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TakeFive

5 Questions on Recent Market Volatility

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Tony Soslow, CFA®, is the lead portfolio manager for the Navigator® International Equity/ADR, U.S. All Cap Core, U.S. Small Cap Core, and U.S. SMID Cap Core strategies. His equity team focuses on identifying high quality, undervalued companies, with improving business prospects with the goal of helping investors achieve long-term results over a full market cycle.

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1. In your view, what does recent market volatility mean for equities?

There are a few components that are currently impacting equities from a macro level. The first headwind that equities are facing is rising rates. The Fed has showed no signs of slowing down as they continue towards a more restrictive monetary policy. We're beginning to see the impact of higher rates in large ticket consumer sectors including housing, motor homes and auto as individuals face higher borrowing costs and less incentive to refinance.

The second headwind facing equities is expanding credit spreads between high yield and U.S. Treasuries. Companies have taken on more debt and we've seen very few defaults as we reach the end of the economic cycle. However, we are beginning to see these spreads expand in anticipation of a slowing economy. And finally, we believe we've already seen the peak of earnings growth, and we expect this to slow going into 2019 and 2020.

There are a few factors working against stocks right now, but there's a silver lining too—prices have fallen and we believe the economy doesn't look like it's poised for a recession within the next six months. Changes in tax policy have also helped bolster the economy, which we view as a positive.

2. Are there any factors that could potentially ease some of these headwinds that equities are facing?

While we think the next one or two rate hikes are effectively in the books, the Fed could always choose to slow down the pace of future rate hikes. If the Fed sees GDP growth declining and wage growth slowing, they could realize that inflation is no longer a threat and ease up their tightening policy.

Any concessions made in the ongoing tariff negotiations could also help equities. Right now, it seems fairly certain that we're looking at raising tariffs to 25% on all Chinese goods at the end of this year or beginning of next year. While we believe the market is starting to price this in, any concessions made during ongoing negotiations would help markets.

3. What are your current thoughts on International Equities?

Emerging markets have come under pressure for most of 2018 due to a strong dollar combined with falling energy and commodity prices. Economic growth across most of the rest of the world also remains weak compared to the U.S. If there are resolutions surrounding Brexit, the dollar could weaken against the Euro, which would help international economies.

But right now, we believe investing in international equities should be viewed as an opportunity to generate yield. Valuations remain cheap and companies are paying out high dividends, which can be an opportunity for investors to generate returns.

4. How are current markets impacting how you manage the All Cap U.S. Equity strategy?

In All Cap, it's easier to be positioned more defensively in down markets. As we look for more defensive holdings in sectors such as Health Care and Utilities, it's easier to find Large Cap names that meet our criteria than companies in Small or Mid-Cap markets.

Right now, our All Cap U.S. Equity strategy holds 20% in Health Care, 13% in Industrials and about 20% across the technology sectors (11% Technology and 9% Communication Services). We hold about 7.5% in Consumer Staples and Consumer Discretionary. Between Energy, Materials and Utilities, we hold about 12%. Our biggest overweight in the strategy is in Health Care, which is more defensive, and we are slightly underweight in the combined technology sectors.

5. Can you summarize what this volatility means for investors and how your strategies are positioned to perform?

Despite the ongoing market volatility, we feel very positive about the underlying companies we hold in our strategies. We believe in holding high quality, undervalued companies with improving business momentum and we will continue to actively manage risk throughout this period of volatility.

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