

## Market Flash

February 5, 2018

What we are experiencing is a normal shift in the economic and market cycle where they are both entering the late period of a recovery/expansion. This has been a quick disruption that was triggered by economic data that indicates inflation is going higher in 2018. It's not only wage growth that is creating inflation fears. Signs of higher inflation are appearing at the wholesale level where higher prices are coming through the pipeline and will lead to higher prices for consumers. The recent tax cut has thrown gasoline on the fire as it is coming at the worst possible point in the economic cycle. Tax cuts should occur when the economy is in a recession and not when it is at full employment.

In these situations, the fear is that the Federal Reserve would be aggressive in raising interest rates. We have a new Chairman at the Federal Reserve and today was his first full day at work. This raises another risk as investors are not sure how he will lead the Fed's reactions.

The market is up 40% since the Presidential election and was long overdue for a pullback. However, it would be irresponsible to not realize that it is being driven by rational concerns. The drop in the markets will happen swiftly as investors are enamored with Electronic Trading Funds (ETF) that simply index the broad market. They can be sold throughout the trading day. These products are not like owning Apple, McDonald's, or UPS that were purchased for specific reasons. ETF products are purchased strictly to be in the market and will be liquidated to exit the market. This has added a new risk to the market.

Keep this in mind. The Dow was trading at 24,345 on January 2 when it rose 801 points during the first trading day of 2018. The markets soared by 10% at one point in January. That is not healthy or sustainable.

It is also important to remember that as the market reached 26,000 and higher, the daily numbers become bigger. The markets have often witnessed 2% daily movements, but that now translates into a 540-point shift in the market. In 2016, a similar 2% move would have been a 300-point shift. The absolute numbers have gotten larger, but the percentage changes are still the same.

As the markets calm down, your portfolio will see a shift into late cycle stocks and away from technology and consumer cyclical holdings. The focus will be on energy, materials, consumer staples, and healthcare. We are already overweighted in these sectors versus our benchmark as we have prepared for this adjustment in the markets.

Please do not hesitate to contact me with any questions, concerns, or general feedback.

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