Financial Services Advisory
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Strong Earnings Equal Choppy Market?
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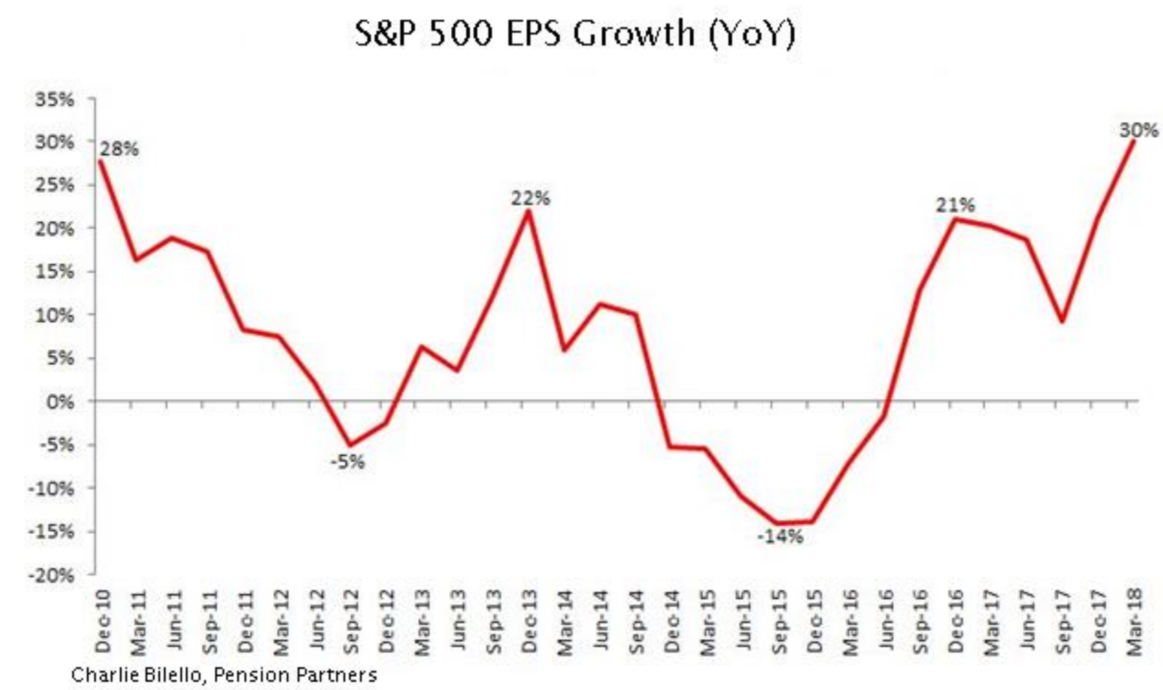
While 2017 was full of frightening headlines and constant bemoaning over both domestic and foreign policy, the market trudged ahead in an exceptionally low-volatility manner. Nothing seemed to matter, whether it was drama from the White House or fears over our relations with international partners. However, 2018 has been a distinctly different environment. After a strong January, the following few months have felt like a roller coaster. Most investors didn't seem too concerned as they've felt that corporate earnings for the first quarter would be stellar, especially now that the new tax rates kicked in in February. In fact, earnings for the S&P 500 constituents were projected to show immense growth. And they have. As of this writing, with 65% of companies in the index reporting, the average of 30% year-over-year earnings growth is the largest increase since the fourth quarter 2010.



So, the high expectations came to fruition. That's good news for stocks, right? Well, one would think so. Unfortunately, we are seeing somewhat of a "buy the rumor, sell the news" reaction to the earnings reports. For example, both Caterpillar and Amazon sported stellar earnings announcements, well above even the highest expectations, and saw their share prices drop.

What could be holding stocks back at this time is concern that earnings may be peaking this quarter, coupled with growing signs of higher inflation and rising interest rates. Since the stock market is looking into the future, it is not so much concerned with the earnings news of today as it is with what may be coming later in the year. And if slowing earnings were to coincide with higher inflation and interest rates, that could be a recipe for continued choppiness from both stocks and bonds.

Currently, we are in the same trading range that we discussed in the April Market Update. Until stock prices break one way or the other from this range, there can be no bullish or bearish biases applied to the overall market. Within the trading range, though, we like small-cap stocks, growth-oriented stocks (like technology and health care), as well as commodities.

Corporate earnings are telling a positive story right now. If investors remained focused on that factor rather than inflation fears or political news, stocks may be able to get back in an uptrend.

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