WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

Monthly Market Comment

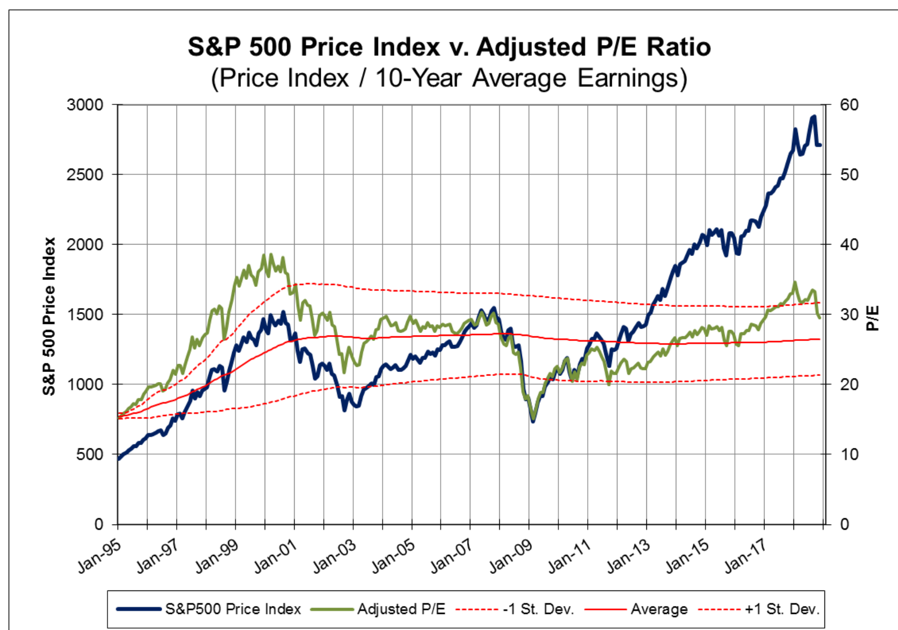
November 1, 2018

The big news in October was that the stock market nearly fell into a correction – defined as a drop of at least 10% from a recent high. Stock prices suffered as investors began to focus on the same risks we've been writing about for months, and commodities fell in tandem. Even bond and real estate prices declined, though not nearly as much as the riskier assets.

Stocks

U.S. stocks had already started to lose momentum in late September, but the selling intensified in early October. Although bargain hunting produced a short recovery in mid-month, the selling started again and lasted almost to month's end. At the end of trading on October 29, the S&P 500 stock price index stood 9.9% below its record high close in late September. At the end of October, the S&P 500 was 6.9% lower than at the end of September, although it was still up 5.3% from the end of October 2017. Taking into account dividends, the total return on the S&P 500 was a negative 6.8% in October and a positive 7.3% over the last year.

Looking into the future, we believe the stock market's near correction has run its course. We think investors have now come to terms with the threats we've been talking about for so long, such as rising inflation pressure, continued interest-rate hikes, the appreciating dollar, and a likelihood that the stimulus from this year's tax cuts and government spending hikes will peter out in 2019. Those are still real threats for down the road. However, now that they're priced into the market, we think investors can start to focus again on the fact that, for the time being, the economy is still expanding and corporate profits are still rising. In fact, because of October's big drop, stock valuations may have fallen enough to spark renewed buying interest by bargain hunters (so long as prices and valuations don't fall farther and spark a panic). If we're right, we think stocks could well rise to at least one more round of record highs before the increasing risks produce a prolonged downturn sometime in the future.



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Admittedly, the October downdraft has left many technical indicators looking sickly at present. For example, the S&P 500 index now stands below all its key simple moving averages (SMAs), and those SMAs themselves are all sloping downward. In addition, the Dow Jones Transportation Index has recently performed even worse than the overall market, and the share of S&P 500 stocks trading above their 200-day SMA has fallen to less than 50%. Those are all typically negative signs for stocks. Nevertheless, we're encouraged by the key short-term momentum indicators (such as the "moving average convergence/divergence," or MACD). Those indicators suggest stocks had become extremely over-sold by late October. They now indicate the negative momentum has petered out, and that positive momentum is starting to build again. If the S&P 500 continues to rise as we anticipate, we believe its next significant resistance level will come at approximately 2,809. If stock prices instead start to fall again, we think the next significant support levels would be at approximately 2,641 and 2,581.

S&P 500 Stock Price Index + "MACD" Momentum Indicator

Source: BigCharts.com

Bonds

With continued strong economic growth, rising inflation pressure, and an increased likelihood that the Federal Reserve will keep boosting interest rates, it should be no surprise that bond demand has kept weakening in recent months. The October stock market decline did spark a short bout of safe-haven buying in bonds, but overall, the air has continued to leak out of the market. The over-arching decline in bond prices continues to boost yields. The yield on the benchmark 10-Year Treasury Note ended October at a seven-year high of 3.16%, compared with 3.06% at the end of September. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was a negative 0.6% in October, and a negative 1.6% over the last year. Times remain very tough indeed for fixed-income investors!

Unfortunately, as we look into the future, we think rising inflation pressure and increased government borrowing will continue to present serious headwinds for bonds. Just as important, while bond demand repeatedly rose over the last year when the 10-Year Treasury yield reached 3.00%, such buying interest failed to materialize when the yield rose above that level in late September and early October. That suggests to us that investors have finally become more convinced about the strength of the economy, the rise in inflation, and the threat of higher interest rates. If so, they could keep selling fixed income and pushing yields higher. In our view, bonds with longer maturities will be most at risk.

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Real Estate and Commodities

Publicly-traded real estate investment trusts (REITs) often perform poorly when bond yields are rising, so it was no surprise that they declined in October. At the end of the month, the FTSE NAREIT Price Index stood 2.8% below its level at the end of September and 2.3% lower than at the end of October 2017. Reflecting their relatively high dividends, the total return on publicly-traded REITs was a negative 2.6% in October and a positive 1.4% over the last year. Looking ahead, we believe the continued economic expansion should keep REITs' operational dynamics healthy, but we are concerned that rising bond yields will continue to weigh on their price performance.

The demand for physical commodities also weakened in October, reflecting some of the same concerns that helped drive down stock prices. For example, investors began to worry that rising interest rates and protectionist trade policies might eventually undermine the global economy, sapping demand for all kinds of raw goods. The S&P GSCI Total Return Index dropped 5.8% during the month, although it was still up a healthy 11.5% over the last year. The concern about faltering demand was especially negative for crude oil and related products. Prices for industrial metals and many agricultural commodities also weakened, but safe-haven buying helped give a boost to gold and other precious metals. If we are correct that investors are now coming to terms with the evolving risks, and if that allows them to focus again on the fact that current economic growth remains robust even as supply becomes more questionable, we think commodity prices would well stabilize or even rebound in the coming months.

Patrick Fearon, CFA
Chief Investment Officer

Asset Class	Index	Ending Reading, Latest Month	1-Month Change	3-Month Change	12-Month Change
U.S. Stocks	S&P 500 Price Index	2,711.74	-6.9%	-3.7%	5.3%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	265.84	-8.2%	-10.2%	-10.6%
REITs	FTSE NAREIT All-Equity Price Index	657.87	-2.8%	-3.4%	-2.3%
Commodities	S&P GSCI Total Return Index	2,692.36	-5.8%	-1.1%	11.5%
Bonds	S&P U.S. Aggregate Bond Index	189.86	-0.6%	-0.6%	-1.6%