



Q1 2018 MARKET REVIEW: THE RETURN OF VOLATILITY

SUMMARY

- The latest MACROCAST™ score was unchanged from a month ago, but higher than our last quarterly review in January. According to the model, the probability of a large and sustained bear market remains low.
- The message from MACROCAST™ was positive. We saw strength in each category of the model, with the exception of Valuation.
- Our quarterly review of performance shows weakness across asset classes, sectors, company size, and countries.
- Despite the flat returns in Q1, a positive MACROCAST™ score has us feeling encouraged about the rest of the year.

THE MESSAGE FROM MACROCAST™

MACROCAST™ was positive throughout 2017, the sixth consecutive year the score did not drop below zero.

MACROCAST™ is Corbett Road's in-house model that measures the attractiveness of risky assets by looking at the **VITALS** of the market—**V**aluation, **I**nflation, **T**echnical Analysis, **A**ggregate Economy, **L**iquidity, and **S**entiment. We use our model to assess the chance of major, protracted bear markets.

Examples of such markets are the declines of 1973-74, 2000-2002, and the financial crisis of 2008. By potentially avoiding major losses in these types of markets, we can preserve capital and reduce our clients' stress and concern.



The current strength in MACROCAST™ is broad based across multiple categories. Among the **VITALS**, “Aggregate Economy” indicators are still strong, and “Sentiment” has improved after showing excessive bullishness to start the year. Only “Valuation” has more than one negative signal, but even that has improved. In January, every single “Valuation” indicator was negative.

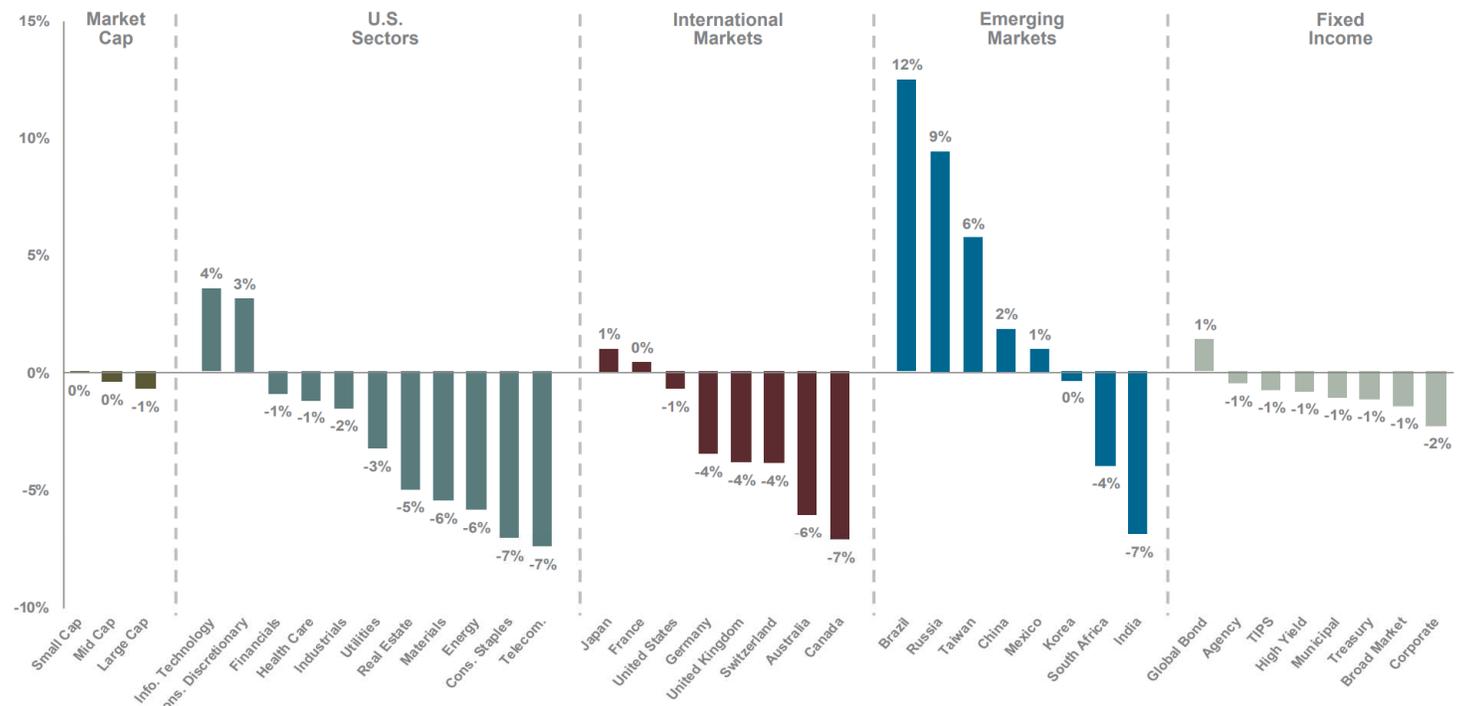
In our last quarterly review at the end of January, the MACROCAST™ score dropped to its lowest since December 2015. Despite the drop, at the time we noted that the score was still constructive and any correction could represent a buying opportunity, not the start of another bear market.

Shortly after publishing that article, volatility erupted and the market corrected 11%. While the market has been choppy since, the S&P 500 is above the February price lows and volatility appears to be in retreat. Time will tell, but we believe the correction continues to represent an opportunity to put cash to work, as long as MACROCAST™ remains positive.



ASSET CLASS REVIEW: A FEEBLE START TO 2018

Year-to-Date Performance of Various Asset Classes



Source: Morningstar Direct. Asset classes are represented by the following benchmarks: Large Cap (S&P 500), Mid Cap (Russell Mid Cap), Small Cap (Russell 2000), Cons. Discretionary (S&P 500 Sectors/Consumer Discretionary), Cons. Staples (S&P 500 Sectors/Consumer Staples), Energy (S&P 500 Sectors/Energy), Financials (S&P 500 Sectors/Financials), Health Care (S&P 500 Sectors/Health Care), Industrials (S&P 500 Sectors/Industrials), Info. Technology (S&P 500 Sectors/Info. Technology), Materials (S&P 500 Sectors/Materials), Telecom. (S&P 500 Sectors/Telecommunications), Utilities (S&P 500 Sectors/Utilities), Real Estate (S&P 500 Sectors/Real Estate), Australia (MSCI Australia), Canada (MSCI Canada), France (MSCI France), Germany (MSCI Germany), Japan (MSCI Japan), Switzerland (MSCI Switzerland), United Kingdom (MSCI United Kingdom), United States (S&P 500), Brazil (MSCI Brazil), China (MSCI China), India (MSCI India), Korea (MSCI Korea), Mexico (MSCI Mexico), Russia (MSCI Russia), South Africa (MSCI South Africa), Taiwan (MSCI Taiwan), Agency (BBgBarc US Agency), Broad Market (BBgBarc US Agg. Bond), Corporate (BBgBarc US Corporate IG), High Yield (BBgBarc US Corporate HY), Municipal (BBgBarc Municipal), TIPS (BBgBarc US Treasury US TIPS), Treasury (BBgBarc US Treasury)

Source: Robert W Baird & Co.

2018 started out strong, with stocks rocketing higher in the first three weeks of the year, only to give up all of the gains and turn negative by the middle of February. There were no standouts among the major asset classes, save a few of the riskier emerging markets.

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Some additional insights:

1. ***Tech and Consumer Discretionary were the only two positive sectors.*** Technology stocks saw the best gains, but were still only up 4% through March. Consumer discretionary stocks were close behind with gains of 3%, but that is a bit misleading. The sector would have been negative if it were not for Amazon. The stock performed strongly in Q1 and makes up 20% of the entire sector!
2. ***Traditionally defensive sectors performed the worst.*** Higher interest rates have hurt traditionally defensive sectors the most. Because the companies in these sectors tend to pay higher dividends, it puts them in more competition with bonds among investors looking for yield. As bond rates rose, these sectors suffered.
3. ***Bonds didn't help.*** Bonds usually provide stability when the market corrects because they tend to often (not always) rise in value while stocks fall. Although bonds performed better during the most recent correction, the overall increase in interest rates caused them to have negative returns for the quarter (when rates rise, bond prices go down and vice versa).
4. ***Market Cap didn't help.*** Companies of all sizes performed about the same. The largest companies represented by the S&P 500 were down about 1%; midsize and small companies were flat.

In summary, Q1 was forgettable, but we still believe major downside risk is small. That doesn't mean positive returns are guaranteed, but with a strong positive MACROCAST score, we view market declines as an opportunity.



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