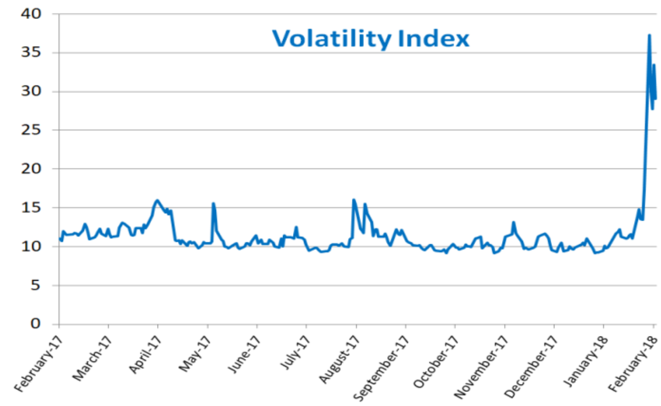
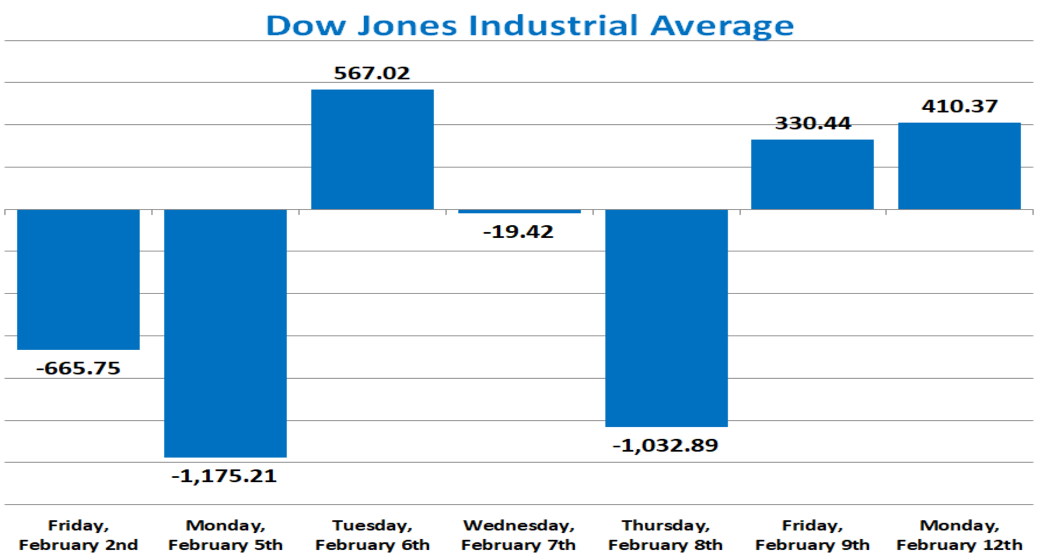


Market Commentary

Monday, February 12, 2018

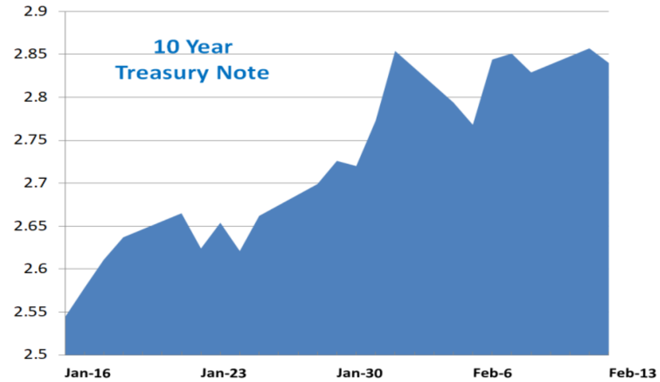
Last week saw the return of volatility in the stock market. After gaining nearly 8% in the first few weeks of January, last week the Dow Jones Industrial Average and the S&P 500 index both fell 5.1%. The chart below shows the Dow Jones Industrial Average's daily gain and loss over the past several days. When major moving market events occur, we want to reach out in order to explain the triggering event, provide an update with our thoughts and discuss the outlook of the market.



The Triggering Event: On Friday, February 2nd, the monthly jobs report from the Bureau of Labor Statistics (BLS) showed average hourly earnings increased 2.9% year over year. That was the fastest pace of wage growth since 2009. Higher wages are a good thing, but faster wage growth has inflation implications. This, in turn, increases the likelihood the Federal Reserve will need to be more aggressive in raising interest-rates, which puts downward pressure on stocks. The Dow Jones Industrial Average responded in kind with a 666 point drop on Friday, February 2nd.

On Monday, February 5th, the market saw a significant spike in volatility. The volatility index or VIX (which measures the market's expected volatility over the next 30 days), spiked higher from below 14 to 38, a 115% increase! (See chart at the top of the page) This is significant because after years of low market volatility, some traders aggressively invested in products that made money if volatility remained low. Oops! Since these traders were only anticipating low volatility, this 100%+ volatility spike essentially wiped out their entire investment. [Note: You did **not** own any of these products. Forward does not put client money into highly speculative products that are mere bets against market volatility.] This volatility spike created a race to get out, thus further exacerbating the selling, leading to even further declines. By the end of the day, the Dow Jones suffered its first 1,000+ point daily decline in history!

The markets began to stabilize on Tuesday and Wednesday, but rising 10 Year Treasury Note yields (See chart on right) continued to put pressure on inflation expectations. Then on Thursday, volatility came back into the market due to a large spending bill, expanding federal deficits, renewed talk of a government shutdown and still more unwinding of the VIX trade. This was the second 1,000 point loss of the week.



As is typical during periods of uncertainty, many investors panic by selling first and asking questions later. This proof was captured in a weekly report that showed investors pulled $23.9 billion out of equity funds last week. **Forward** did not join in the selling. In fact, we were doing the exact opposite. We were selectively buying during the week. So, why did **Forward** buy when so many other people were selling? Because we had been observing the markets and understood the developing situation.

The markets raced almost 8% higher last month, well beyond logic and reason. We were due for a pullback after a 2-year stretch without a normal 10% market correction. Therefore, last week's selloff basically brought us back in line to where we were just a month ago. (That last statement should help put this whole thing in perspective.)

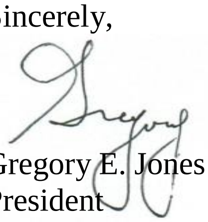
Valuation: Before the pullback, the forward P/E for the S&P 500 (a measure of the overall price of the stock market relative to its predicted earnings) was sitting at 18.5. That was above the historical average of around 16. Typically when a reading is above 18.5 stocks begin to look overvalued or "pricey". After this brief market correction, the forward P/E is now back down to around 16.8, a much better level for long-term investors. The fundamentals of the economy remain strong and the elevated concerns over inflation are likely overblown. Case in point, over the past 2 trading days (Friday, Feb 9th & Monday, Feb 12th) the Dow Jones Industrial Average has gained 5% or over 1,200 points from Friday's intraday low. (A reason why we were selectively buying while others were selling.)

We remain watchful, but do not see a recession or any major event that is likely to significantly imperil this bull market. This is not to say we are giving the 'all-clear' signal. All of the action we described happened in just 7 days. Downward market adjustments can be quick, but seldom are resolved just as quickly. Markets often will re-test their previous lows before moving higher. Therefore, we could be in this trading range for a while and volatility will likely be elevated.

Summary: Before the recent market decline, investor sentiment was high, valuations were becoming elevated, markets were racing higher, and we had not had a normal market correction in over 2 years. The fear of rising inflation triggered the selloff and that was further exacerbated by traders in risky VIX products. Despite the recent turbulence, market fundamentals and valuations remain strong. **Forward** believes markets are now in a bottoming process and, although we are admittedly in the later stages of the economic cycle, we anticipate the stock market will move higher as the year progresses.

The objective of this piece was to provide you with a general understanding of the events that triggered last week's volatile market reaction and help put it into perspective. We would be glad to talk with you more about this at any time. Please give us a call or email me at gjones@forwardinvestmentadvisors.com

Sincerely,



Gregory E. Jones
President