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The Stonebridge Market Commentary

March 2nd, 2018

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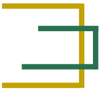


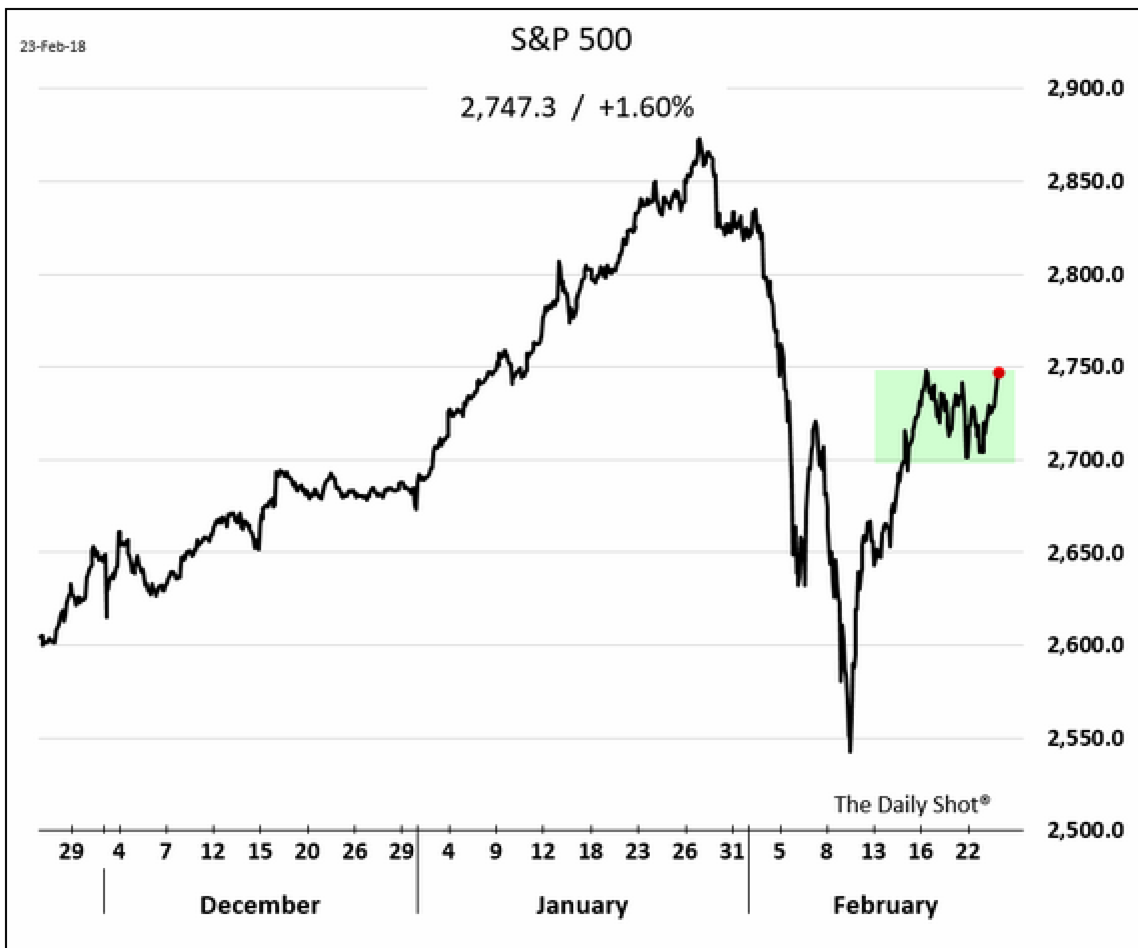
Equity Market Commentary

Ok. Enough punishment for the last comment about how great January was. No sooner that the end of January was upon us, the market took umbrage at some Fed comments, a tick up in rates and the VIX conspired to deliver a quick beat down, sometimes more than 1,000 points a day (chart 1).

The worst of it was over by February 8th but has not felt much like it. Volatility remains high and multi-100 point moves seem to be, for now, the new normal.

The CNN Fear & Greed Index (chart 2) shows that we are still deep in the fear side of things. This seems natural as we have had a very calm ride the last year or so and investors got used to a low volatility grind upwards. The last month's craziness brought back unpleasant memories the 2007-2009 melt down. This will take time to work out, maybe months.

Chart 1



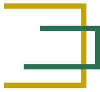
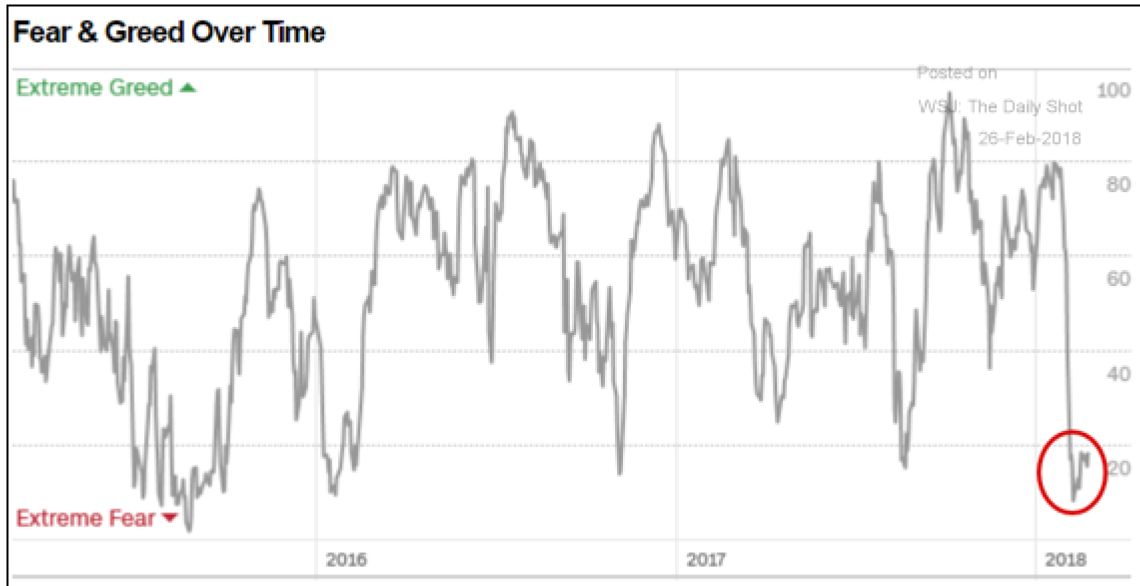


Chart 2



The good news for stock market bull is that the economy is strong, unemployment is low, wages are rising and earnings are strong. Led by the tax cuts, earnings are expected to stay strong in the intermediate future. The bounce back from the low a couple of weeks ago has managed to turn the market positive for the year. As of the end of February, the Dow was up 1.25%, the NASDAQ was up 5.35% and the S&P was up 1.50% year to date. For the month of February, though, the Dow was (4.30%), the NASDAQ was (1.87%) and the S&P was (4.28%). Thus, we ended the Dow win streak at 10 months up in a row and the S&P at 15 months. February was also the biggest monthly decline in two years, going back to January 2016. I guess we will have to start another streak.

As an aside, I took a look at what last year's winners, the FAANG stocks, are doing thus far in 2018.

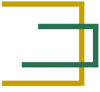
Facebook- 2.83%, Apple- 5.41%, Amazon-29.29%, Netflix- 51.39% and Google-6.09%. Pretty amazing, I would say. All positive in spite of the volatility. This goes a long way toward explaining the outperformance of the NASDAQ so far this year. Can they keep up this pace? I would think that was a long shot, certainly not at this pace.

So, here we are in the third month of the year having had a rather remarkable time of a great month followed by a pretty bad month. Like I said earlier, this kind of investor psyche damage will take time to unwind. We can expect bouts of volatility to recur for awhile, so buckle up.

Fixed Income Market Commentary

Tax-exempt bonds, with the exception of the longest dated maturities, have outperformed Treasuries in the first two months of the year. That does not mean that performance has been all green, it just has not been as weak, relatively speaking. So far this year, the Bloomberg Barclays Municipal Bond Total Return Index is down a little over 1.50%, however, the short-end of the curve has actually turned in some slightly positive performance. One of the factors helping to buoy municipal returns somewhat versus government bonds has been the sharp curtailment in supply of bonds after the historic rush to market by issuers prior to year-end.

To rephrase what was touched on last month, interim bond performance numbers are most relevant for "total return" investors who trade fixed income securities with a goal of generating profits.



For buy-and-hold income investors, yield to maturity (essentially the return locked in at purchase) and coupon income over the life of the bond are more important than short-term performance driven largely by market price adjustments in the interim. Whereby a total return investor would likely view negative performance as a cause for concern, for buy-and-hold income investors, it can actually be a good indicator that pricing and market yields have become more attractive for reinvesting maturing principal.

On the taxable side, corporate bond yields have also risen alongside Treasuries and other fixed income vehicles. While becoming more attractive in recent months, rates are still generally low in historic terms. That has kept many investors continuing to reach down the credit spectrum into junk or high-yield bonds to pick up yield, which along with overall healthy economic expectations, has helped to keep yield spreads tight. We favor solid investment grade corporate credits over adding risk with so little reward right now in most speculative grade company debt. We continue to advocate also using some select high quality taxable municipal bonds to add incremental yield to qualified or exempt portfolios. Their size is often smaller than corporate bond issues and, as a result, they can offer additional yield spread (at arguably higher credit quality) over comparably rated corporate bonds.

Sources

Charts provided through @Callum_Thomas by The Daily Shot

Performance sourced from Bloomberg

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