Wealth Management Market Commentary

REGIONS
ASSET MANAGEMENT

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Let The Expectations Games Commence!

Earnings season is upon us yet again, with last week acting as the appetizer in what is setting up to be every bit of a filling four-course meal. We have to pace ourselves; after all, earnings season is a marathon, not a sprint, but so far at least, results remain quite encouraging. We have an admittedly small sample size at this juncture - just 27 out of 505 S&P companies have reported - and the consumer staples sector is the only group with over 20 percent of constituents having already delivered results. Of the 27 companies that have reported, 92.5 percent reported earnings per share (EPS) that either beat or were in-line with the consensus estimate, while 81.5 percent bested the consensus estimate for sales.

We expect positive results this earnings season, broadly speaking, but it's notable that growth expectations are more than a little lofty for a few pockets of the market. The energy sector is projected to grow earnings by a whopping 143 percent year-over-year on 18 percent revenue growth. Large integrated names such as ConocoPhillips and Chevron, along with companies in the exploration and production, as well as oilfield services areas are expected to drive EPS growth for the sector. West Texas Intermediate (WTI) crude oil averaged just north of $48 per barrel in the second quarter of 2017, and just below $68 per barrel in the 2nd quarter of 2018, setting a low bar and attractive year-over-year comparisons for companies tied to the oil patch. With WTI recently rising into the mid-$70's, conference calls will be closely monitored for what energy execs have to say about industry dynamics and their outlook for crude prices throughout the balance of '18 and beyond.

The information technology (IT) sector has more than doubled the return of the broader S&P 500 over the past year, providing market leadership during times when it seemed like no other sector wanted to step up and lend a hand. The analyst consensus estimate calls for the sector to deliver 24 percent year-over-year earnings growth in the 2nd quarter, driven by internet software and services, as well as semiconductors and semiconductor equipment. Semiconductors and semiconductor equipment have been whipsawed by the ongoing trade spat between the U.S. and China. The People's Republic is a significant export market for many of these companies, and many tech companies "partner" with Chinese firms to make goods there. Chinese regulators continue to hold all the cards on Qualcomm's proposed acquisition of NXP Semiconductors, which may be the bigger near-term semi story. FAANG (Facebook, Amazon, Apple, Netflix, and Google, now Alphabet) has led the technology charge, with those five names generating an average return of 43% year-to-date – outpacing the tech-heavy Nasdaq Composite by 30%. Should one or more of the FAANG names miss on earnings or lower guidance, the group, and IT broadly, could experience some painful profit taking given the recent run.

Earnings season is the quarterly culmination of an ongoing process we would characterize as an expectations game. Management teams spend inordinate amounts of time guiding (read: hand holding) analysts and investors toward a range of outcomes for sales, expenses, and earnings, among other "key" metrics. The best in the business always attempt to under-promise, setting expectations at levels they believe they can at least meet even in the event of an unanticipated downturn, in an effort to deliver above consensus results, thus driving their stock price and investor sentiment higher. Maintaining momentum, both from a business operations perspective, but also with the investor community, is crucial, as yesterday's hot idea is often easily forgotten. After all, the ongoing search for tomorrow's winners is why we and others in the industry show up on a daily basis.

Management teams that have exhibited a consistent ability to deliver metrics above analyst expectations carry a halo effect, receive the benefit of the doubt from investors, and are often above reproach in the eyes of the analyst community. This is often a good thing, but certain managers also wield potentially too much influence, driving overreaction by voicing uncertainty surrounding the backdrop for an entire industry. This quarter, we're likely to hear an inordinate amount of hemming and hawing from management teams, especially those with large international presences, related to trade and tariffs. However, we believe it is too early for management to use tariffs as an earnings miss excuse. While the ongoing trade spat is likely to do little good for C-suite confidence, most commentary surrounding it on conference calls will likely be hyperbole in an effort to lower investor expectations. Understand that this is simply a part of the expectations game, and while noisy and potentially unsettling, the resetting of expectations brings with it opportunities for long-term investors.

A Canary in the Copper Mine?

Copper, or Dr. Copper as it has been called, is often viewed as a leading indicator of global economic growth given the multitude of uses for the metal across industries. The downturn in copper prices of late has been more than a bit unsettling for those all-in on the idea that copper has earned its Ph.D. in economics due to a historical ability to predict swings – up or down - in the global economy. The price of a pound of copper peaked at $3.30 in late December, traded between $3 and $3.15 from March through May, then re-tested the $3.30 level again in early June prior to its recent drop to $2.75. A 17% decline in 5 weeks leaves us scratching our heads.

Volatility in the metal's price is nothing new, but even for a commodity where volatility is expected, the magnitude of the recent drop has us wondering if something more sinister may be afoot on the global economic growth front. Demand from China has driven much of the price action in copper over the past decade, so it stands to reason that traders might be paring back exposure to the commodity on fears that changes to trade policy might lower demand from the People's Republic. At this point we don't really know what to make of the sell-off in copper, it may just be part of a broader de-risking move across global portfolios, but price action in the metal is well worth monitoring over the near-term.

Source: Bloomberg, Factset

	Price/Yield	Total Return (%)					
	7/13/2018	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	25019.41	2.32	-0.60	2.41	18.75	14.46	12.81
S&P 500	2801.31	1.55	1.08	5.86	16.68	12.40	13.08
NASDAQ	7825.98	1.79	1.76	14.00	26.05	16.90	18.17
Russell 2000 Index	1687.08	-0.39	0.77	10.58	19.85	11.61	11.73
MSCI World ex US	1970.89	1.16	-1.94	-1.59	7.15	5.38	5.99
MSCI EM	1075.64	1.52	-4.52	-5.56	6.13	7.38	5.45
Bloomberg Barclays US Aggregate	3.27	0.18	1.06	-1.20	0.05	1.97	2.41
Bloomberg Barclays Global Aggregate	1.99	-0.43	0.14	-1.41	1.67	2.89	1.44
Bloomberg Barclays US Corporate Index	3.95	0.43	1.18	-2.37	0.06	3.54	3.65
Bloomberg Barclays 10-Year Muni Index	2.59	0.30	0.70	-0.31	1.22	2.98	3.73
Bloomberg Barclays High Yield Index	6.39	0.49	0.06	0.67	3.02	5.69	5.36

	Price/Yield						
	7/13/2018	1 Week Ago	1 Month Ago	12/31/2017	1 Year Ago	3 Years Ago	5 Years Ago
1 Month LIBOR (rate)	2.07	2.09	2.07	1.56	1.23	0.19	0.19
30 Year Mortgage (average rate)	4.37	4.37	4.43	3.86	3.86	4.22	4.37
2 Year Treasury (yield)	2.57	2.53	2.57	1.88	1.36	0.67	0.34
10 Year Treasury (yield)	2.83	2.82	2.98	2.41	2.35	2.45	2.59
30 Year Treasury (yield)	2.93	2.93	3.10	2.76	2.88	3.24	3.63
WTI Crude (closing price)	71.02	73.78	66.63	60.46	46.06	52.19	105.95
Brent Crude (closing price)	75.34	74.98	75.07	66.73	47.65	57.63	108.14
Gold (NYM $/oz)	1239.60	1254.30	1296.90	1306.30	1216.30	1155.20	1277.80

Source: Bloomberg

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