City National Rochdale®
AN RBC/CITY NATIONAL COMPANY

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Special Bulletin

A TWEET TOO FAR? THE CORRECTION ENTERS A NEW PHASE

As fundamental analysts, we focus on the expected path of the economy and earnings, taking into account the Fed, trade wars, and signs of global slowdown. We have done extensive analysis on these matters and feel comfortable with our reasoning. However, with the recent downturn, the market has passed a "normal" correction and has entered into a different phase, admittedly one we did not expect to see given the lack of fundamental deterioration.

We are now seeing the impact of politics and psychology. Never have so many normally cool-headed traders and clients called us with extreme frustration, and that frustration was precipitated by the fact that the president would consider firing the Federal Reserve chairman (which he did not actually declare publicly, but which reports have suggested he discussed). These types of proclamations certainly fueled the selling last week, adding to the downward trend of U.S. markets versus global markets. Until the past few weeks, markets seemed to ignore his tweets. Not so much anymore.

We stay anchored to our view of the fundamentals, which remain in growth mode, and the majority of our economic indicators (the City National Rochdale Speedometers[SM]) remain positive. That said, the Speedometer for Geopolitical Risk, which includes the risk associated with international policy, trade, and other events that can impact the normal course of international relations, is negative, and it appears to be in control at the moment.

KEY POINTS

The market has passed a "normal" correction, and we are now seeing the impact of politics and psychology.

We stay anchored to our view of the fundamentals, which remain in growth mode.

Ninety percent of the time, when our "mood" models reach levels indicating panic, the markets are higher one year out.

Though Wall Street may be having a crisis of confidence, Main Street seems to be enjoying the holidays; shoppers just delivered the strongest holiday retail sales increase since 2012.

Our portfolios are built to withstand volatility, and we are taking certain steps within our strategies to cushion the impact.

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Until these factors settle, forecasting the market's next move is difficult, and psychology can push it around more than fundamentals would dictate. We now have to resort to a different set of tools: those that monitor the mood of the markets to understand where it may go.

One of our favorite "mood charts" graphs the percentage of S&P 500 stocks that are down over 20% versus the high yield credit spread. These two levels normally track one another and have only decoupled twice since the mid-2000s: in 2016 and now. This indicates that the equity market is more concerned than the credit market by a large margin, which is a comforting sign. Another model, which tracks panic versus euphoria in the markets, has just dipped below the range of normal behavior and entered into panic territory. We haven't seen that since 2016, though it got a little worse back then and could this time also. **Ninety percent of the time, when the models reach these readings, the markets are higher one year out.**

We do believe stock prices will move higher over time and that cooler heads will prevail. Our discipline, which has served us well over decades, keeps us focused on fundamentals, unless a broad crisis of confidence ensues. Though Wall Street may be having that moment, Main Street seems to be enjoying the holidays. Total U.S. retail sales (excluding automobiles) rose 5.1% between Nov. 1 and Dec. 24—the strongest holiday sales increase since 2012 (according to Mastercard SpendingPulse).

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We on the Asset Allocation Committee are staying on top of this situation 24/7. If we can be of any help, please don't hesitate to call us.

Index Definitions

The Standard & Poor's 500 Index (S&P 500) is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance.

Indices are unmanaged, and one cannot invest directly in an index. Index returns do not reflect a deduction for fees or expenses.