Despite a strong rebound on Thursday, Friday's drop left the Dow down 3%, the S&P 500 down 3.9%, and the Nasdaq down 3.8% for the week. It was a bumpy ride for stocks throughout the week, with declines on Monday, Tuesday, and a steep decline on Wednesday. Stocks partially recovered on Thursday, then tumbled again on Friday.

Intraday volatility saw the Dow down over 500 points on Tuesday to then reverse course over the last hour of trading and close off just 125 points. The Dow had four days last week with intraday moves over 400 points.

Much of the recent market volatility can be traced back to two things, rising bond yields and concerns about trade.

> Bond yields have surged in recent weeks to account for stronger economic growth and the fact that the Fed is allowing interest rates to rise. When yields on Treasuries rise, they compete with the returns from other assets. Rising rates also make borrowing more expensive and slows economic growth.
>
> While one source of uncertainty was resolved with the renegotiation of the trade agreement between Canada, Mexico and the US, the tensions with China remain high. With the prospect of more tariffs looming, trade relations appeared to take another turn for the worse as US officials insisted that China come up with a plan to address American concerns about China's alleged theft of US technology.

Quarterly Earnings Reports
As of Friday, 48% of the S&P 500 companies have reported earnings. Of those companies, 77% have earnings that outperformed the projections. In fact, the earnings growth rate for the S&P 500 is 22.5%, which would represent the third highest market since Q3 2010. While the earnings numbers are promising, sustainability is the question as some companies' earnings reports included warnings about slower sales and lower prices for the remainder of the year. Several of these reports weighed on the market last week, most notably the news from Caterpillar, 3M, Harley Davidson, AT&T, Alphabet and Amazon. Amazon, in fact, is no longer a trillion-dollar company, its market value having fallen to $800 billion. (factset.com)

In a sign that a recession is unlikely in the short term, we had our strongest back-to-back quarters of GDP growth since 2014. The initial estimate of third-quarter growth was 3.5%, above economists' expectations. Consumer spending, which accounts for two-thirds of the US GDP, grew at a rate of 4.0% during Q3, the fastest pace since Q4 2014. In fact, this marks the seventh straight month of consumer spending growth. (www.reuters.com)

Despite the downturn, we see two important catalysts for equities as we move forward from here. The first is the market's typical behavior following midterm elections. Historically markets have traded largely flat ahead of midterm elections. The silver lining is that midterm election years tend to be back-loaded, with strong returns in the final few months of the year. In fact, over the last 17 midterm election years, Q4 returns have averaged 5.1%. We expect stocks to follow this trend and rally into the year end.

Second is the large gap between buyback authorizations and those actually executed. While $716 billion of buybacks have been authorized, only $392 billion have been executed. With earnings reports in full swing, several of these companies should be coming out of a blackout period. The result should be companies eager to buy back their stock at reduced prices, which should provide strong support for equities over the next several months. (www.leggmason.com)

While the series of pullbacks we have experienced this month can be frightening for investors, we believe it is important to distinguish between signals and noise. For the time being the risk of a recession remains dormant; which is why we believe this negative stock market action to be a buying opportunity.

Regards,
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