Despite one of the strongest Januarys on record, the Standard & Poor's 500 Index is now in negative territory for the year, and currently rests 9% below its January 26 high of 2,873. Other markets have provided little to no relief – small cap, international, and fixed income indices are all down year-to-date. Only gold and commodities have posted positive returns over the first three months.

The optimists that comprise a majority of the analyst community are taking comfort from the fact that the bellwether FAANG stocks (Facebook, Amazon, Apple, Netflix, and Google) remain above their 200-day moving averages, despite their recent price declines. Market leaders are usually the last stocks to fall in a declining market, so their weakness is often cited as a sign that the end of a correction is near. Beyond this technical indicator, first quarter earnings reports will begin soon, and estimates for both the quarter and the full year continue to rise. It is expected that S&P earnings for the quarter will be 18% above the same quarter last year. Also, valuations have become more attractive as prices have fallen, and a recession is nowhere on the horizon. However, while not disputing the validity any of the foregoing factors, we think there is ample reason to remain cautious, at least for the near term.

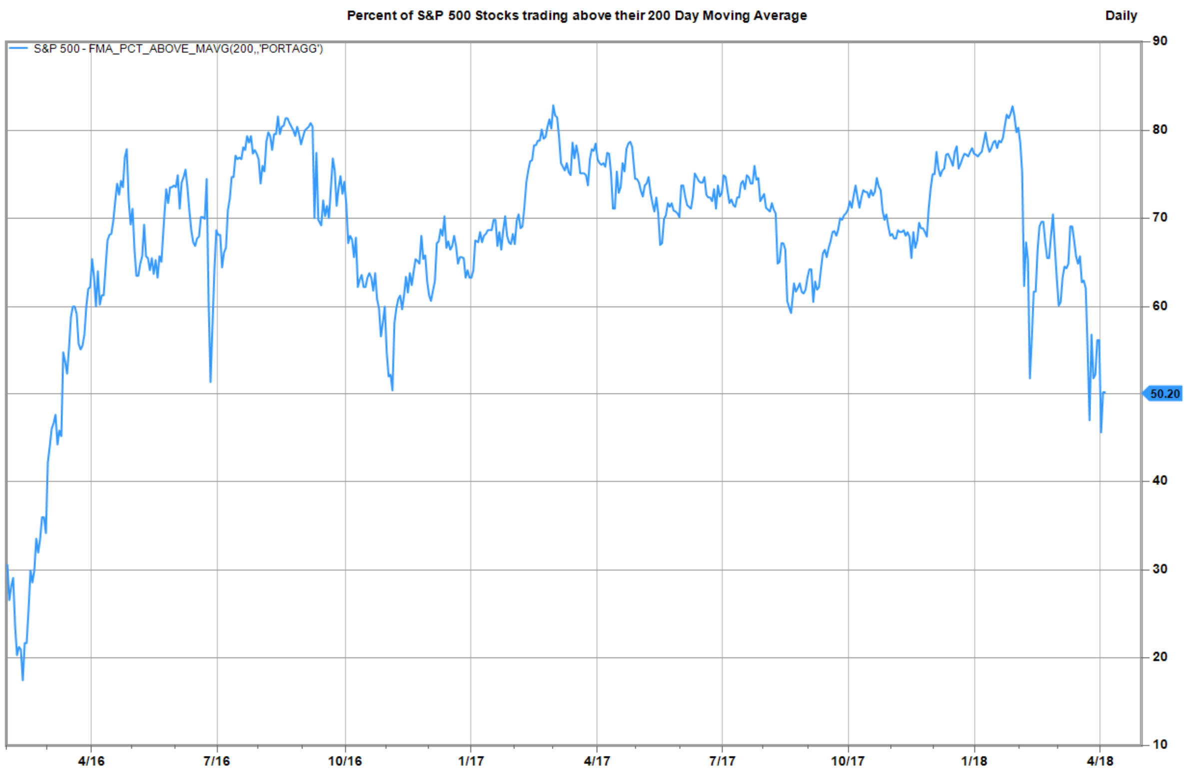
It is true that valuations have fallen back to a level more in line with historical norms, but valuations are more predictive of long term returns than short term direction. Markets can – and have – remained in states of significant over or under-valuation for extended periods.

Earnings expectations may well be met, but we would point out that the market has already risen substantially in anticipation of higher earnings. At some point, market reaction to favorable earnings reports may become more muted as lofty expectations become "baked in" to stock prices.

We would be more inclined to take the optimistic view based on favorable valuations and strong earnings, were it not for the fact that they must be viewed against the backdrop of rising tariffs and the growing risk of global trade disruptions. Despite the President's bellicose rhetoric, it is too soon to call the current situation a trade war. It is also clear from the President's tweets that he views trade as a zero sum game in which every concession must come at the expense of a competitor, and if someone else is winning, it must mean that we are losing. But in an inter-dependent global economy, as simplistic as it sounds, our competitors are also our trading partners. The free flow of goods and services is additive to growth everywhere, encourages more efficient production everywhere, and creates jobs and keeps prices low everywhere.

President Trump's views on trade are entirely consistent with what he proposed during his campaign, so there is nothing new here. What has changed is the market's focus on this issue. Until now, the markets have largely shrugged off this eventuality, choosing instead to focus on the new administration's more stimulative measures of lowering taxes and cutting regulations. Those initiatives are now yesterday's news, and the market's violent reaction to each new trade announcement, along with the apparent escalation of tensions with our major trade partners, suggests that a degree of caution is the most prudent course for the near term.

Finally, the technical condition of the market continues to weaken, if one looks beyond the FAANG stocks to the broader market. Barely 45% of the individual stocks that comprise the S&P index are trading above their 200-day moving average (chart below), the lowest percentage since the 2015-16 market correction that drove stock prices down 15% before it ran its course. That same measure never fell below 50% during the market's run-up from 2016 until now, and remained above 60% throughout the strong market or 2017.



Normally, we would be inclined to use the current market weakness to look for new opportunities. But, for the moment, and for as long as trade uncertainties continue to overshadow a strong economy and rising earnings, we expect that the equity market will, at best, remain range bound and volatile.

Joseph J. Tascone
Senior Vice President &
Senior Investment Officer

Michael D. Blatt, CFA
Vice President &
Portfolio Manager

Michael S. Lares, CFP
Vice President &
Portfolio Manager

John E. Shea
Vice President &
Portfolio Manager