November 6, 2018

Historically, the stock and bond markets during the month of October have often exhibited volatility, and this past October was no exception. Overall it was a challenging month for U.S. and international stock markets, real estate, and bonds in stark contrast to a relatively quiet summer. Many days the markets experienced large swings between positive and negative returns, often trading higher or lower by the minute based on quickly developing news stories.

In our opinion, there are several factors contributing to the recent volatility, including:

- **The Federal Reserve.** The Fed has increased its benchmark interest rate three times in 2018 and is on track for a fourth 0.25% increase in December. The most recent jobs data reported by the Labor Department said that the U.S. economy added 250,000 jobs in October, keeping unemployment at 3.7%, the lowest level since 1969. Perhaps more notably was the increase in wages for employees of 3.1% - the biggest jump since 2009.
    - All of this data continues to bolster the case for a strong U.S. economy and healthy consumer, which in turn could push inflation higher and spur the Federal Reserve to continue raising interest rates. This return to 'normalcy' for rates is encouraging for a long-term investor but increases in rates often push down the prices of bonds in the short-term.

- **Geopolitical tensions and tariffs**. The most expensive U.S. midterm election season in history, mail bombs sent to news agencies and prominent politicians, and escalating trade wars with some of our major international partners have introduced uncertainty to short-term investment and political outlooks.

- **Valuation Adjustments.** Third quarter corporate earnings have been largely positive, with some 80% of S&P 500 firms posting profits that exceeded expectations. Some exceptions have been companies with exposure to tariffs between the U.S. and China, and as trade tensions continue this is beginning introduce downward pressure on their stock prices as earnings targets are adjusted. Other companies like Amazon or Netflix that have seen huge growth in recent years are facing a stock price correction as investors reexamine their valuation in light of potentially reduced growth prospects.

- Finally, many mutual funds have October 31 as their fiscal year-end and may buy or sell holdings in anticipation of the final few months of the year, further adding to market volatility.

When mutual funds trade stocks or bonds throughout the year and create gains, they are required to distribute their income to shareholders in the form of interest, dividends and capital gains by December

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31 each year. For 2018, many of these distributions are in the range of 3-5% of the share price and are paid in the latter weeks of December.

We review each client's accounts after these distributions take place to assess the tax consequences of the capital gains and reduce the income tax burden whenever prudent and in our clients' best interest.

Part of this process includes a review of your previous year's tax return, which is why we ask for a copy of your taxes each year.

In our view, the U.S. economy continues to exhibit strong fundamentals and price/earnings ratios point to a reasonable stock market valuation, overall. Diversified portfolios and a long-term perspective are still the best ways to overcome emotional decision-making in times of market turmoil.

Sources: The *Wall Street Journal*, October 31st, 2018 Capital Ideas Newsletter, J.P. *Morgan Guide to the Markets*, Thomson One & *Barron's.*

*The S&P 500 Index is an unmanaged index of 500 common stocks that is generally considered representative of the U.S. stock market. Performance of an index is not illustrative of any particular investment and performance figures quoted are historical. It is not possible to invest directly into an index.

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