Market Review
November 13, 2018

Market Outlook

The pullback in October has reset investor expectations on future growth, dampened market euphoria and improved equity valuations. Utilities and Consumer Staples stocks have led the recovery from the late October bottom so far, suggesting a more defensive repositioning within equities.

With the U.S. midterm elections now behind us and the outcome consistent with expectations, the two major uncertainties facing markets are: (1) the pace of U.S. federal funds rate increases and (2) the trade war between U.S. and China.

At its most recent meeting, the U.S. Central Bank reiterated its plan for further gradual tightening. The goals of central banks include currency stability, low inflation and full employment. With core PCE inflation on target at 2.0% and U.S. unemployment at a 49-year low of 3.7%, there is no reason to believe the U.S. Fed will deviate from its stated plan.

While financial markets are obsessed with higher interest rates, the consumer and business community appear to be less so. U.S. consumer sentiment and confidence as well as small business sentiment remain at near historically high levels. Manufacturing and services surveys continue to affirm robust expanding activity.

Third quarter earnings season for the S&P 500 companies is nearly complete, with earnings per share (EPS) up over 25% year-over-year. Excluding the beneficial impact of lower corporate taxes, underlying EPS growth is estimated to be 17%. For the year, EPS is expected to be up 23%, and then moderating to 9% in 2019.

Key cycle indicators do not suggest a pending recession. Nonetheless, cautionary management commentary regarding the impact of elevated input costs, a stronger U.S. dollar, tariffs and softness in certain end markets/geographies on future profit growth is concerning. The extent to which these factors negatively impact ongoing corporate profit growth will be closely monitored.

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