Recently, the market downturn has dominated headlines in the financial press. While selloffs are to be expected in the equity markets, that doesn't make them any less unsettling when they occur. This year, the market has experienced two 10% declines, the most recent of which began in late September. However, we have been witnessing a rolling bear market for much of the 2018. Over 60% of the 500 names in the S&P 500 Index have experienced declines of 20% or more from their 2018 highs at some point during the year. Many Metals & Mining, Construction, Industrial, Semiconductor, and Oil Service stocks have fallen over 25% from their 52-week highs.

The question we hear from clients is what happens from this point? Our *April 2018 Investment Perspectives* provided thoughts on the shortcomings of market timing. However, given the market has surrendered its 2018 gains, we thought we would provide some fundamental perspective on the year and describe what we are focused on:

- **Valuation.** The market now sells for around 15x next year's earnings and less than that on 2020 earnings. This P/E level is below the market's longer-term historical average of 16.1x. By this measure the market is not overvalued.
- **Earnings Growth.** Earnings in 2018 grew 21% over 2017 and 13% if you exclude the impact of the corporate tax cut. The bear case is that earnings estimates for 2019 are too high and that estimates will keep falling, perhaps to a 1-4% growth rate. We believe that forecast is overly pessimistic. Share buybacks should generate 2% earnings growth and large tech and communications companies, such as Microsoft, Alphabet, and Amazon appear well positioned to continue double-digit earnings growth. Weaker industries, such as autos, building materials, and energy, account for a relatively small percent of total earnings. Our research points to a 5-7% improvement in earnings per share in 2019.
- **Consumer Economy.** We live in a consumer-driven economy and for GDP and earnings growth to slow precipitously, consumers would need to stop spending. We know that wages are higher, unemployment is low (3.7%), the cost of gas is down, and Americans received a tax cut this year. All of this is positive for growth and consumption.
- **Interest Rates.** The media has focused on the "inverted yield curve", which means that short-term rates are higher than those on longer-term debt. This occurs when investors believe that the economy will weaken in the medium-term, generally a warning sign of a recession. Based on our outlook, we are less inclined to expect a recession in 2019. The Federal Reserve, which has steadily raised rates over the last two years, may now wait on further increases in 2019 unless economic growth justifies the hike.
- **Trade & Tariffs.** The market is also very worried about the trade tensions with China and the imposition of tariffs. While there is likely to be continued negative headlines about this topic for the next few months, we believe it more likely that the president addresses his constituents' concerns and reaches some type of agreement.

In closing, we could trade flat, with zig zags up and down, over the next few months. While there are risks of a slowdown, we do not see systemic signs of a recession in the next year. We believe that following this recent decline, many very good companies are trading at more attractive valuations. Our research efforts are focused on finding companies with secular growth stories and durable business models.