October 25, 2018

COLONY MARKET BRIEF

As you are likely aware, volatility has continued in October and we've seen some dramatic price swings. Equity markets experienced another steep selloff yesterday as selling pressure increased late in the day. For example, the S&P 500 Index declined 3.1% and erased its year-to-date gain. As we've discussed in the past, it's always hard to pinpoint exactly what's driving markets in the short-term as they can behave irrationally. However, markets seem to be reacting to a combination of ongoing geopolitical risks, in addition to the potential negative impacts of a trade war with China.

Some companies have mentioned in their recent earnings announcements rising input costs resulting from tariffs, which has a negative impact on profit margins. Of the 110 S&P 500 companies that have reported third quarter earnings thus far (as of Tuesday's close), nearly 40% of them have addressed the impact of tariffs directly in their earnings report or during analyst calls. Despite the overhang of tariffs, according to FactSet, 80% of companies have reported better than expected earnings results with an overall growth rate of 19.5%, well above long-term averages. Analysts continue to expect S&P 500 corporate earnings to grow at double-digit levels in the fourth quarter, but a more moderate growth rate of 10% in 2019 as the benefits of the corporate tax reductions anniversary.

Our investment committee met recently to review our quarterly asset allocation research and to discuss portfolio positioning and strategy. Given that there are no material changes to our base case assumptions (continued modest economic growth accompanied by a modest increase in interest rates and inflation), we think it's appropriate to add selectively to equity positions on recent weakness. Specifically, we think emerging markets stocks present an attractive risk/reward profile and we plan to rebalance portfolios back to their target weight.

While equities traded higher today, we do expect volatility to remain elevated as we continue through third quarter corporate earnings season and approach mid-term elections. Our portfolios continue to have higher levels of cash/short-term fixed income as "dry powder" to potentially take advantage of attractive investment opportunities. Additionally, our overweight to flexible/alternative strategies has the potential to benefit from higher market volatility.