MarketUpdate

Stormy March drags down markets

March was a rough month for markets, with all three major U.S. indices finishing down. The Dow Jones Industrial Average lost 3.59 percent, the S&P 500 Index fell 2.54 percent, and the Nasdaq Composite was down 2.79 percent. For the quarter, the Dow and S&P were down 1.96 percent and 0.76 percent, respectively. But the Nasdaq gained 2.59 percent.

Even as prices dropped, the fundamentals continued to improve. According to FactSet, as of March 29, the estimated earnings growth rate for the S&P 500 was 17.3 percent—the highest since 2011. But technical factors also weakened during the quarter, with the indices closing close to long-term trend lines.

International equities fared similarly. The MSCI EAFE Index declined 1.97 percent in March and 1.70 percent for the quarter on concerns over Russian aggression and potential protectionist policies. The MSCI Emerging Markets Index declined 1.97 percent in March, but strong performance to start the year helped it hang onto a 1.33-percent quarterly gain. Technical factors weakened toward quarter-end, taking both indices close to their long-term trend lines.

Fixed income rebounded somewhat in March, as yields dropped following a large increase in February. The Bloomberg Barclays U.S. Aggregate Bond Index gained 0.64 percent in March but lost 1.46 percent for the quarter.

High-yield bonds, which are less affected by interest rate movements, were also weak. The Bloomberg Barclays U.S. Corporate High Yield Index lost 0.60 percent for the month and 0.86 percent for the quarter.

Economic growth continues as February concerns abate

March was a solid month for economic news. Gross domestic product (GDP) growth for the fourth quarter of 2017 was revised up to a strong 2.9 percent annualized.

Meanwhile, a staggering 313,000 new jobs were added in February, with another 39,000 added to the already strong January report. The average workweek also increased by more than expected.

The Federal Reserve recognized this economic momentum in March with a 25-basis-point hike in the federal funds rate. Market participants expect two to three more rate hikes in 2018.

Both business and consumer confidence remain strong

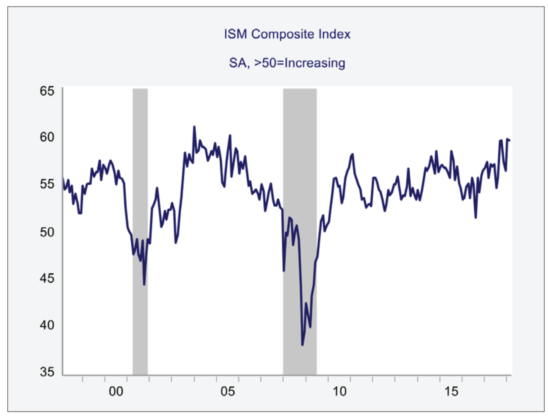
This news helped keep confidence near multiyear highs. On the business front, following a slight dip in December, the Institute for Supply Management Composite index rebounded to near highs last seen in the mid-2000s (see Figure 1).

Consumer confidence improved as well—to levels last seen in the 1990s. Business and consumer spending data improved, too.

Both headline and core durable goods orders, which reflect business investment, bounced back from a weak January. In particular, core business investment grew by 1.2 percent for the month, which was more than enough to offset earlier declines.

The news on the consumer side was mixed. Retail sales disappointed in February, but personal spending data beat expectations, with growth steady at 0.2 percent.

Figure 1. ISM Composite Index, 1998–2018



Source: Institute for Supply Management, Haver Analytics

Housing is another area to watch. Homebuilder sentiment declined in March, and housing starts and building permits both declined by more than expected. Supply shortages for new homes could lead to a material slowdown.

Political risks surge to the forefront

Meanwhile, political risks remain a concern. The White House's announcement of tariffs on steel and aluminum imports and on Chinese goods raised the perception of risk. The tariffs appear to be more negotiating tactic than settled policy. Even so, the potential economic damage that could result from a trade war spooked markets during the month.

The attempted assassination of a former Russian double agent in the U.K. also increased the odds for political disruption. Following the event, many western countries responded by expelling dozens of Russian diplomats, and Russia has promised to retaliate in kind.

More volatility ahead?

The first quarter had its ups and downs, but improving fundamentals and high confidence levels should keep driving the economic expansion. Markets may be more at risk, though. The political risks strike directly at confidence, which could drive more volatility. As always, a well-diversified portfolio that matches your risk tolerance and time horizon remains the best way to pursue your financial goals.

All information according to Bloomberg, unless stated otherwise.

Certain sections of this commentary contain forward-looking statements based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Nasdaq Composite Index measures the performance of all issues listed in the Nasdaq Stock Market, except for rights, warrants, units, and convertible debentures. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Bloomberg Barclays Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Bloomberg Barclays government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Bloomberg Barclays U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

Co-authored by Brad McMillan, CFA®, CAIA, MAI, managing principal, chief investment officer, and Sam Millette, fixed income analyst, at Commonwealth Financial Network.