WOLVERINE INVESTMENTS
YIELD-ENHANCED STRATEGIES

April 27, 2018

"America's best days <u>always</u> lie ahead." – Warren Buffet

Mr. Buffet's perpetually optimistic outlook notwithstanding, the financial markets are undergoing prophetic changes! Long-absent volatility has finally returned to the markets with a vengeance in 2018, driven by a cloudy forecast for our geopolitics, interest rates, inflation, trade wars, and so forth. In February and March, multiple economic surprises erased January's strong stock market gains and caused the S&P 500 to finish the first calendar quarter with a loss of nearly 1%. If there's a single reason for the market's volatile start to the year, it could be summed up in one word – <u>uncertainty</u>! The uptick in volatility has perpetuated well into the month of April.

What's behind all these new concerns? First, there is nervousness associated with the Federal Reserve Bank's policy of rising interest rates. The Fed hiked rates in late March (as anticipated) but made waves with a more aggressive plan for 2019 than was being priced into the market. Fed-watchers fear that its new chairman, Jerome Powell, is much more focused that his predecessor on normalizing short-term rates – and the potential for "too much, too soon" rate hikes – than simply supporting the economy. It is widely felt by market pundits that the Fed historically causes recessions by taking its interest rate hikes too far, thus choking off economic growth.

Next, there is anxiety over the possibility over a trade war with China, after the Trump Administration proposed tariffs on steel and aluminum imports. The Administration then compounded concerns by announcing an additional $60 billion in tariffs on Chinese products. China unhesitatingly countered with their own $50 billion in proposed tariffs on U.S. goods. Negotiations are said to be ongoing in the diplomatic back channels, but the mere threat of a trade war with China has roiled the markets.

Third on our list is the uncertainty of new regulations on the use of personal data by our large technology companies. America's top five favorite growth stocks – the so-called "FAANG" stocks, composed of Facebook, Apple, Amazon, Netflix and Google's Alphabet – account for over an 11% weighting in the S&P 500. This nifty group of market leaders (harkening back to the 1960s' "Nifty Fifty") were subjected to uncharacteristic stress during the past few months. All it took was a few bad business practice allegations to spark a certain uneasiness about the long-term viability and validity over their business models, especially in the case of Facebook.

Even though market volatility spiked upward during the first quarter, the fundamental foundation behind this multi-year market rally remains steadfast. Strong economic data reports and expanding corporate profits that have helped propel stocks higher last year are still in place. For example, the Atlanta Fed's recent estimate of Q1 GDP were between 2%-3% and earnings expectations are higher for both 2018 and 2019. In summary, while an increase in macro-economic uncertainly has translated into a significant increase in market volatility, the longer term, fundamental drivers of stock performance persist. This context is important as we survey the months ahead.

Looking ahead, we expect the new normal of heightened volatility to continue for the foreseeable future, and quite possibly for the remainder of 2018. As previously mentioned, uncertainties such as the Fed's interest rate policy, trade war worries, and tech company crackdowns will continue hang over the market. Other forces are also at work: the impact of Washington, D.C. "noise" (potential political wrongdoing, ongoing executive branch personnel shakeups, and daily impromptu White House tweets, to name a few), data and cyber security breaches, and whether companies can meet or exceed rising corporate earnings expectations.

Except for scheduled earnings releases, there is no clear timetable on when these uncertainties can get resolved. That means we will have to remain extra vigilant on monitoring both the economic news as well as political machinations. The recent move above 3% on the benchmark 10-Year U.S. Treasury Note has also unsettled the markets. The Fed seems intent on pursuing its normalization process of increasing short-term rates to a point where the Committee would feel better prepared in the event they need to reverse course in anticipation of unseen economic weakness. We shall see just how successful President Trump is with his deal-making tactics in recrafting international trade agreements. Many political observers are justifiably nervous with his initial posturing and the provocative rhetoric he has used.

In closing, we are sincerely thankful to our clients, friends and colleagues who make our ongoing success possible. As always, we welcome any input and collaboration with you, especially if there have been any significant changes to your risk tolerance level, investment objectives, return expectations or investing criteria to better reflect what you would like to accomplish in your investment portfolio.

Sincerely yours,

John M. Babyak
President & Chief Investment Officer