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April 2018 Financial Market Update

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A Tale of Two Cities

The first quarter of 2018 can be placed into two distinctive camps. Market action in January was a continuation of 2017's upward trajectory, with investors pricing in sharp upward revisions to 2018 profit estimates primarily due to the recently enacted corporate tax reform. The tide shifted in February and March, however, with volatility replacing relative tranquility.

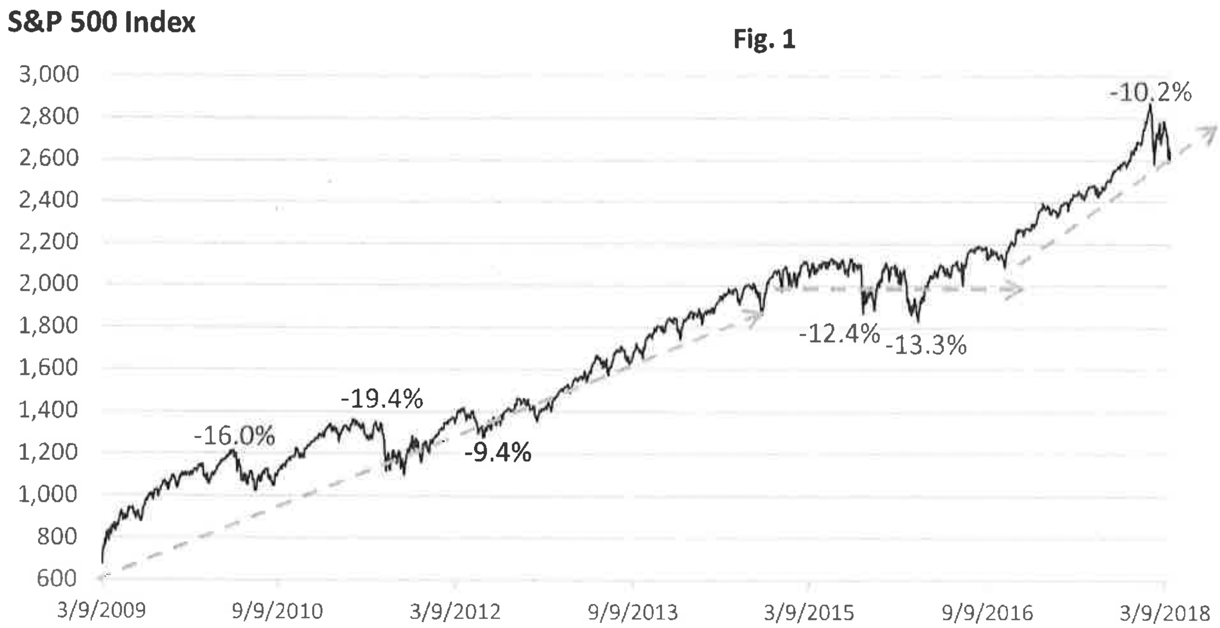
Did you know the S&P 500 Index snapped its longest streak ever without back-to-back daily declines of ½% or more at the end of January? That's right – 310 trading days without two consecutive days of a pullback of at least ½%. The length was nearly double the prior streak.

The lack of volatility, which can create complacency, was nearly unprecedented. While volatility can often lead to uneasiness, it must not dictate an investment strategy. When we develop a plan for a client, we ultimately focus on their goals, the return necessary to achieve their desired outcomes, and then construct a portfolio (and financial plan) to provide the highest probability of meeting these goals at the most prudent risk level.

Stock Indices*	March Return*		2018 YTD Return %
S&P 500 (large)	-2.54%		-0.76%
S&P 400 (midsize)	-0.93%		-0.77%
Russell 2000 (small)	1.29%		-0.09%
MSCI EAFE (intl.)	-1.80%		-1.53%
Bond Yields	**March 29 Yield & Qtr. Change**		**Dec. 29, 2017 Yield**
3-month T-bill	1.73%	+0.34%	1.39%
2-year Treasury	2.27%	+0.38%	1.89%
10-year Treasury	2.74%	+0.34%	2.40%
30-year Treasury	2.97%	+0.23%	2.74%
Commodities	**Mar 29 Price & Qtr. Change**		**Year end 2017**
Oil per barrel	$64.94	+$4.52	$60.42
Gold per ounce	$1,323.85	+$27.35	$1,296.50

** Stock indices include reinvested dividends*

Figure 1 highlights the path of the broad-based S&P 500 Index since the bull market began in 2009. It has been a profitable upward trend for a diversified investor, but one that has included five market corrections of at least 10%. The most recent 10% pullback from the record-closing peak on January 26 took just **nine trading days**, the shortest such correction on record.



The initial selloff was sparked by a rise in the yield on the 10-year Treasury bond. The drop was exacerbated by investment products tied to market volatility. Without getting into all the minutia, too many speculators piled into a trade that bet low market volatility would continue. They were wrong.

When stocks swooned in early February, the unwinding of the "volatility trade" aggravated what likely would have been a very modest decline. That trade eventually unwound, but investors were exposed to another round of instability when President Trump surprised investors by announcing steep tariffs on steel and aluminum imports – tariffs designed to pry open foreign markets to U.S. goods.

Protectionism has always been a risk that could create instability. While new barriers to imports had been placed on the backburner by the Trump administration in 2017, things changed this year. Among the reasons for worry with such policies is that tariffs raise U.S. manufacturing costs, hinder new projects, and may encourage some firms to move production offshore. Newly erected barriers can also spark a tit-for-tat trade war as other countries retaliate against U.S. exports, slowing economic and profit growth both domestically and worldwide. It is a scenario that creates heightened uncertainty and added to volatility.

The Ebb and Flow of Risk

Stocks have a long-term upward bias that is periodically interrupted by various issues.

Over the past several years, investors have fretted about Greece, the expanding debt crisis in Europe, and the loss of the USA's triple-A credit rating by Standard & Poor's. During late 2015 and early 2016, a slowdown in China's growth, an unexpected devaluation of China's currency, and the collapse in oil prices threw investors an additional short-term curveball.

Volatility re-entered the investment landscape in February after an unusually quiet period in 2017. Table 1 highlights the daily percentage changes in the S&P 500 Index over various periods. In the 13 months that ended in January, the daily percentage change in the S&P 500 (up or down) was just 0.31%. That compares to a daily percentage change of 0.55% over the last five years. Note the much larger average move in February and March. For comparison purposes, we have also included 2011, when stocks last experienced an extended period of volatility.

Table 1: Tuning into Normal

	S&P 500 Average +/- Daily Change
13 months ended Jan 31, 2018	0.31%
5 years ended Mar 29, 2018	0.55%
February - March 2018	1.11%
12 months ended Dec 30, 2011	1.05%

Note: These are average daily percentage changes regardless of an up or down move

Expect Volatility and Accept It

Volatility can be unnerving, but it is not unusual. Given this, the important fact is that economic fundamentals remain solid, including economic and profit growth, still-low interest rates, and recent announcements of large stock buybacks by many firms. Equally important, valuations are reasonable with the S&P 500 now trading at under 17 times expected earnings for 2018 which should help put a fundamental floor under the stock market.

As a note by LPL Research recently pointed out, "Corrections (10% or greater declines) are never fun, but they also aren't new territory for investors. Prior to the most recent period, we have experienced 36 corrections since 1980, and the S&P 500 fell by an average of 15.6% from peak to trough during these periods. Twelve months later, the index made up much of the lost ground, rising an average of 16.0% from the low, and after 24 months, the S&P 500 had climbed by an average of 28.0%, reinforcing the need for long-term investors to maintain their diversified strategies."

Stock market corrections are inevitable. The important point is to understand that they occur and develop a financial plan that takes this into account. By utilizing this approach, it will greatly increase the probability that you will meet your financial goals.

Final Thoughts

As amazing as it is for all of us, we will be celebrating our **15 year anniversary** this year. We are now in the process of organizing a party to celebrate this momentous occasion. It will likely be in **September** and we would like for all of you to attend. We will keep you posted as things progress.

Finally, it is that time of year when we are required to send our Privacy Policies and Procedures (enclosed if you are an Investment Management or Financial Planning client). In addition, if you would like a copy of our annual ADV 2 Brochure (which we file annually with the SEC) which gives more detailed information about our services, please let us know.

Thank you for all your support through the years. We will keep striving to make a meaningful difference in your lives; you have done so for us.

Hopwood Financial Services, Inc.