BERMAN
CAPITAL ADVISORS

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Pre-Holiday Market Update
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With Thanksgiving this week and the winter holidays around the corner, we decided to update our thoughts on the market before everyone takes (hopefully) a well-deserved break. Compared to the past several years, the markets do have a different feel now. Interest rates are higher, sector performance has diverged more sharply and most notably the number of down >1% days have risen. In our last note, "October Market Turmoil," we covered the rapid pullback in the equity markets that month. Essentially, we argued for a pullback but not a larger or lasting downturn. We cite economic and earnings fundamentals as the basis for this view, and see the declines as resulting from a too-complacent market. This view hasn't changed, but we do want to assure you we are not perma-bulls: a deterioration in the indicators we think are most important could change our minds.

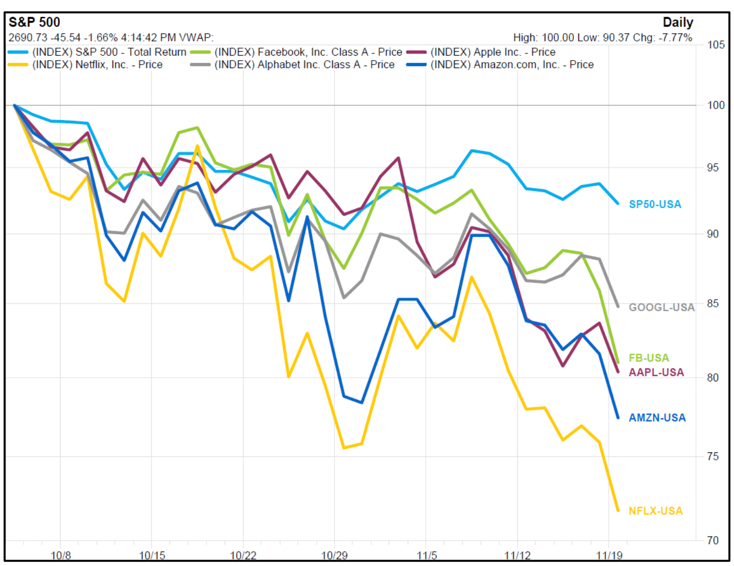
	Total Return through 11/18	
Index	2018 YTD	Q4 QTD
S&P 500	4.1%	-5.8%
Russell 1000 Growth	6.5%	-9.1%
Russell 1000 Value	0.7%	-3.1%
Russell Midcap	0.0%	-6.9%
Russell Small Cap	0.5%	-9.8%
MSCI EAFE (International)	-8.8%	-7.9%
MSCI Europe	-9.6%	-7.8%
MSCI Emerging Markets	-12.7%	-5.8%
MSCI Japan	-7.7%	-9.4%
US Aggregate Bond	-2.0%	-0.4%
Long Term Treasury Bonds	-7.6%	-1.7%
High Yield Bonds	-0.1%	-2.6%
Leveraged Loans	3.6%	-0.4%
Crude Oil	-6.2%	-22.6%

Source: Factset Research

Note: Int'l market returns reported in U.S. Dollars, not local currency

For now, we wanted to provide a little more context for what we see in the markets. The key question is, will the downturn be limited, or is the (so far) lack of success from "buying the dip" a bad sign? So far, our view hasn't changed. On one hand, trade war concerns continue apace, and we just don't know how it will shake out. Oil has again tumbled, largely because the U.S. decided to (planned to?) issue waivers to allow some countries to keep importing Iranian oil, at least for now. This will hurt earnings in the short run but will reduce inflationary pressures and help both U.S. consumers and large emerging market countries like India and China.

Damaged Tech Momentum

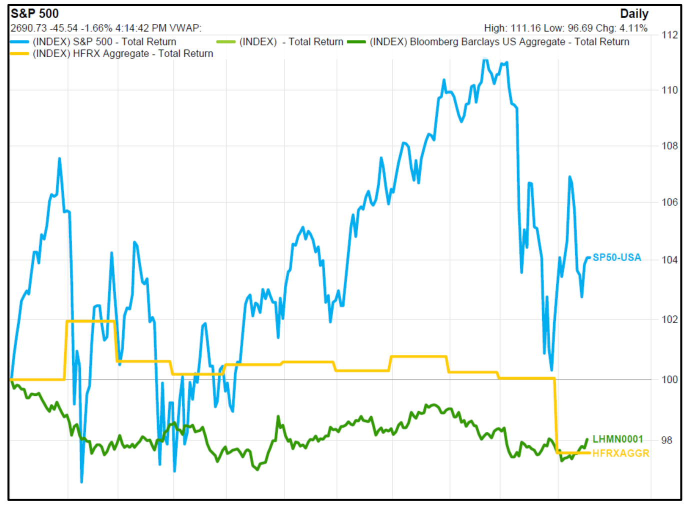


Source: FactSet Research

While all but the most defensive stocks have come under pressure, the tech high-flyers have been the hardest hit. The chart at left traces the returns of the S&P 500 Index vs. the FAANG stocks from the start of the downturn on October 3rd. As you can see, they are all down much more than the market index – although it should be remembered these stocks have soared in the past two years. Using a common method for measuring momentum (trailing 12 months excluding the most recent month), their uptrend *still* isn't broken.

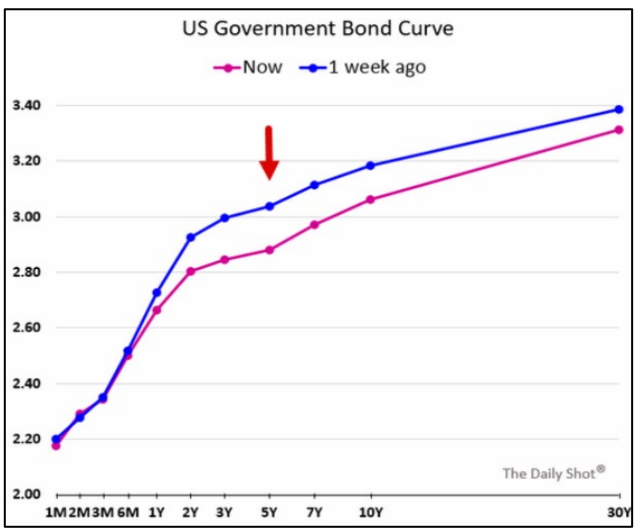
We do think it's notable that value strategies have significantly outperformed in that period, although they still lost ground. This could be evidence of internal rebalancing in the market more than a selloff set to continue.

For perspective, U.S. stocks have outperformed bonds and hedge funds both this year and for the past decade. The chart at right shows the S&P 500 (blue), the Barclays Aggregate Bond Index (green) and the monthly-updated HFRX Aggregate Hedge Fund Index (yellow). While weakness has persisted, the recent decline has been orderly. The market can be described as fearful but not panicked, which we are inclined to interpret positively.



Source: FactSet Research

There are some signs of rising fear in the market, which is good from the contrarian perspective. Many measures of sentiment have turned bearish. The equity risk premium, conceptually, the premium to own stocks rather than bonds has moved higher but hasn't blown out. Similarly, the volatility index (VIX) has come off recent highs but is still above the historically low levels it was trading at for most of the past few years. Corporate spreads over Treasury bonds, a measure of credit risk, have widened but not sharply.

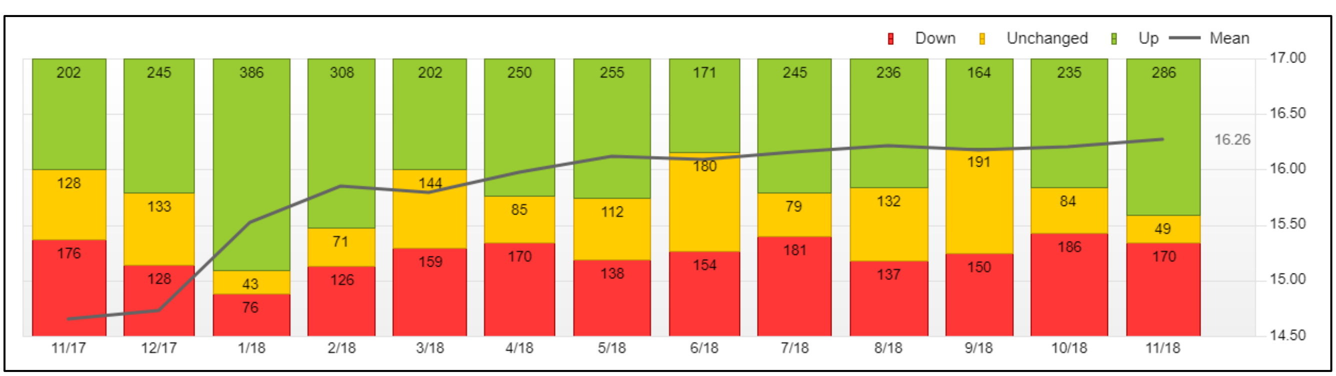


Source: The Wall Street Journal; 11/19/2018

Some risk aversion can also be seen in the shape of the yield curve. The past week (November 11-16) saw buying in the "belly" of the curve as seen at left. This indicates the market thinks we could have economic weakness in the intermediate term that puts the Fed on hold. Note also that in contrast to recent worries, the yield curve is not inverting.

Finally, let's turn to earnings fundamentals. According to FactSet Research, the nearly-concluded Q3 earnings season is on pace to show the fastest earnings growth since 2011. The earnings beat rate was high, and downward revisions for Q4 and 2019 were right at the normal trend. The market does expect the combination of lapping the 2018 tax cuts and slower global growth to produce much slower earnings in 2019. Specifically, the current S&P analyst estimate is for 9% earnings growth vs over 20% this year. Overall, earnings fundamentals are still fine. The chart below shows the history of earnings revisions for the S&P this past year. There are still more revisions up than down, and while the average is no longer improving, it is holding steady.

S&P 500 Index – Count of Analyst Earnings Revisions



Source: FactSet Research

The bottom line is that we haven't seen anything yet that makes us change our view, but we are indeed watching. If the markets don't experience the seasonal Q4 bounce, that would be a negative sign. Apart from seasonality, the momentum trend I referenced earlier would also likely be broken at that point. By the end of the year, we should see more clarity on the trade situation, which is still the biggest overhand on the markets. The Italian budget situation should also be resolved, or more likely, papered over.

We thank you for your continued trust and wish you a happy holiday season!

Berman Capital Advisors