

# A Sentiment-Driven Market Correction

February 6, 2018



## WHAT

After an impressive start to 2018, volatility has reasserted itself and ignited a severe rout in stock markets across the world – leaving no region or sector unscathed. Notably, the CBOE Volatility Index soared to levels not seen since August 2015 and posted its largest one-day rise on record on Monday, February 5, 2018, while the S&P 500 has pulled back by over 8% since last week's record levels and now sits in negative territory for the year. The collapse in risk-assets has also reverberated more broadly, with the gauge of world equities tumbling lower, while commodity (ex-gold) prices have also been caught in the crossfire. In contrast, renewed market angst has spurred a bid for safe haven assets such as government bonds, the US dollar, and gold.

## WHY

The plunge in global stock markets has come on the heels of some investor trepidation that the latest back-up in bond yields will curtail global growth and erode corporate profitability - all at a time when stretched valuations and euphoric investor sentiment have left little cushion for disappointment. Specifically, the downward move in risk assets was sparked by last Friday's US employment report, where concerns emerged that the faster pace of hiring and wage gains would lead to a resurgence in inflation and prompt a faster pace of rate hikes from the Federal Reserve. As such, given the record number of days without a

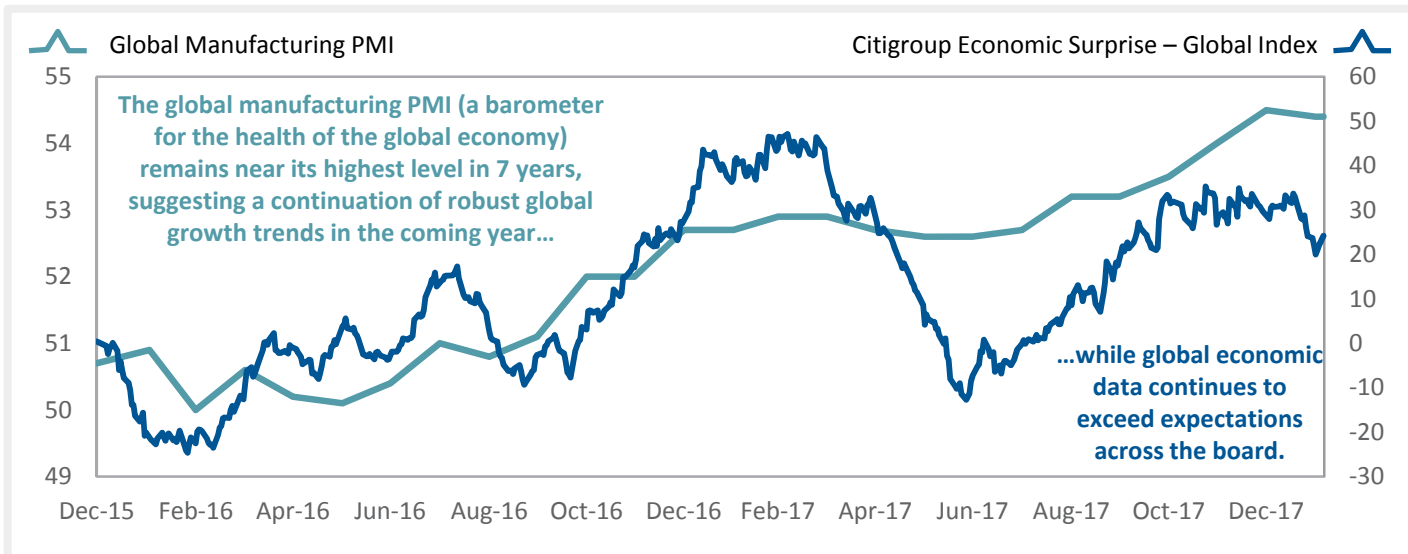
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significant market correction and the heightened levels of complacency in the marketplace, it is not surprising to see some profit-taking following the latest global equity melt-up - representing what we believe to be a healthy pullback from some severely overbought levels.

## WHAT'S NEXT

The good news is that the favorable conditions that have underpinned the stock market rally over the last year remain largely intact at this time. It is important to remember that recessions, not valuations, trigger bear markets and the conditions for a recession remain elusive at this time. Encouragingly, the stronger, more synchronous global expansion continues to linger-on this year, while corporate earnings also remain in acceleration-mode. And while central banks around the world have responded to this economic resilience and have begun reining-in their ultra-accommodative monetary policies, we believe their gradual and pragmatic approach should allow the global recovery to continue on uninterrupted through 2018, lending support to global equity markets in the coming year. As such, after adopting a neutral stance in late 2017, our bias would be to re-establish an overweight allocation in stocks for 2018 at more attractive levels.



Source: Bloomberg as of 2/6/18.

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The S&P 500 Index (SPX) is a stock market index made up of approximately 500 US large cap stocks. The index comprises a collection of stocks of 500 leading companies and captures 80% coverage of available market capitalization.

The CBOE Volatility Index® (VIX® Index®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.

The PMI monthly Composite Reports on Manufacturing and Services are based on surveys of over 300 business executives in private sector manufacturing companies and also 300 private sector services companies. Data is usually released on the third working day of each month. Each response is weighted according to the size of the company and its contribution to total manufacturing or services output accounted for by the sub-sector to which that company belongs. Replies from larger companies have a greater impact on the final index numbers than those from small companies. Results are presented by question asked, showing the percentage of respondents reporting an improvement, deterioration or no change since the previous month. From these percentages, an index is derived: a level of 50.0 signals no change since the previous month, above 50.0 signals an increase (or improvement), below 50.0 a decrease (or contraction).

Citigroup Economic Surprise – Global Index measures economic news and is defined as weighted historical standard deviations of data surprises (actual releases vs Bloomberg survey median).