PROSPECT BANK
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OUTLOOKS

April 2018

EQUITY OUTLOOK

Summary

The S&P 500 fell 2.5% in March, finishing in negative territory for the second straight month. Although, because of the strong start in January (+5.7%), the index sits just 0.8% below the 2017 close. Trade war rhetoric continued to escalate last month as President Trump announced tariffs on steel and aluminum which was met by a retaliatory response from China. The President also continued to make changes in his cabinet, replacing moderate voices with hardline members more likely to support his agenda.

There were several instances of negative, company-specific news targeting some of the technology leaders which have helped fuel the market's momentum over the last several quarters. Partly as a result of those headlines, the Russell 1000 Growth Index fell 2.7% underperforming the Russell 1000 Value which lost 1.8%. It's possible the disruptive innovations from the likes of Amazon, Facebook, Google, Netflix and Tesla will continue to play an increasing role in day-to-day life. Yet, it's still a bit early to know whether new leadership will emerge from the current stock market pullback or if these same bellwethers will continue to carry the torch.

The possible trade war, cabinet changes and tech selloff was enough to create uncertainty in the minds of market participants. Volatility, which spiked in early February, remained elevated throughout the month of March. We expect volatility to continue near term, although headline risks that caused the dislocation in technology stocks will eventually subside. Trade talks are still in the early innings and the potential impact may not have been fully digested by markets. In spite of the headline risks, fundamentals look very solid heading into earnings season. During the first quarter, analysts revised S&P 500 earnings higher by 5.4%. Historically, earnings are much more likely to be revised lower throughout the reporting quarter. In fact, S&P 500 earnings have been revised lower during the quarter by an average of 3.9% over the last five years and 5.5% over the last 10 years. The catalyst for the upward earnings revisions this quarter has primarily been the reduction in the corporate tax rate. If earnings come through as or better than expected in the coming weeks, it's quite likely equity markets will stabilize and possibly resume the long-term upward trend. However, disappointing results could be met with selling pressure.

Positives

- Synchronized global expansion
- Corporate earnings momentum
- Positive consumer and business sentiment

Negatives

- Trade war threat
- Elevated volatility