MARKET Insights

Webster Private Bank

November 2018

Fall Backwards

The abrupt sell off in stock markets last month was the worst October return in ten years. The S&P 500 index declined nearly **-7%** in price. Other sectors and regions fared much worse, with small cap stocks down **-10.9%** (Russell 2000 index), international stocks down **-8.0%** (MSCI EAFE index) and emerging markets down **-8.9%** (MSCI EM index). Plenty of digital ink has been spilled to explain the recent market action. As we pointed out in previous editions of Market Insights, we have expected markets to be more volatile in a cycle of rising interest rates. Yet, the past month's sell off was unique among Octobers. It was one of the worst October results in stock market history, but there was no overriding economic cause for the decline, such as a banking panic, recession or war. We believe that prices for many stocks are more attractive now than during the past year and we have added to several positions in our clients' accounts in recent weeks.

One Of These Kids Is Not Like The Others

Ten Worst US Stock Market Returns in October, Since 1928

Month	Return	What was Happening
October 1987	-21.76%	Black Monday, Oct 19
October 1929	-19.93%	Black Monday-Tuesday
October 2008	-16.94%	Great Recession
October 1932	-13.86%	Great Depression
October 1937	-10.17%	Great Depression
October 1978	-9.16%	Oil Shock 1978-79
October 1930	-8.88%	Great Depression
October 1933	-8.85%	Great Depression
October 2018	-6.94%	FAANG Sell Off
October 1941	-6.86%	World War II

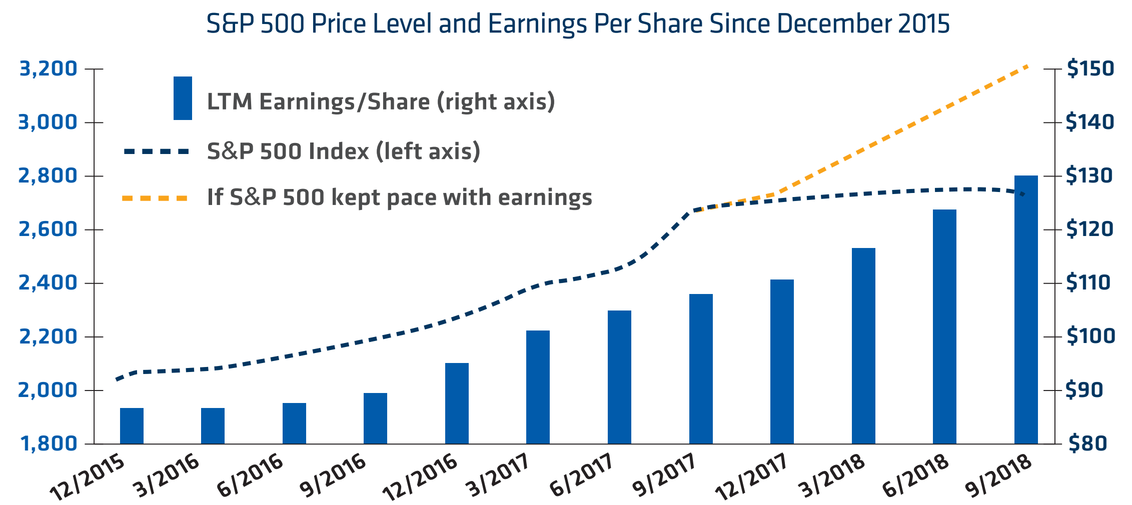
Source: Morningstar database, S&P 500 index monthly price change, 1928-2018. Webster Private Bank calculations.

What Gives? In 2018, The Market Is Behind Fundamentals

The recent sell off in the stock market places investor expectations about future growth at odds with the current trajectory of corporate sales and earnings. With nearly 90% of S&P 500 companies reporting, US earnings are on pace to grow **+25%** through the third quarter (per FactSet Earnings Insight, Nov 9th). This would place reported earnings through September 30th at $129 per share (per S&P Dow Jones Indices). Since the Federal Reserve began its current interest rate hiking campaign in December 2015, earnings per share have grown by **+49%** (from $86.53 to $128.79) while the S&P 500 Index has gained **+33%** (from 2,043.94 to 2,711.74) from the end of 2015 through October 31st this year.

However, the US stock market has been essentially flat for the past ten months. As the chart on the next page shows, if stock prices kept pace with the growth in earnings since the end of 2015, we would be discussing S&P 500 values in the 3,000+ range. A move up to that level would take the market up by more than **+10%** from where it stands today. While we don't provide price forecasts, we expect that the risks are skewed to the upside for stock prices, at least over the next year.

Mind The Gap: S&P 500 Prices Haven't Kept Pace With Earnings



Source: S&P Indices, FactSet Indexes, FactSet Earnings Insights, reported through Nov 9, 2018. S&P 500 Index and earnings/share are ending values as of quarter-ends and Oct 31, 2018.

Conclusion – Navigate With Caution And Courage

We have seen neither the harbingers of recession in economic data or interest rates, nor the kind of collapse in corporate earnings that precedes a bear market. As we have discussed in previous Market Insights, we expected markets to be more volatile in the current cycle of rising interest rates. While there is likely upside for stocks into the remainder of the year, we expect the Federal Reserve will continue its path of interest rate increases with a fourth hike in December, and three more 0.25% hikes likely in 2019.

An environment of higher volatility requires better preparation and response. This has led us to use both cash balances and allocations to uncorrelated, alternative investments as stores of "dry powder" to make investments in stocks at potentially more attractive prices. Bouts of volatility in February and October provided chances for us to employ this more rigorous and careful approach to managing portfolios through the current cycle.

TO VIEW A MORE DETAILED DESCRIPTION AND ANALYSIS OF THESE INSIGHTS, VISIT WWW.WEBSTERBANK.COM/PB.

We hope you've found this commentary helpful. When you're ready to put these insights into action, visit www.WebsterBank.com/pb, contact your Webster Private Bank Portfolio Manager, or email us at pbinfo@websterbank.com.

Webster Private Bank®