October Uncertainty Spooks Investors

October 29, 2018

Global markets were caught in a whirlwind last week marked by plunging intraday selloffs and subsequent recoveries. Concerns over future earnings for many U.S. companies and slowing economic growth in China and Europe spooked investors, putting major indexes on course for their worst month in several years.

Michael Gibbs, *Managing Director of Equity Portfolio & Technical Strategy, and* **Joey Madere, CFA,** *Senior Portfolio Strategist, Equity Portfolio & Technical Strategy*

It is very difficult to call a bottom when the market cascades lower and does not respect recent support levels. We do believe the market is near a low, as short-term internals have reached oversold levels. A lot of technical damage has been done in the selloff. Prior support levels now become resistance levels. Once the S&P 500 does find a bottom, we believe the market will be range bound as it digests the sharp pullback and investors balance the headwinds (China, interest rates) with the tailwinds (economy and earnings).

We would be buyers of this pullback, and as the rebuilding process takes place, we suggest investors patiently accumulate equities as they reach support levels. Along with earnings and economic growth being supportive of equities, valuation is now fairly attractive. Click HERE For Full Report (Client Approved)

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

Friday was the kind of session that exemplifies the roller coaster nature of the recent stock market. The intraday swings highlight the kind of indecision that is typically seen at market turns, so this still looks to us like part of the bottoming process. The good news is that while the major stock averages all made new intraday reaction lows, they did so with less downside momentum and were able to rally enough into the close to prevent new closing lows. This means that we did not get the kind of acceleration to the downside that has occurred recently when new lows are made. Weakness on Fridays typically spills over into Monday and then we have a "turnaround Tuesday" to mark a bottom, so that could very well be in the cards here again. Though if we see strength on Monday we will very much take it since the market continues to be washed out and oversold.

Nicholas Lacy, CFA, *Chief Portfolio Strategist, Asset Management Services*

The U.S. is in the midst of a late-cycle selloff characterized by high earnings growth expectations that are expected to decline moving into 2019. U.S. companies are likely experiencing peak earnings growth as the impact of the 2017 tax cuts is in full effect. While 2019 still looks promising from an earnings and economic growth perspective, we are not expecting the same degree of growth as 2018.

Volatility is likely to continue in the near future as the earnings season continues to unfold and the markets digest forward guidance on earnings for next year. Continued rate increases by the Federal Reserve will start to impact the cost of doing business from an equity and debt standpoint. This is not an issue the rest of the developed world as rates are expected to stay low as central banks attempt to stimulate growth. In addition, foreign markets appear to have much lower valuation relative to U.S. markets, providing future benefits to foreign stocks.

The objective of a well-diversified portfolio is to provide exposure to assets that behave differently, especially during equity market pullbacks. A diversified portfolio should rarely, if ever, have the highest total return from year to year, but should help smooth out the returns over time.

Comments below issued as October 24, 2018.

Chris Bailey, *European Strategist, Raymond James Euro Equities**

Fear and greed are emotions that can have a big influence on financial markets - especially over the shorter term - and it is the former which has been preeminent during October as the cumulative pressure of a number of issues have accrued. Angst over the future direction of world trade has grown, diplomatic relations have

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become more strained and concerns about the future profile of global growth rates have built, at a time when interest rates and bond yields have started to creep up. Meanwhile, the corporate earnings season has seen many individual companies cite issues such as the strength of the dollar, the impact of higher input costs, and political uncertainty in a range of countries around the world.

So how can the current fear factor be tackled? It is certainly possible to sketch out a scenario over the next few months where the upcoming mid-term election results induce a more conciliatory tone to world trade discussions, where in Europe, compromises are found on the Brexit and Italian budget debates and China keeps on encouraging its burgeoning consumer base to keep on boosting their spending, a combination that would be taken positively by global markets. A key factor in this scenario may very well be a lower value for the U.S. dollar against many of its key global currency peers.

In short, even after over nine years of generally firm equity market returns, it is not yet time to panic. Not only are there plausible scenarios where the global economic outlook can be once again perceived in a more positive light, but the current dividend yield on many global equity markets remains ahead of even medium-duration bonds. As always in investments, the key is to keep abreast of the news flow and to keep thinking about its implications.

Scott Brown, Ph.D., *Chief Economist, Equity Research*

Periods of low market volatility (or "complacency"), such as we saw in the months leading up to October, tend to be followed by turbulent readjustments. Market participants appear to be shifting their focus between near-term economic strength and concerns about the longer term. There are no signs of recession on the immediate horizon, but many investors are worried about the possibility of a downturn in 2019 or 2020. Trade policy disruptions, tighter monetary policy, and downside risks to the global economy are only a few of the worries, but those worries have been with us for a while.

While the odds of a recession remain low, there are limited policy options to deal with a downturn. The Federal Reserve normally lowers short-term interest rates by 500 basis points in a recession, but the current federal funds target rate is 2.00-2.25%. With a sharply rising federal budget deficit, fiscal policy (tax cuts or increased spending) is expected to be either out of the question or very much constrained. As the November 6 election approaches, it looks increasingly likely that the Democrats will win control of the House and the Republicans will retain control of the Senate – but that doesn't mean we'll see a significant change in regulatory policy (although that outlook would change if the Democrats somehow managed to flip the Senate).

Doug Drabik, *Senior Strategist, Fixed Income Services*

The bond market tone has hurriedly turned to the risk-off trade (money flowing from stocks to bonds). Global events and policies are impacting interest rates. Global markets are still being driven largely by accommodative policy which is keeping foreign sovereign rates low and interest in U.S. securities high. The U.S. economy remains strong, even as U.S. monetary policy contrasts most worldwide central bank policies and the Federal Reserve inches towards what many experts consider "neutral," or around a 3.00% Fed Funds rate. The 10-year Treasury's high/low yield (close) range for the month of October is 3.236%/3.064%. Intraday short-term swings have been wide albeit within a ~25 basis point band. The 10-year yield currently sits at ~3.15%. We anticipate continued volatility as investor sentiment remains unsettled. As the year has progressed, the lows and highs remain tightly banded but in a slightly higher yield range.

Pavel Molchanov, *Senior Vice President, Energy Analyst, Equity Research*

On October 22, the Raymond James Energy Group raised the oil price forecast for the third time year-to-date. To summarize, our global oil supply/demand model looks even more bullish than it did several months ago. Production in Venezuela continues to decline; U.S. secondary sanctions against Iran are set to take effect imminently, and the security situation in Libya remains volatile. Just as importantly, capital discipline among U.S. E&P companies and multinationals, alongside steepening field decline rates, constrains production growth in the U.S. and other non-OPEC countries. Finally, looming over all this is IMO 2020, the new low-sulfur regulation for marine fuel that we believe will effectively erase 1.5 million bpd of global oil supply in 2020. Putting all this together, we anticipate four consecutive years of drawdowns in global petroleum inventories, through 2020, putting inventories at unsustainably low levels. Simply put, oil prices must become high enough to where they will begin to meaningfully slow global oil demand growth. For 2019, we forecast $77.50/Bbl WTI and $90/Bbl Brent. For 2020, we forecast a cyclical peak at $92.50 WTI and $100 Brent. And while that high a price level is not sustainable, we have also raised the

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long-term assumption by $5, to $75 WTI and $80 Brent.

Kevin Pate, *Vice President, Asset Management Services*

Preparing for drawdowns in advance is key to our risk management approach. As valuations have drifted higher during the last few years, future return prospects have declined and tail risks have elevated. In general, as the market has continued its advance, we have taken countercyclical action to increase the certainty of drawdown support while not sacrificing total return potential. This was accomplished by gradually reducing risk exposures that are deemed relatively expensive or providing worsening risk-return trade-offs. We also look forward to the opportunities surfacing from the recent market adjustment.

Jeffrey Saut, *Chief Investment Strategist, Equity Research*

Our short and intermediate models are currently conflicted. Indeed, the intermediate model remains constructively configured, but our short-term model is still on a "sell signal." Quite frankly, our instincts told us the equity markets bottomed on a trading basis on October 11, 2018 at ~2710, but last Thursday surprised us as the SPX lost a large 62-points from Wednesday's intraday high into Thursday's intraday low. This has left the S&P 500 vulnerable to further downside.

We see it as one of two potential possibilities. First, prices could consolidate in a pretty narrow range into the mid-November energy peak often mentioned in these reports. Given the current level of energy, that is a distinct probability. However, there is still a lot of negative energy out there and if prices stay around the recent lows of 2710 – 2730 (basis the SPX), then we could experience another spell of panic selling that would take the S&P 500 to new reaction lows. If this is a "selling stampede," they typically last 17 – 25 sessions and we are 12 sessions into this one. Sometimes such stampedes last 25 – 30 sessions, but it is really rare to see one go more than 30 sessions. Quite frankly, we feel much better about equites after the mid-November energy peak.

On a more positive note, it is worth mentioning that the low of 2710, which we thought would be the bottom, registered a rare bullish signal. The two session, two-step decline that occurred last Wednesday and Thursday lopped some 5.3% off of the S&P 500 for one of the largest two-session declines in the last 50-years. Moreover, the S&P 500 has lost 7.8% from its all-time high into its recent ~2710 intraday low. In the process, the Relative Strength Index (RSI) fell to a VERY rare reading of 17.6. A reading below 30 is considered to be an extremely oversold level and over the last 30 years, the RSI has only traded below 20 six times with stocks being a "buy" every one of those times. Accordingly, while we are conflicted on a short-term trading basis. This is not the best place to be selling stocks and we feel much better about stocks after the mid-November energy peak.

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IMO- International Maritime Organization (IMO) is an agency of the United Nations which has been formed to promote maritime safety.

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