630 Business Center Drive, Third Floor, King of Prussia, PA 19406 • www.tp-advisory.com
Phone: 610-254-0451 Fax: 484-580-8482 email: thomaspadilla@comcast.net

Stormy Weather

Global Markets and Regions

	1st QTR	2018 YTD
US	-0.59%	-0.59%
Developed Europe	-1.90%	-1.90%
Asia	0.45%	0.45%
Emerging Markets	2.09%	2.09%

US Markets

	1st QTR	2018 YTD
Dow 30	-2.01%	-2.01%
Large Cap Cos.	-0.68%	-0.68%
Mid. Cap Cos.	-0.84%	-0.84%
Small Cap Cos.	0.65%	0.65%
Bonds	-1.50%	-1.50%

Markets generally delivered negative returns for the first quarter of 2018. That hasn't been the case since the summer of 2015. To be sure, there have been clusters of weekly declines in the interim. But there hasn't been a sustained decline, punctuated by volatility and high percentage price fluctuations, for a while. The return of volatility to the markets has gotten investor attention. It's not like there hasn't been plenty of stormy headline news. When hasn't there been? But the markets had been not so stormy. They've tended to trade positively on good news and negatively on bad news, but without the violence we've seen so far this year.

The first quarter of 2018 has ended with a thud. Is there a storm coming to the markets? The reality is periodic bouts of volatility are actually a normal characteristic of markets. It's their absence, especially for extended periods of time that's unusual, but like storms, they are part of the nature of things. In nature, storms make things messy and can do damage. Storms get our attention.

Economic news has continued to be generally positive. Unemployment claims continue to decline as Gross Domestic Product (GDP) continues to expand. In general, wages are starting to climb, boosting consumer spending and home sales and prices. Corporate earnings, which are the ultimate driver of stock prices, continue to expand. This self- reinforcing positive momentum is not happening just in the US, but globally. Global geopolitical turmoil has downshifted from hot shooting wars to more normal rhetorical disputes. It is not a totally rosy scenario, but the trend is still upward. So what's with all the market turmoil?

Volatility is sign that things are changing and the markets are adjusting to that change. Change could be as benign as just a shift in positive economic and market drivers. For instance, one of the key drivers of the major stock indexes the last year or so has been technology. Technology stocks are well represented in all the major stock indexes that make up the markets such as the Dow 30, S&P 500, NASDAQ and the small and mid-cap indices. The FAANG stocks, Facebook, Apple, Amazon, Netflix and Google, are heavily represented in the higher profile indices. Their financial fortunes and share prices have been particularly strong and a major driver of recent, particularly last year's, rise in markets. With the passage of tax reform, the financial fortunes of a lot of other companies, think Boeing, Caterpillar and others, has brightened. Notwithstanding some of the recent problems with Facebook, money managers will sell some stocks to buy the others where they see opportunity.

Volatility can be a harbinger of more ominous macro- economic changes. We've had an exceptionally long economic expansion and an exceptionally long bull market reflective of that expansion. It has not been a particularly robust expansion, but it has kept plodding along, providing support for the markets. But economic expansions are cyclical, meaning someday there will be another recession of some sort. The recent tariff disputes between the US and China could be potential recession catalysts. The Federal Reserve has been slowly raising interest rates in order to control inflation and continue the process of unwinding the extraordinary monetary support unleashed in response to the Great Recession. Other Central Banks around the world, while not as far along in the process as the Fed, are also beginning to scale back their own programs of monetary support. Higher interest rates will eventually slow the expansion.

The domestic political backdrop has introduced another source of disruption. The rancor has diverted attention from actions to address the long term financial issues such as the national debt, underfunded pensions and other issues that affect the long term financial health of the country. The recent Congressional Budget battles are indicative of how difficult it has become to solve these long term problems. While the global geo-political situation appears to be improving with Korea and the Middle East, for the time being at least, relatively calm. They have been market disruptors in the past.

Volatility is not necessarily a sign of a market top. It is indicative that important priorities are changing. Earnings and their continued expansion are the real drivers of the market. When earnings begin to decline, markets will also. Any threat to continued economic and earnings growth is a source of concern and the volatility of markets demonstrates that investors have taken notice. Time will tell if this is just a passing storm or the beginning of something else.