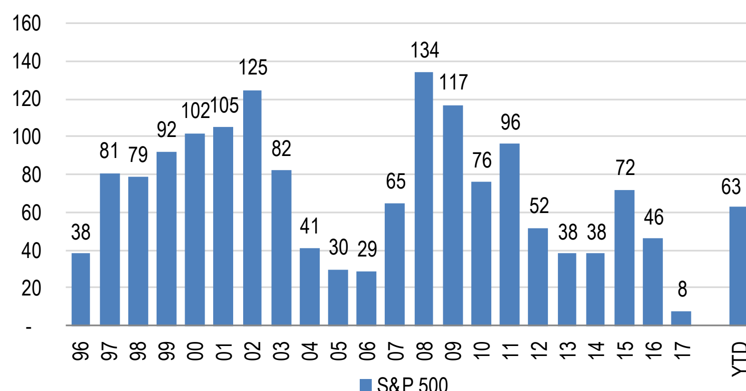
Weekly Capital Market Comments

Friday, December 28, 2018

NORTHEAST
PRIVATE CLIENT GROUP

U.S. equity markets continued to exhibit a significant amount volatility this week, posting almost 20% of cumulative intraday moves (from low to highs), including a 5.2% rebound the day following Christmas. Volatility should not be a surprise this late into a cycle, especially following such massive fiscal stimulus ushered in with the Trump Tax Cut and Job Act, alongside relatively loose global monetary policy. But the voracity of recent moves has surprised even us. To put the recent volatility into perspective, we compiled some data which illustrates the number of trading days the S&P500 has traded up or down 1% (100bps) over the last several years. What we found interesting is that the last time the S&P exhibited the current level of volatility (above 60 trading days), was in 2015. This was a period that included, and was followed shortly thereafter by significant Chinese equity-market disruption (ultimately resulting in the devaluing of the yuan), a rapid decline in oil, a Greek default, a noteworthy taper of quantitative easing here in the U.S., and the passing of the BREXIT referendum. Does any of this sound familiar? All we need to do is replace Greece with Italy, and past is prologue.



Source:Yahoo Finance, Bloomberg, NEPCG

While a fair amount of uncertainty exists in global markets, we believe there to be a significant dislocation between market fundamentals here in the U.S. and current market valuations. According to Yardeni Research, the current 2019 consensus earnings per share estimate for the S&P500 is $174, which pegs the S&P500 forward P/E at roughly 14.3x. This compares to the average dating back to ’07 of a little less than 16x and over 17x dating back to ‘97. This also implies that the S&P500 is trading almost one standard-deviation tight of ’97 levels, implying almost a 6x decline in the last 12 months. Although we concur that the US economy is decelerating, it is not in outright decline, which is an important distinction that many investors forget. Further, we could rationalize the recent downside retracements in equity markets if global monetary tightening was occurring, however we simply do not see any material upward move in inflation or rates; in fact to the contrary, we see the opposite. So while we remain cautious regarding equities, we believe value is emerging in certain sectors and segments of the market. For equity investors, we continue to believe in value over growth and for bond investors, we opt for duration over credit. (Chris Pike, CFA 12/28/18)

Source: Yardini Research and NEPCG

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