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INSIDE THIS ISSUE

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Perspectives

Stocks had a blow-out January with a gain of 5.62% for the S&P 500, but the large-cap index finished the quarter down 1.17% due to declines in February and March of 3.89% and 2.64% respectively. The catalyst to which many traders assigned blame was a single reading within the January employment report released on February 2. Average hourly earnings increased 0.3% versus the consensus estimate of 0.2%. The difference seems too small to make a difference, but the market needed perfection in all reports related to potential inflation due to the excessively long run without a technical correction or even a 5% dip. The logic among those who panicked was that if wages increase too fast, the costs will be passed along to consumers in higher goods and services prices and inflation will get out of hand before the Fed can raise rates fast enough. To avoid hyperinflation, the Fed might need to raise rates faster than previously forecast.

Selling led to more selling as previous levels of key technical support began to break. These technical breaks triggered computer algorithms that sold faster than any human could, and stock prices fluctuated more in each hour than they did in most days throughout 2017. Once the index reached a full 10% correction, which happened to coincide with 200-day moving average, the algorithms' selling stopped and human traders returned from hiding to buy relatively inexpensive stocks that had been sold in sympathy with the broader markets. The original thesis that drove stocks higher was still in place. Deregulation, tax cuts, and infrastructure spending were all lined up to push corporate earnings higher, even if the longer-term outlook might be more tenuous due to the downside risks of the first two stimulus.

Stocks resumed their climb higher, but the rally fell apart again when the president started tariff talks. Major Dow Jones and S&P 500 components, such as Boeing (BA), sold off sharply based on fears their international business revenues would have massive headwinds. Soon after the scare of a tariff war began, leaks emerged that pointed to the bluster to be more of a negotiating tactic than an actual plan of action. Stocks recovered some on the rumors, but then individual stocks that had been market favorites began to falter. Facebook's (FB) Cambridge Analytica scandal helped to pull the stock down more than 15%. Amazon (AMZN) lost almost 15% when the president began sending daily tweets about what he thought the company was doing wrong. Tesla (TSLA) fell more than 30% when fears emerged that rising interest rates and their production delays were going to lead to bankruptcy as early as this summer.

All three of these stocks (especially FB and AMZN) weigh heavily in both the S&P 500 and NASDAQ-100 indexes. Due to the individual stock declines, the indexes fell and once again, algorithms began forced selling that pulled other stocks lower. The selling stopped this past week when TSLA gave positive guidance for its production schedule, followed by members of the administration admitting they had no plans to act on the president's tweets regarding AMZN. Then FB said they haven't seen a loss in users or revenue since the scandal hit. All seemed to be right in the investing world until the president doubled down on his tariff rhetoric the night before a jobs report that fell below expectations.

In the middle of all this turmoil, the Fed voted to raise the federal funds target range by 25 basis points to 1.50%-1.75%, as expected. The new Fed Chair, Jay Powell, calmed fears when he bluntly stated during his first press conference following a Fed decision, that the decision to raise rates was all that they decided. Any rumors over four rate hikes this year versus three is all speculation and should be ignored. While four rate increases could happen, his succinct response settled traders' nerves.

Individual company's stories of drama will move the markets from day to day, but investors' focus will revert to fundamentals as earnings begin hitting the tape next week. If growth is anywhere close to expectations, the headlines of the past few weeks will disappear, and valuations will return to be the priority of the month, at least on days without political posturing.

The unknown factor will be how investors value the earnings and what price to earnings multiple they assign to stocks. With all else being equal, multiples contract when uncertainty hangs over the economy. Change will always happen, and the transition times are the toughest. Once the rules are set, be it tariffs or another input, companies will find a way to make money and investors will allow multiples to expand again. Current valuations are not high, but they can always go lower in extended times of worry, just as they could move higher when the dust settles.

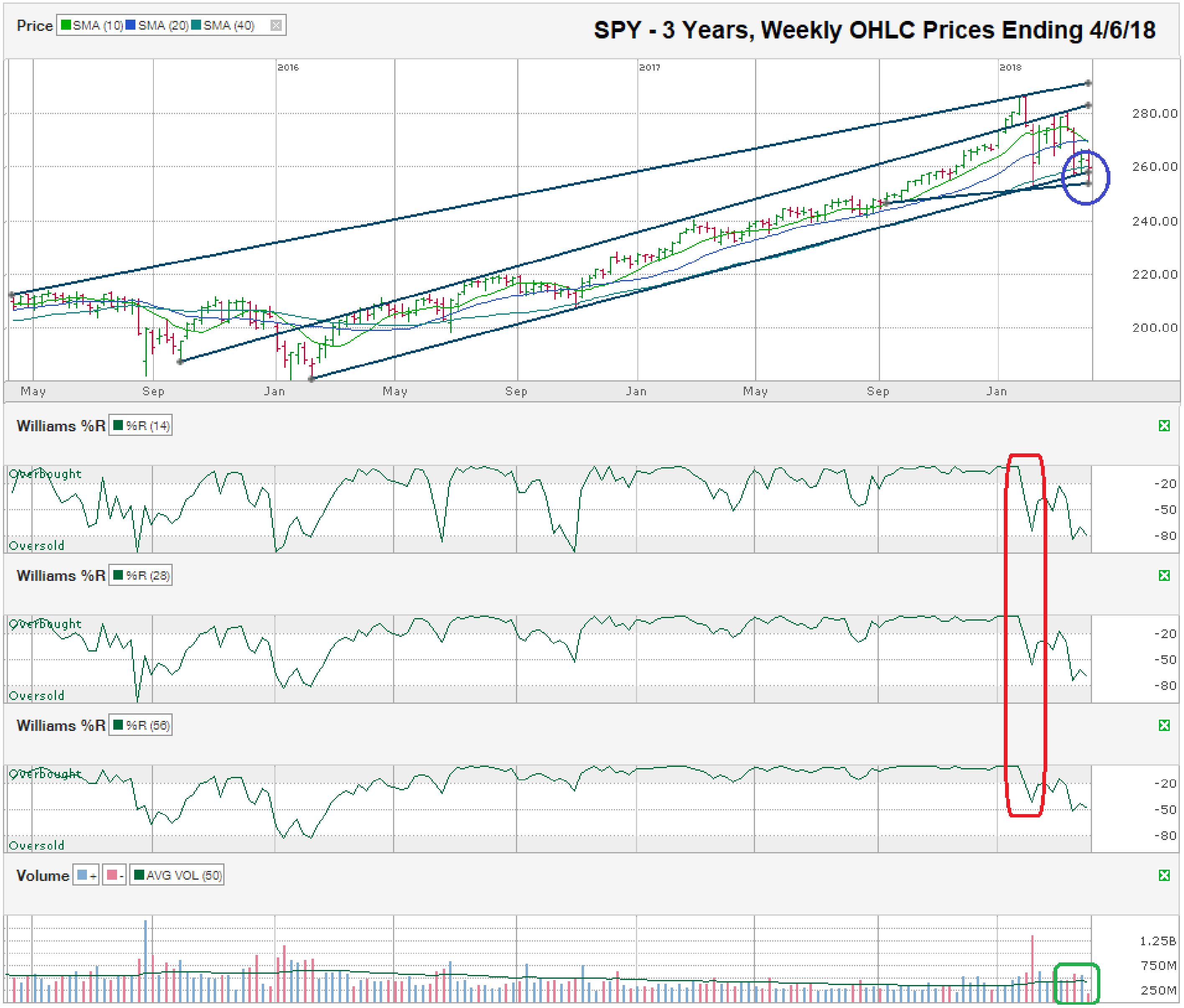
Outside of political issues, interest rates will remain on the top of traders' watch list. As mentioned above, the concern is over how fast the Fed raises rates and if companies can adjust quickly enough. When interest rates rise, those companies that have been borrowing excessively (see TSLA) to grow and fund production will have less free cash flow, if any. This change in production costs will hinder growth. As investors begin to consider how late we are in the business cycle, companies that are highly leveraged (more debt, less positive cash flow) become less attractive. When the next economic slowdown begins, these companies with high debt levels will have a harder time remaining or becoming profitable. The race is on for these companies to turn the corner on profitability before higher interest rates cripple their chances of success.

Summary of Indexes

Courtesy of Morningstar.com

Name	As of Date	YTD	1-Year	3-Year	5-Year
US Stock Indexes					
DJ Industrial Average	4/6/2018	-2.62	18.53	13.00	13.18
NASDAQ Composite	4/6/2018	0.17	17.62	12.04	16.63
Russell 2000	4/6/2018	-1.12	12.36	7.78	11.91
S&P 500	4/6/2018	-2.10	12.63	10.05	13.22
S&P MidCap 400	4/6/2018	-2.07	10.25	8.19	12.25
Global Stock Indexes					
MSCI Emerging Markets	4/6/2018	0.30	20.62	4.93	2.88
MSCI World, Excluding US	4/6/2018	-1.63	15.04	4.63	6.36
Bond Indexes					
Core Bond	4/6/2018	-1.56	0.84	1.27	1.79
Intermediate Core Bond	4/6/2018	-1.28	0.29	1.26	1.84
Long-Term Core Bond	4/6/2018	-3.35	2.61	1.76	2.75
Short-Term Core Bond	4/6/2018	-0.33	0.17	0.72	0.86

Index Chart & Analysis



The chart above shows the weekly prices for the past three years on SPY, the SPDR ETF that tracks the S&P 500 Index, after closing the week at $259.72 on April 6, 2018. One of the best methods to remove the "noise" of near-term volatility is to stretch a chart to multiple years and switch the bars to weekly instead of daily. By looking at a longer timeline, a chart technician can see if the long-term trend is still intact. I drew four trendlines that cover the past three years on this chart. The top trend line shows the absolute points of higher highs. The next trend line shows the trend line that starts with a point of support that became resistance with exceptions in January 2018. The bottom trend line marks the trend of higher lows that began in the winter of 2016 and held support until last week. The shortest trend line covers approximately seven months, including the February low and the low from this past week.

This short line has become the crucial line of support (circled in blue) for the large-cap index. After breaking below every moving average from the 10-day to the 50-week moving average, SPY needs to find buyers above this short trend line to keep the sell-off from gaining more momentum. If the $255 range doesn't find buyers, the next stop could be closer to $240 where SPY found support last summer and then as low as $220, an area of temporary support in December 2016. Falling to $220 would mean SPY was in bear market territory, down 23% from its high, and would have given back more than 50% of its gains since its January 2016 low.

After SPY hit an intraday high of $286.58 on January 26, it fell 11.13% to $254.68 on April 2 and finished the week at $259.72, 9.37% off its high. Many technicians viewed this retest of the February low as a mandatory step before stocks could resume the rally that has run for more than nine years. Without this double dip, stocks would've recovered too quickly and not shaken out those investors with less conviction. While a correction (a 10% decline) feels like the wheels have come off the bus, the reality is that outside of 2017, these moves are a normal part of the market cycle.

The Williams %R indicator predicted the weakness in stocks in January when it fell below the overbought range (highlight in red), but stocks didn't follow through on the initial weakness. This consolidation period over the past couple of months has left the Williams %R indicator in a state of limbo. The sell signal was obvious, but until the indicator reaches the oversold range and bounces, the buy signal will be harder to call, at least on a weekly chart.

In the bottom right corner of this chart, I circled the weekly volume in green to highlight how few shares traded hands in the first week of the second quarter. This drop off in volume (the lightest week in more than three years) shows the price declines hit the indexes with little conviction. Fewer sellers can make a bigger difference when volume is low. The losses are real for now, but often not sustained in the weeks that follow. In other words, don't panic over a price decline that has few sellers driving it.

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