CORBETT ROAD

MACRO MUSINGS

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SOLID ECONOMIC DATA, HIGHER INTEREST RATES

SUMMARY

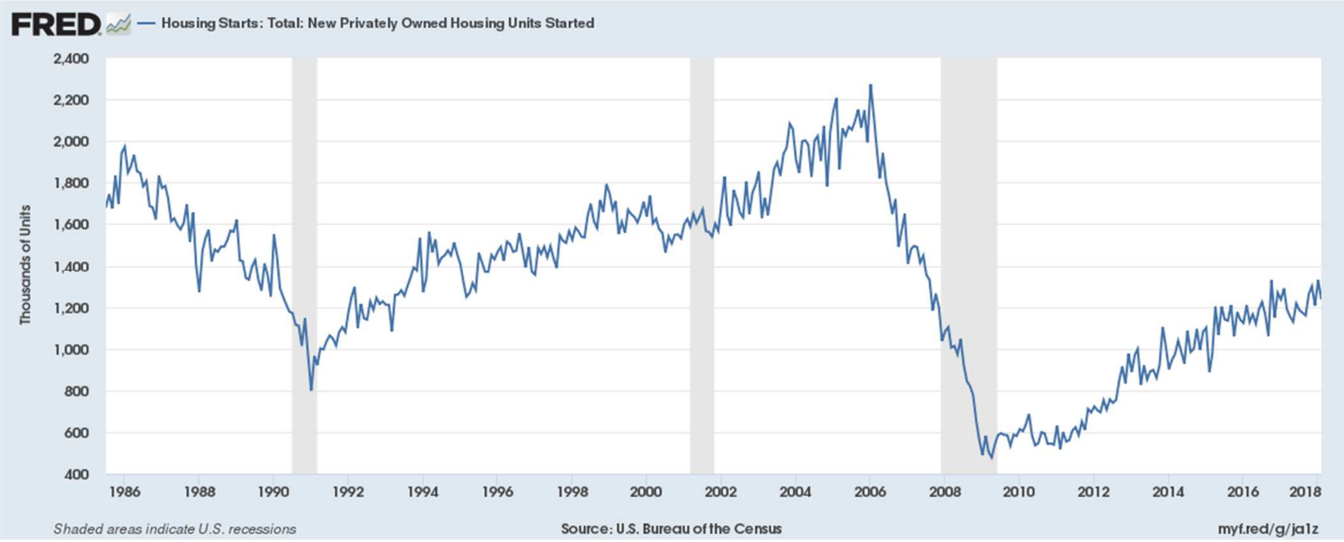
- MACROCAST™ continues to suggest risk of a major bear market is low.
- The latest economic data from employment, housing, and retail sales point to a constructive outlook. Recession is unlikely in the next 12 months.
- As expected, the Fed raised interest rates yesterday. Their overall outlook was little changed, suggesting they will take a wait and see approach on the potential for higher inflation and stronger economic growth.
- The companies in the S&P 500 are projected to grow earnings by more than 10% in 2018. In years where earnings grew double digits, the market has performed very well.

ECONOMIC DATA REMAINS CONSTRUCTIVE

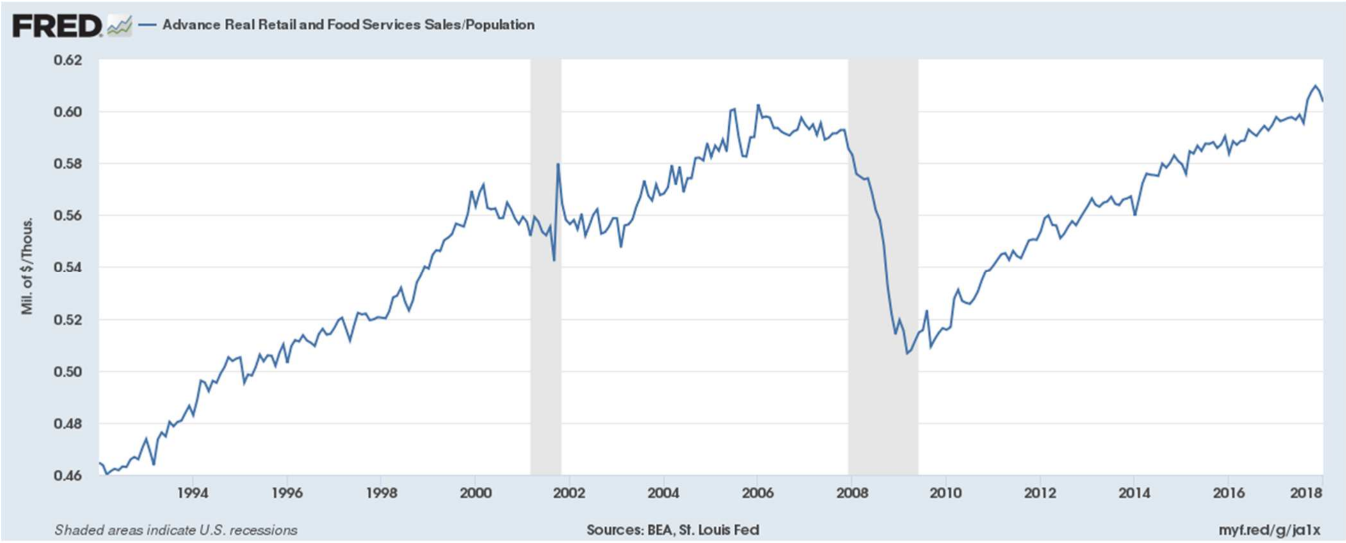
The latest batch of economic data remains positive when viewed through the lens of three key areas; employment, housing, and retail sales. Furthermore, these data points are good leading indicators of recession and often peak 6 to 12 months ahead of the overall economy.

Employment data is strong. Initial claims for unemployment are at multi-decade lows. Claims usually rise at least 6 months ahead of recession:

Housing starts hit a new decade high earlier this year. Housing normally peaks at least a year before a recession begins:



Finally, a look at real retail sales. Consumers make up 70% of the US economy and retail sales make up a large part of that. Although off its high in early 2018, the trend is still up. Retail sales typically turn down at least year before a recession begins:



AS EXPECTED, THE FED RAISES RATES. WHAT NEXT?

In a move that was widely expected, the Federal Reserve raised rates by 25 basis point (0.25%) yesterday. Savings accounts, Money Market funds, and Certificates of Deposits should all see a small bump in payouts, while anything tied to the Prime Rate, such as credit cards and home equity loans, will see the cost of borrowing rise by that amount as well.

The important takeaway from the meeting was the expectation for future rate hikes. The path of rates is what concerns the market the most, not any one individual hike. In this regard, the base case remains three increases of 0.25% this year, followed by four rate increases next year. We believe the Fed will have to see sustained GDP growth of greater than 3%, or sustained inflation of greater than 2%, to increase their projections for rate hikes.

STRONG EARNINGS USUALLY LEADS TO STRONG MARKET RETURNS

The combination of strong global growth and corporate tax cuts has pushed earnings growth expectations to be in the mid double-digit range for 2018. This is important because when earnings growth is 10% or greater in a given year, the market return has been positive 12 times in a row (data from LPL):

A GOOD SIGN FOR EQUITY BULLS THIS YEAR?

When Earnings Are Up >10%, The S&P 500 Is Higher 12 Of 12 Times

Year	S&P 500 Earnings	S&P 500 Earnings Growth	S&P 500 Total Return
2018	$152.5*	13.8%	?
2017	**$134.0**	**13.1%**	**21.6%**
2016	$118.5	0.8%	11.8%
2015	$117.6	-1.8%	1.4%
2014	$119.7	8.3%	13.5%
2013	$110.6	6.7%	32.2%
2012	$103.7	4.8%	15.9%
2011	**$98.9**	**15.9%**	**2.1%**
2010	**$85.3**	**37.8%**	**14.8%**
2009	$61.9	-13.7%	25.9%
2008	$71.7	-19.6%	-36.6%
2007	$89.1	2.4%	5.5%
2006	**$87.0**	**14.1%**	**15.6%**
2005	**$76.3**	**13.2%**	**4.8%**
2004	**$67.4**	**15.2%**	**10.7%**
2003	**$58.5**	**11.5%**	**28.4%**
2002	$52.5	5.2%	-22.0%
2001	$49.9	-11.7%	-11.9%
2000	$56.5	1.3%	-9.0%
1999	**$55.8**	**20.9%**	**20.9%**
1998	$46.1	0.0%	28.3%
1997	**$46.1**	**10.7%**	**33.1%**
1996	$41.7	8.0%	22.7%
1995	**$38.6**	**23.1%**	**37.2%**
1994	**$31.3**	**16.3%**	**1.3%**
1993	**$26.9**	**15.8%**	**10.0%**
1992	$23.3	9.5%	7.5%
1991	$21.2	-14.1%	30.2%
		S&P 500 Avg Return If EPS >10%	16.7%
		% Higher	100% (12 of 12)
		S&P 500 Avg Return If EPS Is Negative	1.8%
		% Higher	60% (3 of 5)

Source: LPL Research, Bloomberg 03/14/18
*LPL Research's 2018 S&P 500 EPS forecast is $152.50
Bold is 10% or more S&P 500 earnings growth

When earnings grew by double digits, the market averaged close to 17% per year. When you contrast that with years where earnings declined, you notice that the market on average was up less than 2%.

INTRODUCING THE CORBETT ROAD PODCAST

This month, we launched the first episode of the Corbett Road Podcast, which discussed the latest market correction, why the Fed is so important to the market, and why asset allocation strategies have generally underperformed the past 5 years. You can listen to the podcast by clicking the link below:

https://soundcloud.com/user-402506844-741459357/corbett-road-podcast-episode-1

If there is a topic or question you would like discussed in future releases, please let us know! Contact your advisor and we will do our best to include it in a future episode.

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