached two very timely investment pieces from Federated Investors. We think you'll enjoy these two brief articles.

- Linda Deussel, Federated's Senior Equity Strategist, is one of our favorite strategists. She travels the country every week, listening to what is on peoples' minds, and is a fantastic writer. We always say you don't want to follow the herd, so it's important to know what the majority of investors are thinking. In Linda's article, she gives examples of one-hit wonders, who successfully called a major stock market crash, but never got it right again; we've said that for years. Every week, Linda lists positives and negatives in the current economy.

- Phil Orlando, Federated's Chief Equity Market Strategist, has a knack for making market predictions without speaking over the layman's head with statistical jargon. Phil is sticking to his S&P 500 year-end target of 3,100, which if correct would be a 12% rise above last Friday's close of 2,767. Like Raymond James' Jeff Saut, and us, Phil believes we are in a long-term bull market, which has years left to run.

Last week's stock market rout hurt, but Linda and Phil do a great job calming jittery nerves, backing up their outlook with facts.

In the Raymond James article we sent on Oct 11, 2018, "Tumbling Time: Trade & Tightening," Jeff Saut said:

> "Our short-term model turned negative after the close a week ago on Tuesday (October 2) and we wrote about that, telling traders to abandon trading positions on a short-term basis. Coming into this week we noted that there was a negative energy blast due early week, which would likely be over by late week."

A few clients have asked whether we should have heeded Jeff's advice and reduced our equity holdings on October 2; that's a fair question. Our response was that we do not make short-term trades in our portfolios. While Jeff may have been right about this particular short-term market decline, our observation is his short-term calls are wrong as often as they are right. Our experience is that moving in and out of markets, for *anticipated* short-term moves, is a formula for losing money. We construct our portfolios for our long-term expectations, and make modest changes along the way as certain asset classes look expensive or inexpensive,

compared to their long-term valuations. We ride out the hiccups along the way, as we've never met anyone who is able to consistently forecast short-term market moves. We remain bullish on equities, as we (and Jeff Saut) believe we are in a secular (long-term) bull market, which has many years left to run.

Last week's stock market sell-off is healthy. It flushes out people who are invested in stocks, who don't belong in stocks, because they can't tolerate the swings. It reduces investor optimism, and reminds people stocks don't just go up. Once bullish sentiment becomes more bearish, as it did last week, the market can resume its grind higher. It's been said "the stock market climbs a wall of worry." This means the stock market tends to rise when people are scared it's going to fall, and vice versa.

As always, if you have any questions or concerns, please don't hesitate to contact us.

Michael & Erica

Michael J. Fisette, CFP®, MSF
President, Fisette Financial Services LLC
Raymond James Financial Services
P 425.507.9005 // F 425.369.4981
michael.fisette@raymondjames.com

Erica S. Fisette, CFP®
EVP, Fisette Financial Services LLC
Raymond James Financial Services
P 425.507.9006 // F 425.369.4981
erica.fisette@raymondjames.com

963 NE Discovery Drive
Issaquah, WA 98029
www.fisettefinancial.com

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Any opinions are those of Michael & Erica Fisette, and Linda Deussel and Phil Orlando, and not necessarily those of RJFS or Raymond James.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

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Weekly Update: If you're stressed about a correction, visit Wisconsin

10-12-2018

Off to friendly Wisconsin this week. We started in Madison with a client event where my comments about record optimism, jobs and confidence were received with polite silence, followed by their listing of big worries: the unwinding of the Fed's balance sheet, money-printing powering the market, tax cut just a sugar high. "Aren't you worried about a black swan?" Our advisor host asked if investors in other parts of the country also want to discuss politics, "because it's a hot button here." Yes, ad nauseam. We had an excellent conversation with an advisor in Milwaukee about behavioral finance and the fact that it is next to impossible to predict a black swan. Remember Elaine Garzarelli? (She made the bear call a week prior to the Oct. 12, 1987 "Black Monday" crash.) Meredith Whitney? (She warned of major bank problems just prior to the onset of the global financial crisis.) Both stumbled with subsequent dire predictions. We had dinner in beautiful "Lake Country." Wisconsin has more lakes than Minnesota, the self-described "Land of 10,000 Lakes" state, yet it promotes itself as a dairy state even though California's dairy industry is bigger. I asked the group if their clients are nervous. "There is blind optimism. Our clients tell us to 'let it run'," I was told. At least, that was as of Wednesday.

A lot of pundits have been blaming the sell-off on the Fed. What's new there? Chicago Fed President Charles Evans did say this week that the central bank plans a pause after reaching 3% on its target rate around mid-2019, but that's in line with market expectations. Some say it was Wednesday's higher PPI reading, but Thursday's CPI went the opposite way (*see below*). Others contend the trade war is catching up to the U.S., as suggested by recent guidance and preannouncements for the coming earnings season (*more below*). But didn't we just nail down more favorable agreements with Canada and Mexico and aren't President Trump and China President Xi Jinping set to meet next month on this very topic? Many, of course, blamed the spike in bond yields, but all that did was cause the yield curve to steepen. Weren't we worried about a flattening yield curve just a few weeks ago? And isn't a 10-year yield of 3.25%-3.50% historically consistent with 3%+ economic growth, a positive for earnings? The fact is, nothing new has happened fundamentally to change the path of the economy or the backdrop for U.S. financial markets. This suggests something of a more technical nature may be going on. Wednesday's selling had characteristics of a climactic flush—the percentage of stocks trading at a 20-day low spiked through 50%, NYSE breadth was 11 to 1 decliners vs. advancers, about half of S&P 500 constituents posted a 2 standard-deviation move, volume sharply expanded and the volatility curve (spot VIX vs. 3-month VIX) inverted. As of this writing, the market was flirting with its 200-day moving average of 2,765. This level was undercut in January and again in late March, but it proved to be temporary and reasonable support that eventually set the stage for summer's advance. A sustained period below the 200-day would be discomforting, but we're not there yet. Dudack Research suspects the potential closing of three substantial hedge funds may have contributed to the illiquidity, with individual stocks further pressured by buyback constraints due to the coming earnings reporting season.

All things considered, Strategas Research posits the market is within the ballpark of a tradeable low, particularly given the seasonal tailwind that begins to emerge by late October. Historically, 3% daily S&P declines in uptrends have proved to be buyable events over the last 75 years, with forward returns coming in above historical averages one, three and six months forward. The decline has pushed the forward P/E multiple on the S&P below 16 to a level that's acted as a reliable floor for equities since Brexit. In researching the past three post-recession rate-hiking cycles (1984-1988, 1995-1998, and 2004-2005), JP Morgan uncovered what it calls 16 "late-cycle potholes"—relatively short-lived but sharp pullbacks averaging from 5.36% to 13.06%. Before Friday's strong opening, the S&P was 7% below its September peak. Our meeting in Fond du Lac—the first of my three final stops in Wisconsin yesterday, the others being Green Bay and Brookfield—was so pleasant, you'd forget Wednesday's market rout. Rather, we had a lengthy discussion about beer and cheese curds. Incidentally, string cheese was invented just 20 minutes outside of the city. Never knew that it squeaks when you eat it warm off the line. I suggested the correction has more to do with normal pre-election corrections, technical factors and tariff-related earnings worries. An advisor disagreed, claiming there is too much money in exchange-traded funds (ETFs), and sales of such on Wednesday caused the market to fall hard in a "blink." (Fundstrat reports the combined inverse ETF+VIX volumes reached 6% of all NYSE trading on Thursday—think about that—6%!! This matched the February reading, arguably another sign of a bottom.) And then we continued our beer discussion.

Positives

- **Small businesses enthusiastic** A monthly survey of members by the National Federation of Independent Business said optimism slipped in September off August's record but continued to be very high—matching the second highest reading on record. Inventory, capital expenditure and hiring plans all moderated but remained robust.
- **Strong consumer sales up and down the income scale** A Redbook survey of chain stores said September sales rose 5.9% year-over-year (y/y), the most since at least 2005, with sales growth strengthening the final week of the month and jumping even more the first week of October. A separate International Council of Shopping Centers survey of chain stores reported similar trends, just not quite as robust. The weekly Bloomberg Consumer Comfort Index did fall by the most since May 2014, but held near a 17-year high, while the preliminary Michigan consumer sentiment take on October also dipped but remained solidly optimistic.
- **Do we or do we not have an inflation problem?** September's headline PPI rebounded after slipping in August, with the year-over-year (y/y) core rate rising to 2.5%. But outside of a big jump in transport services, prices were relatively benign. September's CPI posted its smallest increase in six months, in part because of a sharp drop in used-car prices, with the y/y headline rate increasing at its slowest pace since February and the y/y core rate holding steady at 2.2%. Ex-petroleum prices, import inflation moderated, with the y/y rate declining to 3.5%.

Negatives

- **Here's my vote for why we're correcting** Earnings optimism has been acting as a firewall protecting stocks, but warnings from PPG, Fastenal and others and concerns that tariffs may harm tech this week seemed to sour the mood on the eve of the third-quarter reporting season. The sample size is still too small to draw any firm conclusions, but JP Morgan notes consensus 2019 forward earnings-per-share of around $178 has been lending solid valuation support to the S&P.
- **The labor market is tight** A record-matching 38% of firms surveyed by the National Federation of Independent Business reported current job openings that they cannot fill, with more than half of all respondents saying they are encountering recruiting difficulties. A record 37% said they had to raise worker compensation to find and keep employees. Although its Employment Trends Index slipped in September for the first time in four months, the Conference Board expects continuing strong labor demand will push the jobless rate to 3.5% or lower in 2019.
- **Do we or do we not have an inflation problem?** Based on the Atlanta Fed's latest measure, inflation expectations among businesses rose to 2.3% y/y in October, matching April of this year as the highest for this series since it was initiated in 2011. In many ways, the Fed pays closer to attention to inflation expectations than it does inflation.

What else

Will there be a Fed 'put?' A 10% pullback might get the Fed's attention—another bad day like the last two could do it—but Evercore ISI believes it would take something closer to 15-20% falloff to potentially lead policymakers to change their rate-hike path.

Deficits in the context of a record large economy When the 12-month rolling federal deficit hit $900 billion in August, many said the U.S. was on the path to $1 trillion deficits for years to come. Then came September's surplus (not unusual for the month), lowering fiscal 2018's deficit to $782 billion. That's still large but represents an arguably manageable 3.9% of GDP, and an increase of just three-tenths of a point the past 12 months despite a tax cut of nearly seven-tenths of a point of GDP.

Wisconsinites are proud of this A USA Today article entitled "The Drunkest Cities in the U.S." said 10 of the top 20 were in Wisconsin, with the state accounting for the top 4! "Why," I asked the advisors there. "We don't do anything without drinking!" They credited their German background. Yes, I said, but we have Germantown in Pittsburgh, and we drink Yuengling. "Yuengling? Come on!" was their reply.

Connect with Linda on LinkedIn

Linda Duessel, CFA, CPA, CFP
Senior Equity Strategist

Also by Linda Duessel

Weekly Update: 'I'm going to Pittsburgh for fun'

Weekly Update: Rarely do politics matter for the markets

Weekly Update: They were talking DEE-fence in Chicago and it wasn't about Da Bears

Recent Equity

Orlando's Outlook: Risk of 'Blue Wave' rolls markets, creates buying opportunity
Philip Orlando

Orlando's Outlook: Florence distorts solid jobs report
Philip Orlando

Orlando's Outlook: 'Particularly bright moment'
Philip Orlando

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Consumer Price Index (CPI): A measure of inflation at the retail level.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

Price-earnings multiples (P/E) reflect the ratio of stock prices to per-share common earnings. The lower the number, the lower the price of stocks relative to earnings.

Producer Price Index (PPI): A measure of inflation at the wholesale level.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

Standard deviation is the measurement of the spread or variability of a probability distribution; the square root of variance. It is a simple, symmetrical distribution where 66% of all outcomes fall within +/-1 standard deviation of the mean, 95% of all outcomes fall within +/-2 standard deviations, and 99% of all outcomes fall within 2.5 standard deviations. Standard deviation is widely used as a measure of risk for the portfolio investments.

The Bloomberg Consumer Comfort Index is based on weekly telephone survey of consumers seeking their views on the economy, personal finances and buying climate.

The Conference Board's monthly Employment Trends Index measures eight indicators that reflect labor market trends in the economy.

The University of Michigan Consumer Sentiment Index is a measure of consumer confidence based on a monthly telephone survey by the University of Michigan that gathers information on consumer expectations regarding the overall economy.

VIX: The ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

Federated Equity Management Company of Pennsylvania

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Federated®
Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3779
Telephone: 412-288-1900

Orlando's Outlook: Risk of 'Blue Wave' roils markets, creates buying opportunity

10-12-2018

Bottom Line *The upcoming midterm election may be the most controversial in recent memory, with both Democrats and Republicans highly energized. Voter turnout should be much higher than normal, and the fear for investors is that a potential "Blue Wave" could have significant fiscal policy implications.*

We're now enjoying the fastest GDP growth in four years, the strongest corporate earnings growth in seven years, business and consumer confidence metrics that are surging to multi-decade cycle highs, unemployment at a half-century low, wages growing at their fastest pace in a decade and retail sales running at their strongest pace in seven years. Consequently, the S&P 500 hit a new record high on Sept. 21, up 40% from the presidential election in November 2016.

But the risk for investors is that a shift in Congress to Democratic control could reverse some of President Trump's fiscal policies, such as the tax cuts, deregulation, repatriation and the immediate expensing of capital spending. This likely would result in both slower economic growth and declining share prices. That potential risk, in our view, has contributed to this recent air pocket in stocks.

The S&P corrected nearly 8% over the past three weeks, while the small-cap Russell 2000 plummeted 11% since Aug. 31, both to deeply oversold levels. Benchmark 10-year Treasury yields soared from 2.80% in late August and from 3.05% last week to our full-year target of an oversold 3.25% on Oct. 5—a 7-year high—before backing off in recent days to 3.15%. The volatility index (VIX) nearly tripled in a week to an overbought 29 on Thursday. As a result, we added 2% to our equity overweight last night (raising our equity overweight to 70% of maximum and our overall equity weight in our stock-bond model to 61%, or 95% of maximum) to take advantage of what we believe is a very compelling buying opportunity.

So against the backdrop of a circus-like atmosphere in Washington these past two years, which neither side of the political aisle appears to like, what will ultimately motivate voters next month? An end to the polarized nonsense in Washington, or a desire to continue the strong run of economic and financial-market success we've enjoyed since November 2016? While we believe that the majority of voters will edge toward favoring their pocketbooks, we'll know for sure in less than a month...maybe.

Shift in voter demographics Since the presidential election in November 2016, there has been a marked shift in registered voter demographics. According to Gallup, registered Republicans have slipped from 27% of the voting public in November 2016 to 26% in September 2018; Democrats have declined from 31% to 27%; and Independent voters have surged from 36% to 44%. Why the sharp increase? In our view, the average American is disgusted with the polarization on regular display between the far-right Tea party and the far-left Herbal Tea party. They're looking for a sensible refuge somewhere in the middle of the political spectrum, where legislation is marked by intelligent discussion and compromise, and decisions are guided by equal parts fiscal prudence and social responsibility.

Will pocketbook issues matter more to this independent plurality of voters?

GDP growth of 4.2% in the second quarter of 2018 is the fastest in four years, due to Trump's structural and sustainable fiscal policy reforms. Over the past five quarters that Trump has been president, GDP has averaged 2.9% versus 1.5% over the previous seven quarters under President Obama. We're expecting 3.4% growth in the upcoming third quarter (to be reported on Oct. 26), and we're projecting full-year, trend line growth of 3% in each of 2018 and 2019.

S&P corporate earnings growth is up 25% in this year's first half, and has experienced double-digit growth for five consecutive quarters for the first time in seven years. We expect the third-quarter earnings season, which starts today, to be up another 20%. Contrast that with the end of 2014, all of 2015 and the first half of 2016, when we were mired in an earnings recession that lasted for seven consecutive quarters.

Business and consumer confidence is at a multi-decade cycle high:

- **Conference Board's Consumer Confidence Index** soared to a new 18-year cycle high of 138.4 in September, as post-election confidence has surged from a cycle trough of 100.8 in October 2016.
- **ISM manufacturing index** surged to a new 14-year high of 61.3 in August, up sharply from a contraction reading of 49.4 in August 2016.
- **ISM nonmanufacturing index** increased to a new 21-year high of 61.6 in September.
- **Leading Economic Indicators (LEI) index has** increased sequentially for 24 consecutive months to August's 111.2, an all-time, 58-year cycle high.
- **National Federation of Independent Business (NFIB) small-business optimism index** rose to 108.8 in August, an all-time, 44-year high.

Contrast that with five regional Federal Reserve indices that were in negative territory in the summer and fall of 2016, suggesting that the economy was decelerating toward recession just prior to the presidential election. Note also that these metrics turned on a dime after the election and have since gone vertical over the past two years:

- **Dallas:** Cycle trough of -4.8 in August 2016, rising to a 12-year high of 37.2 in February.
- **Empire:** Cycle trough of -5.5 in October 2016, rising to a 17-year high of 30.2 in October 2017.
- **Kansas City:** Cycle trough of -5 in July 2016, rising to a 17-year high of 29 in May.
- **Philadelphia:** Cycle trough of -2.9 in July 2016, rising to a 34-year high of 43.3 in February 2017.
- **Richmond:** Cycle trough of -11 in August 2016, rising to a 24-year high of 30 in November 2017.

Unemployment at a new 49-year low, as measured by the unemployment rate (U-3), which fell to 3.7% in September 2018. Also, the initial weekly unemployment claims (an important leading economic indicator) for the survey week ended Sept. 15 fell to 202,000, a 49-year low.

Wages grew 2.9% in August, their fastest pace in a decade, and are on their way to an estimated 3.5% to 4% growth over the next two years.

The Job Openings and Labor Turnover Survey (JOLTS) posted a record 6.939 million job openings in July. Again, there are more available jobs than unemployed Americans who could fill them.

Retail sales are running at their strongest pace in seven years, with Back-to-School (BTS) sales in July and August rising 6.7% on a year-over-year (y/y) basis. That augurs well for Christmas sales, which tend to be highly correlated to BTS strength. Moreover, because the consumer accounts for 70% of GDP, this strong consumer spending will help to boost economic growth in the third and fourth quarters.

The S&P hit a record high on Sept. 21, up 40% from the presidential election in November 2016. We remain confident the S&P will hit our year-end target of 3,100 because of these strong underlying fundamentals. That implies a powerful double-digit rally from yesterday's deeply oversold trough at 2,710. We are using the equity market's current air pocket, for which we have been patiently waiting these past few months, as an opportunity to add to both large- and small-cap domestic growth stocks. We remain overweight value.

Connect with Phil on LinkedIn

Philip Orlando, CFA
Chief Equity Market Strategist, Head of Client Portfolio Management

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Also by Philip Orlando

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Recent Equity

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Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

Russell 2000® Index: Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. Investments cannot be made directly in an index.

Small-company stocks may be less liquid and subject to greater price volatility than large-capitalization stocks.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The Conference Board's Composite Index of Leading Economic Indicators is used to predict the direction of the economy's movements in the months to come.

The Consumer Confidence Index is based on a survey by the Conference Board that measures how optimistic or pessimistic consumers are with respect to the economy in the near future.

The Institute of Supply Management (ISM) manufacturing index is a composite, forward-looking derived from a monthly survey of U.S. businesses.

The Institute of Supply Management (ISM) nonmanufacturing business activity index is a gauge of production activity derived from a monthly survey of U.S. businesses.

The Empire State Manufacturing Index gauges the level of activity and expectations for the future among manufacturers in New York.

The Federal Reserve Bank of Dallas' monthly Texas Manufacturing Outlook Survey is a measure of the current level of activity and expectations for the future.

The Federal Reserve Bank of Kansas City surveys manufacturers in its district monthly to gauge the level of their activity.

The Federal Reserve Bank of Richmond surveys manufacturing and services businesses monthly to gauge their level of activity and expectations for the future.

The Federal Reserve Bank of Philadelphia gauges the level of activity and expectations for the future among manufacturers in the Greater Philadelphia region every month.

The National Federation of Independent Business (NFIB) conducts surveys monthly to gauge how small businesses feel

about the economy, their situation and their plans.

VIX: The ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

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Federated®
Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3779
Telephone: 412-288-1900

Tumbling Time: Trade & Tightening

October 11, 2018

On Wednesday, there was a significant selloff in U.S. stocks, with the S&P 500 falling 3.29% and the Dow Jones Industrial Average down more than 830 points. Members of the Raymond James Investment Strategy Committee provide their thoughts on Wednesday's market activity below:

Scott Brown, Ph.D., Chief Economist, Equity Research

A strong economy, increased government borrowing, tighter monetary policy, and the Fed's unwinding of its balance sheet each put upward pressure on inflation. Inflation has picked up this year, but is expected to remain moderate – unlikely to force bond yields higher. Long-term interest rates have remained low outside of the U.S., which has helped to restrain our 10-year Treasury note yield. Yet, market volatility often follows periods of complacency. Until recently, bond market volatility has been very low, which usually leads to significant adjustment even if there is no change in the underlying fundamentals – that may be what's happening now.

The near-term prospects for the economy remain strong, but there are concerns about the November election, trade policy disruptions, tighter Fed policy, a stronger dollar, risks to global growth, and labor market constraints. All else being equal, higher long-term interest rates are not good for the stock market, unless earnings growth is strong enough to offset that. In the short term, a weak stock market normally pushes bond yields lower. Expect increased volatility and see-sawing markets in the near term.

Ed Mills, Washington Policy Analyst, Equity Research

I have spent the last couple of weeks speaking with U.S. and China trade experts and they universally think things are getting worse. A key issue that has not received any attention in the U.S. is how domestic political pressure in China is making it really hard for Xi to cut a deal. They do not want new foreign competition. I am also hearing that China is placing too much hope on a Democratic victory in November, thinking it weakens Trump. Even if Democrats win, it does not change things. I think the concern that we are in for a bumpier and longer ride than expected is contributing to the uncertainty. (Read more)

Nick Goetze, Managing Director, Fixed Income Services

The fixed income markets, which have been showing some softness on the long end, firmed up today as the equity market looks to be going through a legitimate pullback. While much of the focus is on the equity markets, do not ignore the fact that we are seeing higher yields in bonds than we have seen in some time. 4.0-4.5% in solid taxable names inside ten years is very attainable. The muni market has also fallen off where you can now get 4% bonds at par and great kicker structure yields with over 3% to call and yields exceeding 4% to maturity. On a tax equivalent basis, these are very attractive returns.

Jeffrey Saut, Chief Investment Strategist, Equity Research

Our short-term model turned negative after the close a week ago on Tuesday (October 2) and we wrote about that, telling traders to abandon trading positions on a short-term basis. Coming into this week we noted that there was a negative energy blast due early week, which would likely be over by late week.

Well, it is now "late week" and the Relative Strength Index (RSI) is about as washed out as it was during the February 9, 2018 "undercut low" that we recommended buying. Likewise, the S&P 500 is about one standard deviation below its 50-day moving average, and the various stochastic indicators are also washed out. So, unless this is a crash (we doubt it), you should get your buy lists ready. (Read more)

Nicholas Lacy, CFA, Chief Portfolio Strategist, Asset Management Services

• It's too early to tell if the recent selloff in the U.S. will be followed by a larger global selloff in equities.

• While all equities tended to decline today as well as this week, other investments also experienced a risk off decline (such as oil, which was off 3% today).

• Some areas of the market offered investors places to help mitigate the selloff either from a correlation perspective (going up when stocks go down a lot) or from offering a

lower downside relative to the markets.

• As we have been saying for some time, when there is a significant decline in the stock market, the bond market tends to rally. This is especially true for U.S. high quality bonds (such as U.S. Treasuries), which rallied at the end of the day. In fact, the longer maturity Treasury market had a positive total return today as it is supposed to during these markets.

• Not all bonds act as equity risk tools like Treasuries. For example, high yield bonds declined today similar to stocks. The lower the quality, the worse the performance has been during selloffs.

• Other equities declined less today. Those areas that generate dividend income and those areas with lower volatility relative to the market held up much better as one might expect.

• On the flip side, the technology and high growth areas of the market that have driven much of the return this year felt the largest declines as stress from a variety of places put downward pressure on their prices.

• While international markets did decline, they held up better than the U.S., but most were already closed by the time the U.S. market experienced its largest declines.

• We have been advocating improving the quality of investors' portfolio allocations, including moving up the market cap, improving quality in fixed income, and adding exposure to low volatility U.S. stocks. There is no way to know when the markets will go up or down, but there are some themes that are worth following. It makes sense to allocate to areas of the market with favorable fundamentals, and one must be careful owning too much low credit when the yield advantage is very low.

Michael Gibbs, Managing Director of Equity Portfolio & Technical Strategy, and Joey Madere, CFA, Senior Portfolio Strategist, Equity Portfolio & Technical Strategy

After spending all of Q3'18 with zero daily moves of 1% or more (as a reminder: 29% of days in the first half of the year had a 1% move in either direction), volatility returned in the past week. The low volatility in Q3 suggests investors were too sanguine given potential issues (trade being the main issue). The surprise move in interest rates and the Fed Chair's comments woke investors up. Now the complacency is quickly shifting to fear, and a much needed "wall of worry" is being rebuilt. Today's pull back of -3.29% on the S&P 500 was the worst day in the market since February 8th, and the first 1% daily move since June 25th. The technology sector has felt the brunt of the decline to begin Q4, with the tech-heavy Nasdaq Composite down -7.8% since the end of September.

The move over the past five days has been very sharp. For example, the five day price change of the S&P 500 is -4.78% (two standard deviation move). Similarly, the S&P 500 has pulled -3.74% below its 10 day moving average, which is also a two standard deviation move. Moreover, 91% of volume on the NYSE and 90% of volume on the Nasdaq today was to the downside. These moves are typically consistent with the market approaching oversold conditions in the short term. The CBOE Put/Call Ratio[1] and Volatility Index (VIX) have also approached oversold levels.

The S&P 500 closed on its lows today, undercutting numerous support levels throughout the day (which is often the case when the market cascades down). We look for an area near the 200 day moving average (2765) to act as support, which the S&P 500 has been able to hold near during the pullbacks earlier this year. On a valuation basis, the S&P 500 now trades at 16.0x next 12 month earnings, which is in line with this year's lows and below the five year average of 16.45x.

Economic and earnings growth support our buy the pullback theme. We think the new worries regarding interest rates are "noise" given our belief that U.S. yields are not set to run to the upside (due to modest inflation and wage growth, low global yields, U.S. economy growing above trend and likely to moderate in the coming years). Earnings season begins on Friday "unofficially" with the banks. S&P 500 Q3'18 estimate revisions have been solid heading into the quarter, and currently reflect very strong sales and earnings growth of 8.1% and 20.6%, respectively. Should earnings growth reach expectations, current negative investor sentiment will likely improve.

From here, stocks are unlikely to race back to new highs in short order. Likewise, they are unlikely to plummet to levels too far beyond the 200 DMA. Range-bound trading may develop over the coming weeks as investors balance strong economic and earnings growth with rising interest rates and the trade battle with China. Nevertheless, strong economic conditions and earnings growth outweigh other issues for now, and reinforce our buy the pull-back mentality.

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[1]Chicago Board of Exchange, the Put/Call Ratio is an indicator that shows put volume relative to call volume

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Andrew Adams, CFA, CMT, Senior Research Associate, Equity Research

No way around it – yesterday was not a good day. The S&P 500 had not closed down 1% in over 70 sessions coming into Wednesday, and, as is increasingly the case these days, the market made up for that lack of volatility by giving up much of its gains over the last few months in one session. The S&P 500 is now back to where it was in early July and has now fallen a bit over 5% from its all-time high set last month. While it's happened very quickly, that's still very much in the realm of a normal market dip, so it's still too early to panic or overreact. We wrote in Wednesday morning's commentary that we would start to get a little more concerned about the near term if the S&P 500 took out support at Monday's low, but, while we thought breaking that support might lead to a further 2-3% decline in the near term, we did not expect it to happen in one day.

The bad news is that we did not really see a bounce into the close, which increases the chances that we see continued selling today (Thursday). The good news, though, is that the market is already hitting washed out levels that have historically marked bottoms. Yesterday's move took the S&P 500 almost three standard deviations beneath its 50-day moving average, a level of "extendedness" that's not really supposed to happen. Fewer than 20% of stocks on the NYSE are currently above the 50-day moving average as well. There have only been four other times over the last five years when that has happened and at least a near-term bottom has occurred each time shortly after such poor breadth levels are hit. The volatility curve inverted yesterday too, which has also been a pretty good indication that selling is hitting extremes the past few years. And while yesterday was not a 90% downside day on the exchanges, selling was still close to that extreme (see below), and we did see signs toward the end of the day of indiscriminate selling that often comes near turning points.

Now, we look for signs of buyers coming in to support this market. If we do see continued selling today, the first area I'll be watching is the S&P 500's 200-day moving average at 2765. The 200-DMA has not been touched since May, and it's a sign of just how good the market has been that we can get a bad day like yesterday and still have the S&P trading above its 200-day moving average. If that were to fall, next I'll be looking for 2740-2750 to provide some support and then 2700. Ideally, if selling does continue today, support will be found at one of these areas and that will lead to a bounce that can restore some confidence.

Pavel Molchanov, Senior Vice President, Energy Analyst, Equity Research

Energy stocks followed the broader market down yesterday - despite the fact that the commodity landscape remains very healthy. Spot oil prices for both WTI and (especially) Brent are near their highest levels since mid-2014. While 2018 has been a good year for energy on the whole, it is certainly true that the stocks have lagged behind the commodity. What explains this divergence? The short answer is that the futures curve has been, and remains, highly backwardated (i.e., downward-sloping). Simply put, the commodity market is indicating that oil prices will be heading lower from here on. We disagree. Notwithstanding normal short-term volatility, we believe that prices will be generally higher in 2019, with a likely cyclical peak in 2020 due to the IMO 2020 sulfur regulations. Thus, we would take advantage of any equity dislocation to buy quality oil-levered equities.

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The NYSE Composite Index is an unmanaged index of all stocks traded on the New York Stock Exchange. VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. The VIX is a widely used measure of market risk. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors. Commodities' investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising. The Relative Strength Index - RSI is a momentum indicator that measures the magnitude of recent price changes to analyze overbought or oversold conditions. It is primarily used to attempt to identify overbought or oversold conditions in the trading of an asset. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities.
IMO- International Maritime Organization (IMO) is an agency of the United Nations which has been formed to promote maritime safety.
The 200-day moving average is a popular technical indicator which investors use to analyze price trends. It is simply a security's average closing price over the last 200 days. The 50-day moving average is one of the most commonly used indicators in stock trading.

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880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // TOLL-FREE: 800.248.8863 // RAYMONDJAMES.COM

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