U.S. STOCKS SELL OFF: PERSPECTIVES FROM THE RAYMOND JAMES INVESTMENT STRATEGY COMMITTEE

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Andrew Adams, CFA, CMT, *Senior Research Associate, Equity Research*

In true Groundhog Day fashion, investors were scared away Friday when they saw something they didn't like. The S&P 500 experienced its worst day since September 2016, as bond yields spiked and big tech's earnings weighed on the major averages all session. It was the culmination of what had already been a poor week, but the dip was not too surprising given that it was preceded by some of the most overbought readings you'll ever see and a straight-up trajectory that was just not sustainable. Our models had also signaled some problems could be arriving in February, so we have been advising a little more caution over the last week as the stretched market began to stall out. It is important, though, to maintain perspective and to not panic despite the first real test in months. Just over a week ago, the S&P 500 was already up a healthy 7.5% in 2018 and, until Friday, it had not experienced a drawdown of more than 3% from a previous closing high since just before the November 2016 election. We all knew a record-breaking run like that could not last forever.

Yet, our view is that stocks firmly remain in a secular bull market and that this pullback is likely to represent what has historically been just a normal corrective move. No significant damage has been done to the charts of the major indices and all should have several possible support areas underneath current levels to entice buyers to step in. Prior to the down move, we wrote a 5-10% dip was all we envisioned if the market started to fall and that is still the case. Despite the disappointing reports from a few of the big tech companies, this has still been a better than expected earnings season and future estimates continue to rise for the S&P 500. Interest rates do require watching closely, with the benchmark 10-Year U.S. Treasury rate now at its highest point since early 2014: above 2.85%. However, we do believe this recent weakness in the stock market will eventually lead to perhaps the first real buying opportunity investors have had in a while. Markets rarely bottom on a Friday, as everyone broods on their losses over the weekend and comes in ready to sell on Monday, but we will be watching stocks closely over the next few days for signs of possible support and renewed buying interest.

Bottom line: The run of absolutely no downside volatility appears to be over, but that does not mean the market has to crash now.

Dr. Scott Brown, *Chief Economist, Equity Research*

The U.S. economy entered 2018 with positive momentum and broad-based strength across sectors. However, the combination of corporate tax cuts, tighter job market conditions, a potentially more-hawkish Federal Reserve (Fed), and political turmoil in Washington add considerable uncertainty to the outlook for the second half of the year and into 2019.

The labor market is the widest channel for inflation pressure, and tight conditions should boost wage growth. However, faster wage growth ought to be more easily absorbed due to the corporate tax cuts and need not necessarily be passed through to higher prices. Personnel changes should result in a somewhat more hawkish tilt to the Federal Open Market Committee this year (that is, Fed policymakers are more likely to raise short-term interest rates than they were in 2017). The unwinding of the Fed's balance sheet adds modest upward pressure on bond yields. More importantly, the U.S. Treasury announced a huge increase in its borrowing needs for the first half of 2018. All else equal, higher bond yields ought to put some downward pressure on share prices in the near term.

James Camp, CFA, M*anaging Director of Fixed Income, Eagle Asset Management**

The minutes from the Fed were suggestive of at least three rate hikes this year. Employment, wage growth, and fiscal policy are all supportive of accelerating growth. But, the market is moving away from liquidity (low rate) driven, to earnings driven. I suspect some leverage unwind to continue in risk markets, creating higher volatility and the importance of security selection and risk management.

Michael Gibbs, *Managing Director of Equity Portfolio & Technical Strategy*

The nearly 4% pullback registered last week by the S&P 500 was long overdue. The magnitude of the decline and over-zealous investor sentiment prior to it raises the odds of additional weakness or, at least, sideways trading in the coming weeks or longer. But, we feel the weight of the evidence remains bullish. Global economic growth is good, earnings are growing, and despite the move in interest rates, yields remain low. For this reason, we would patiently accumulate stocks during periods of weakness in the weeks ahead.

Interest rates and (wage) inflation: Rising rates and wages weigh on sentiment due to the potential negative impact on corporate profits and stock valuations.

Since year-end, interest rates have trended higher as the 10-year Treasury yield moved from 2.4% to 2.84%. The equity market ignored the move from 2.4% at year end to 2.66% by 1/26. However, the move from 2.66% to 2.84% in the past five trading days was a bit "too much too fast" for investors. The strong jobs report on Friday and, more importantly, the above consensus 2.9% 12-month gain in hourly earnings (vs. 2.7% in December) stoked fears of inflation.

We concur with the market's anxiousness over the recent rise in interest rates as well as the fear of potential rising inflation due to higher wages. As a reminder, higher interest rates and wages eat into corporate profits. With valuations for equities at elevated levels, any headwind to corporate profits would be a problem. Also, higher inflation and interest rates typically cause investors to feel less compelled to pay a premium valuation for stocks, hence the current lofty P/E would likely contract. However, at 2.9% 12-month wage growth and 2.84% 10-year yields, we think investors are overreacting ... for now. We think more evidence of a problematic rise in interest rates and wages will be needed before the market merits a meaningful setback (10%+) with all other market-influencing factors so positive.

MACRO ISSUES AT PLAY – ONE IN AND ONE OUT ON FRIDAY IN DC

Ed Mills, *Washington Policy Analyst, Equity Research*

FBI Memo Released and Janet Yellen is out.

We have seen market jitters on DC fears for many years. The release of a House Intelligence Committee Memo critical of the FBI has raised the partisan tensions in DC. One of the last selloffs came when former Trump national security advisor, Michael Flynn, pleaded guilty to making false statements to the FBI and there were heightened concerns that the Mueller investigation was inching closer to President Trump. With the release of the FBI memo, there is a real question of what is next here in DC and the fear of a constitutional crisis is a constant debate within the beltway. This debate comes against a Thursday deadline to fund the federal government and a March deadline to raise the debt limit. A deal still remains more likely than not, but we always brace for brinkmanship during these fiscal fights.

Friday marked Janet Yellen's last day as Chair of the Federal Reserve and Jerome Powell is set to be sworn in today, Monday, February 5. When Janet Yellen and Ben Bernanke were set to begin their time at the Fed, there was considerable interest in the idea that that market was going to test the new Chair (as it had long been comfortable with a perceived Greenspan put). There has almost been no chatter about this for Powell's transition, but perhaps the market has decided to test him on day[1].

THOUGHTS ON THE RECENT DROP IN OIL PRICES

Pavel Molchanov, *Energy Analyst, Equity Research*

The past week's jump in bond yields has paralleled recovery in the U.S. dollar from three-year lows, and that has spurred profit-taking in the oil market (alongside equities, of course). Notwithstanding the inverse short-term correlation between oil and the dollar, we continue to believe that oil prices have room to exhibit further strength in the course of 2018 – and this view is in contrast to the oil futures curve, which is indicating a sizable decline from current prices over the next 12 months.

As always, we should focus not on short-term trading moves but rather the underlying fundamentals. The fundamentals of the oil market remain broadly supportive: OPEC is sticking with its production discipline; there are still supply declines in several non-OPEC geographies (e.g., Mexico), alongside ongoing supply disruptions/ challenges (especially Venezuela); and the picture for global demand growth is broadly upbeat.

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880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // TOLL-FREE: 800.248.8863 // RAYMONDJAMES.COM