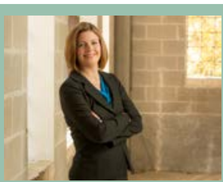

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Volatility Dominates, but Economic Data Remains Healthy

Despite the current market turmoil, several factors support future equity growth, says Chief Investment Officer Larry Adam, CFA, CIMA, CFP®.

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Equity market volatility continues to dominate the investment landscape. However, note that the volatility has been in a fairly contained range over the last two months, and the midpoint of that range is not that far from Tuesday's close. Additionally, over the last few weeks, several positive factors have continued to support our expectations that equities will move higher by year-end and into next year. A few positives include:

Healthy economic data.

Consumer data has remained strong with better-than-expected personal income, personal spending and vehicles sales. Manufacturing data has also been better than expected as reflected in the strong ISM manufacturing reading, which remains well above 50 at 59.3.

Near-record business and consumer confidence.

Per research from The Conference Board and the National Federation of Independent Business, consumer confidence remains near the highest levels since 2000, and small business confidence is at its highest level since 2004. Robust confidence should continue to support consumer and business spending.

A data-dependent Fed.

Recent speeches by Fed Chair Powell and Fed Vice Chair Clarida suggest that the path of further interest rate hikes is data dependent and not on a set course. In fact, the market has decreased its expectations for interest rate hikes: the probability of two rate hikes between now and year-end 2019 has gone from 92% on November 7 to 66% as of Tuesday.

Attractive valuations.

The combination of strong 2018 earnings growth (~22%) and fairly muted year-to-date S&P 500 performance (+~2.8%) has contracted the multiple of the S&P 500. With consensus 4Q18 earnings growth of ~15%, another strong quarter of earnings should highlight the attractiveness of the equity market. The current Next Twelve Months (NTM) P/E is 15.9x compared to 18x at the beginning of the year.

Volatility Dominates, but Economic Data Remains Healthy (cont.)

Inverted yield curve reality.

With the 10-year Treasury yield falling below 3% to 2.92%, longer duration bonds have become incrementally less attractive going forward given our expectation of slightly higher yields. (Admittedly, cash, as represented by the 3-month T-Bill, has become more attractive with a yield of 2.42%.) The potential for an inverted yield curve, with the current spread between the 10-year Treasury and 2-year Treasury down to 11 basis points, looms as a potential market negative. However, even when the yield curve inverts, it is not an imminent sign of a recession or equity market top as it takes well over a year before it negatively impacts the economy or market.

"Vaguely specific" trade negotiations.

While there is skepticism around the timing and details of a massive trade deal between the U.S. and China, the fact is that the uptick in tariff rates on Chinese goods (from 10% to 25%) expected to take effect on January 1 has been postponed for three months, which is a positive sign that the two sides are engaged in discussions. Knowing how important trade and equity markets are for President Trump's re-election campaign, there is still a belief that a compromise will ultimately prevail early next year.

Biased bearishness.

While not all sentiment indicators are flashing extreme oversold conditions, one to note is the American Association of Individual Investors (AAII) Investment Sentiment Bearish Reading, which last week reached its highest level since February 2016 (the last time we had a 10%+ pullback). Importantly, that pullback proved temporary as the market recovered its losses and continued its upward ascent (up more than 20% from the lows until year-end).

Bottom line: The balance of economic and fundamental dynamics we analyze suggest the current market sell-off presents a buying opportunity for investors with a long term investment outlook.

Important Investor Disclosures

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