## January 2018

| Market Index | January Return |
|---|---|
| Standard & Poor's 500 | 5.7% |
| Dow Jones Industrial Average | 5.9% |
| NASDAQ | 7.4% |
| Russell 2000 (small company) | 2.6% |
| MSCI EAFE (international) | 5.0% |
| Barclays Aggregate Bond Index | -1.2% |

# Monthly Update

### Volatility Returns

After a long hiatus, volatility returned to global stock markets in the first days of February. Stocks rose swiftly in the first weeks of 2018. The January gains were the best since 1997 for the S&P 500 Index. However, the week ending February 2nd was the worst since January 2016 for the Dow Jones Industrial Average, which fell 4.1%. The following Monday, the Dow fell another 1,100 points in wild trading. This was its largest-ever single-day point decline, but not nearly the largest-ever percentage decline.

The selling and drastic intra-day swings spilled over into Tuesday morning, as the Dow lost another 567 points. In percentage terms, the Dow dropped approximately 10.7% from its January 26th peak to the intra-day bottom on Tuesday. By Tuesday afternoon, stocks had regained their footing and turned higher to finish with a gain of more than 2%. The volatility has continued throughout the week, and as of this writing, U.S. stocks are roughly back to where they were at the beginning of the year.

### The Fundamentals Remain Strong

The selling was sparked at least in part by a very strong jobs report that was accompanied by the largest year-over-year spike in wage growth since 2009. On its face this sounds like encouraging news. But for some this is a signal the economy may be overheating, which could lead to higher inflation. Higher inflation has sometimes been a headwind for stocks in the past. Higher inflation and other strong economic data have also led to increasing interest rates. As stocks fell, the yield on the 10-year Treasury note rose above 2.8%, its highest level since January 2014. Higher interest rates have also been a headwind for stocks over time.

However, these readings and other economic data are clear indications of a strong global economy. On top of that, corporate earnings are also proving to be healthy. And companies are giving positive guidance in part related to the reduced corporate tax rate. As a result, the backdrop for stocks remains positive from a fundamental standpoint.

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# Monthly Update (continued)

But even after the recent drop valuation remains at higher levels. This means that the margin for error is small going forward, and positive economic data and corporate earnings growth will be key to any further market gains.

The Fed and new Chairman Jerome Powell will be key to watch as this unfolds in 2018. The market will be paying close attention to the pace of Fed tightening. The Fed will be attempting to manage the tension between raising rates to avoid overheating and inflation, but doing so without choking off continued economic growth.

**Volatility is Normal and is Likely to Remain**

The resurgence in volatility came on the heels of a highly-unusual two-year period of low volatility. In fact, 2017 was a record year for low volatility in the markets. It was the first ever "perfect year" for the S&P 500 Index, which posted a positive total return in all twelve months. It was also by far the calmest year ever in terms of market swings up or down as measured by the VIX, the most commonly-used measure of stock market volatility. After such a long stretch of calm, it's not surprising that the gyrations of the past week rattled some investors. But volatility is the norm, and investors would be wise to view the last two years as the exception, not the rule.

**Diversification and Quality are the Best Defense**

Investing always involves risk, even in periods like 2017 when it may not seem like it. Our approach at JIC emphasizes appropriate diversification and a focus on quality. The benefits of both of these are put on display in periods of stock-market downturns like that of recent days. And because volatility is inherent in investing, the inclusion of high-quality bonds alongside high-quality stocks will remain a key aspect of the way we manage client portfolios. In periods of economic recession, short-term stock market corrections, and longer-term bear markets, bonds often hold steady or even increase in value. In addition, higher-quality, dividend-paying stocks often hold up better than the overall stock market during such periods.

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