

# 2018 Economic & Stock Market Outlook:

## Clouds Could Test Investor Resolve

Supplemental Chart Pack

December 13, 2017

The background of the bottom section of the slide is a blurred image of a stock market chart. It features several jagged lines in red, green, and yellow, representing different market indices or stock prices, plotted against a light gray grid.

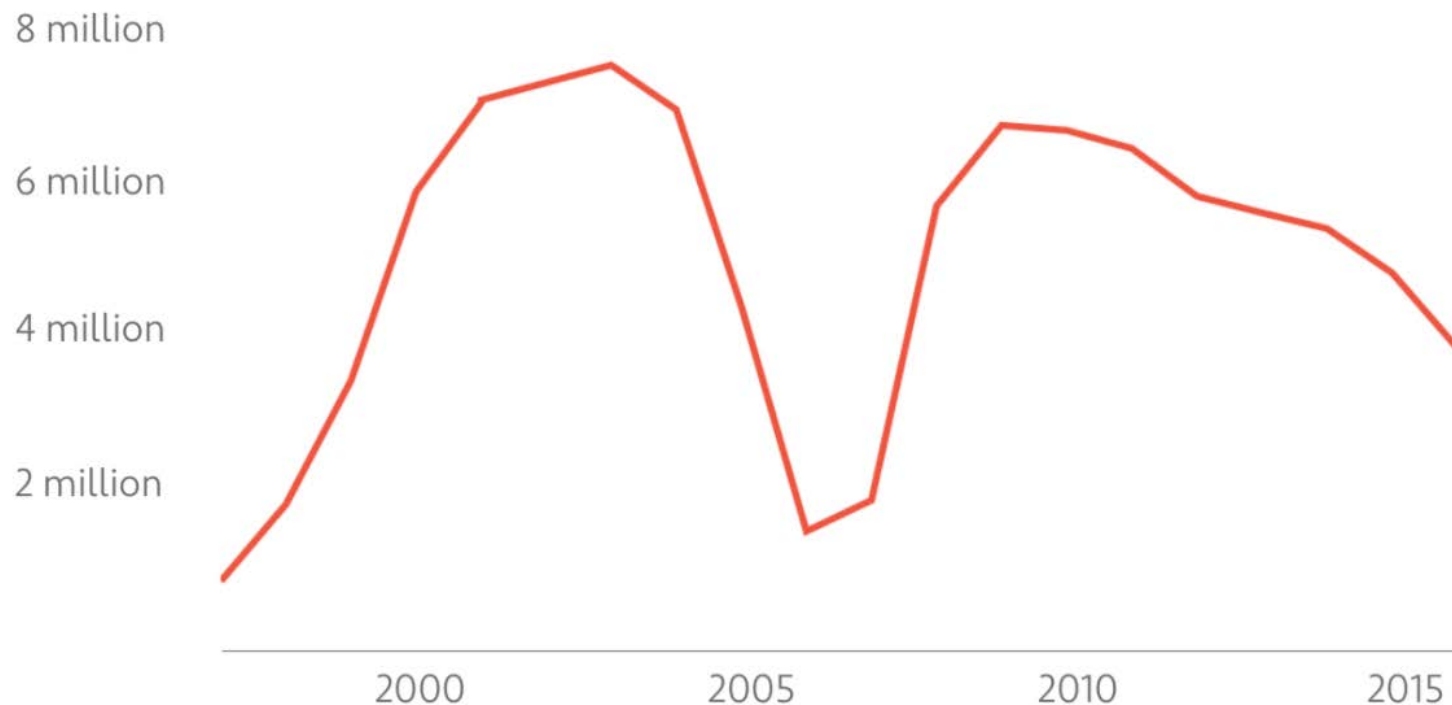
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*The trend here is heading in a more hopeful direction, but the country is still grappling with the consequences of previous decisions.*

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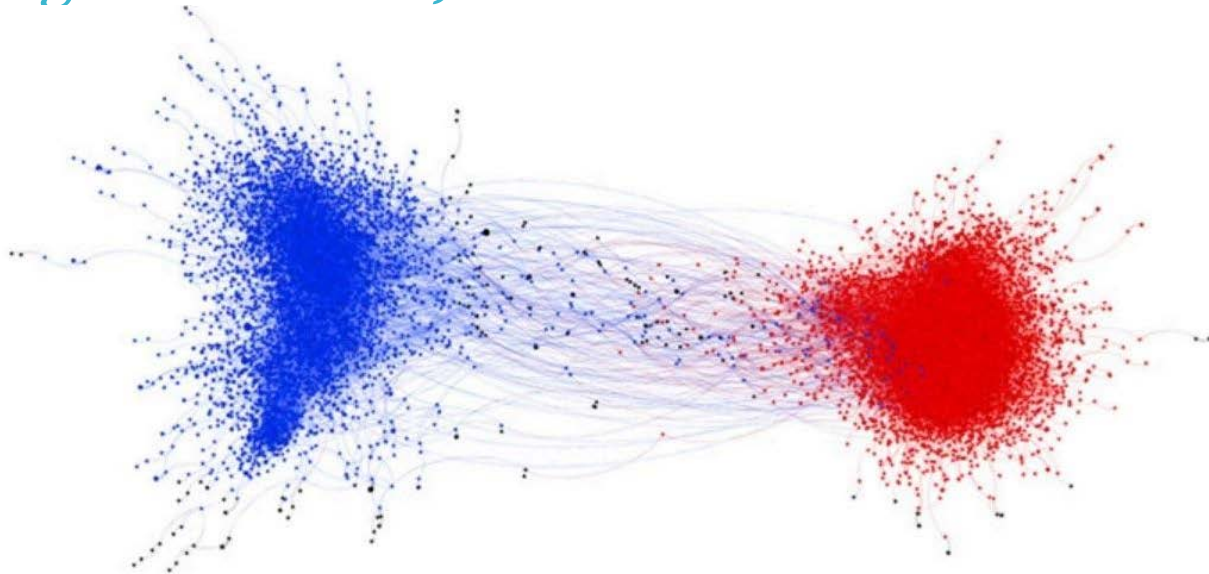
## OxyContin prescriptions 1997-2016



Data courtesy of IQVIA

Sarah Menendez/Marketplace

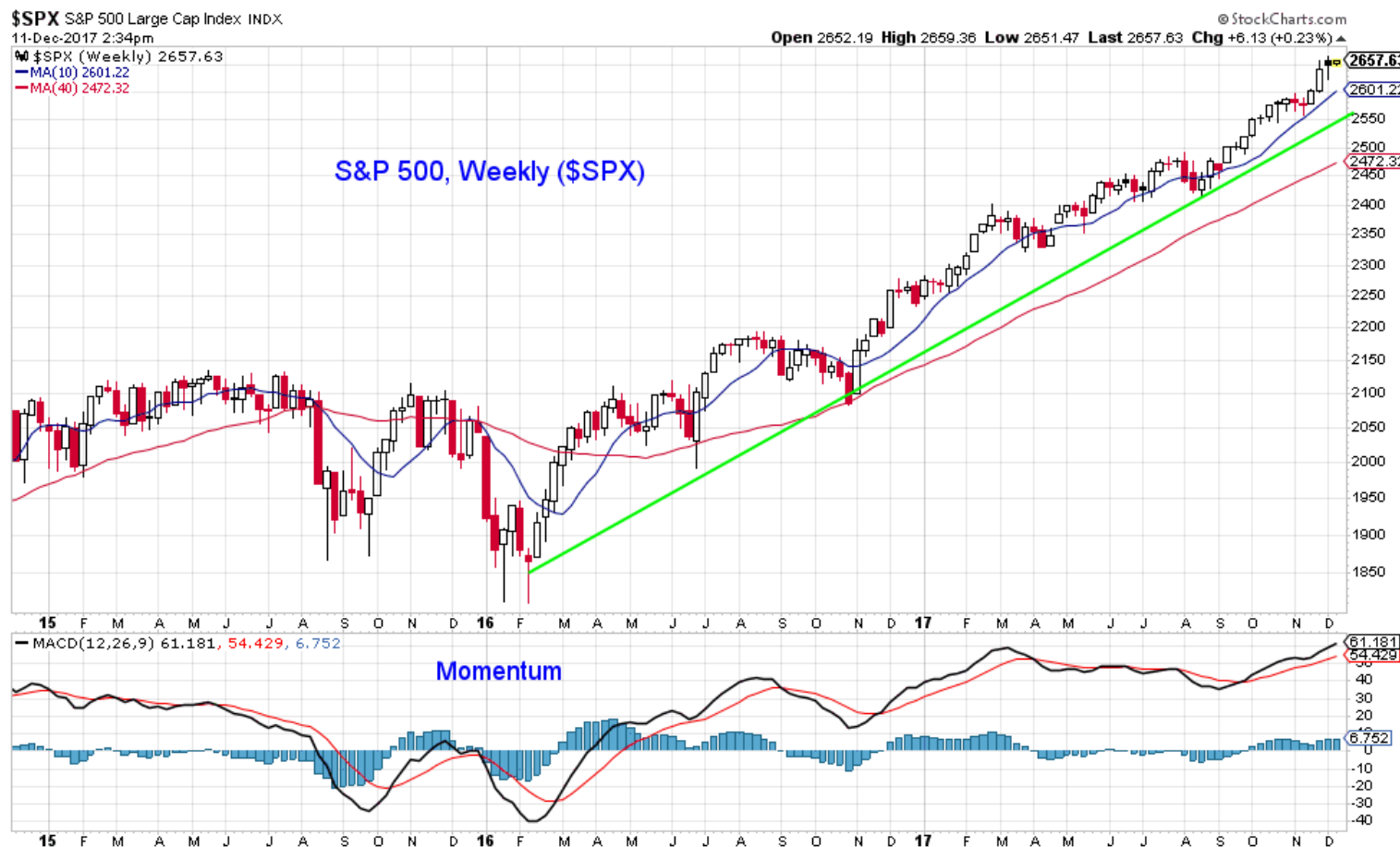
*Our social networks show that we tend to associate with others that share our views. Rather than broadening our horizons, we create echo chambers.*



**Fig. 3.** Network graph of moral contagion shaded by political ideology. The graph represents a depiction of messages containing moral and emotional language, and their retweet activity, across all political topics (gun control, same-sex marriage, climate change). Nodes represent a user who sent a message, and edges (lines) represent a user retweeting another user. The two large communities were shaded based on the mean ideology of each respective community (blue represents a liberal mean, red represents a conservative mean).

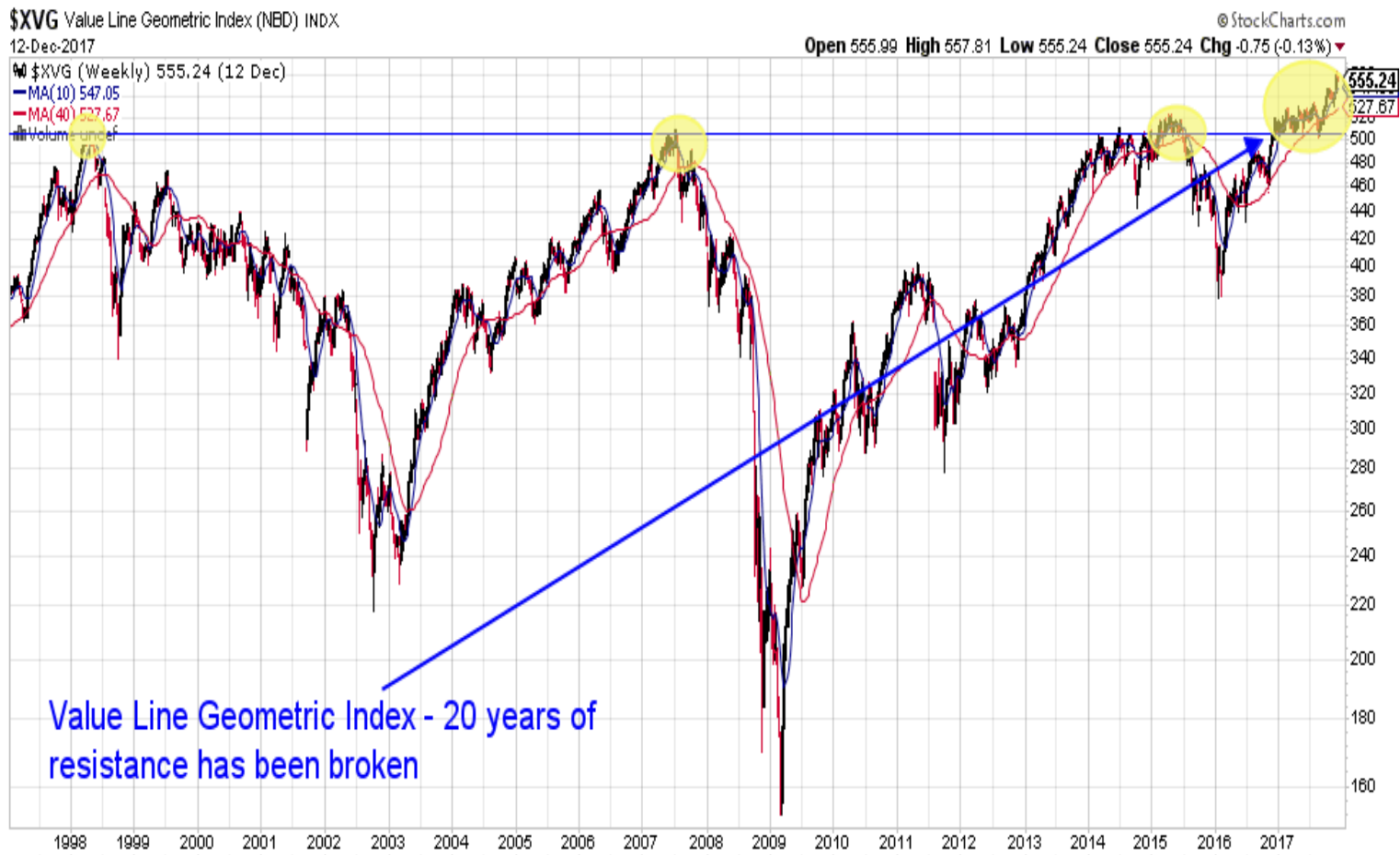
*The cyclical rally in the S&P 500 that emerged off of the early 2016 lows continues to get the benefit of the doubt.*

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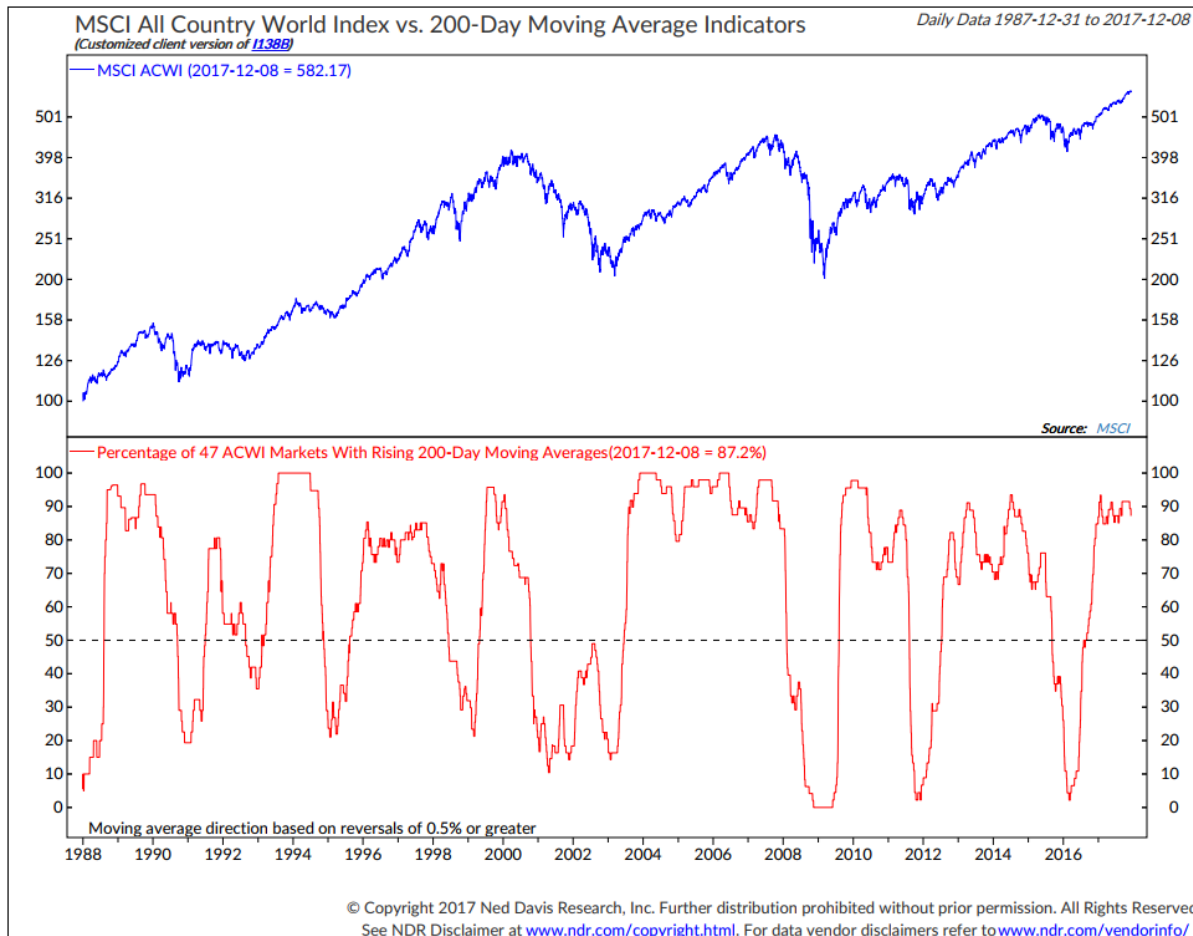
*The Value Line Geometric Index, a gauge of how the median stock is behaving, has broken out to new highs.*

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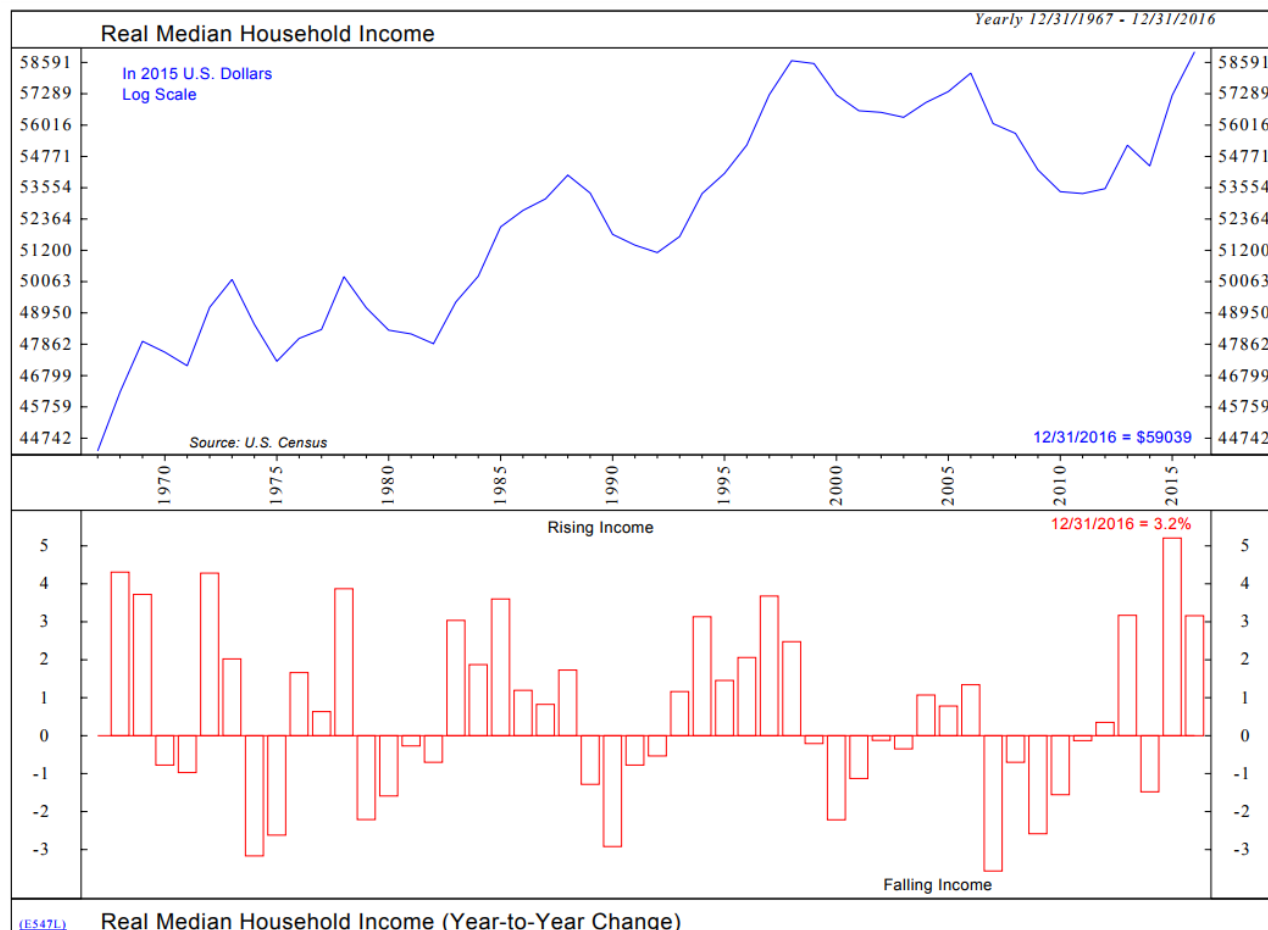
*Stock market strength is currently a global phenomenon – virtually all markets are rallying.*

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*The U.S. economy is making secular progress – real median household income moved to a new high.*

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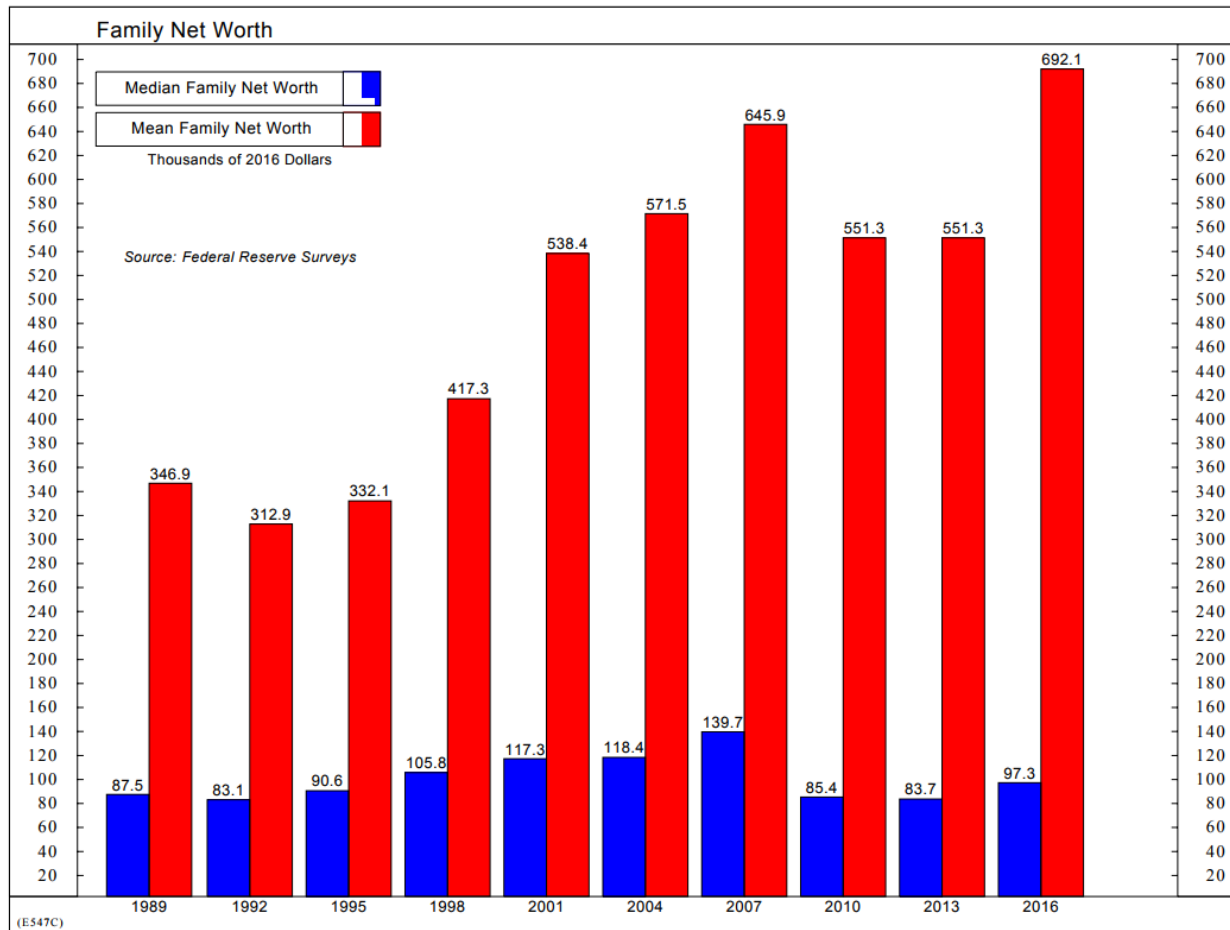


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*Median income has recovered, but net worth for the median family remains below its peak.*

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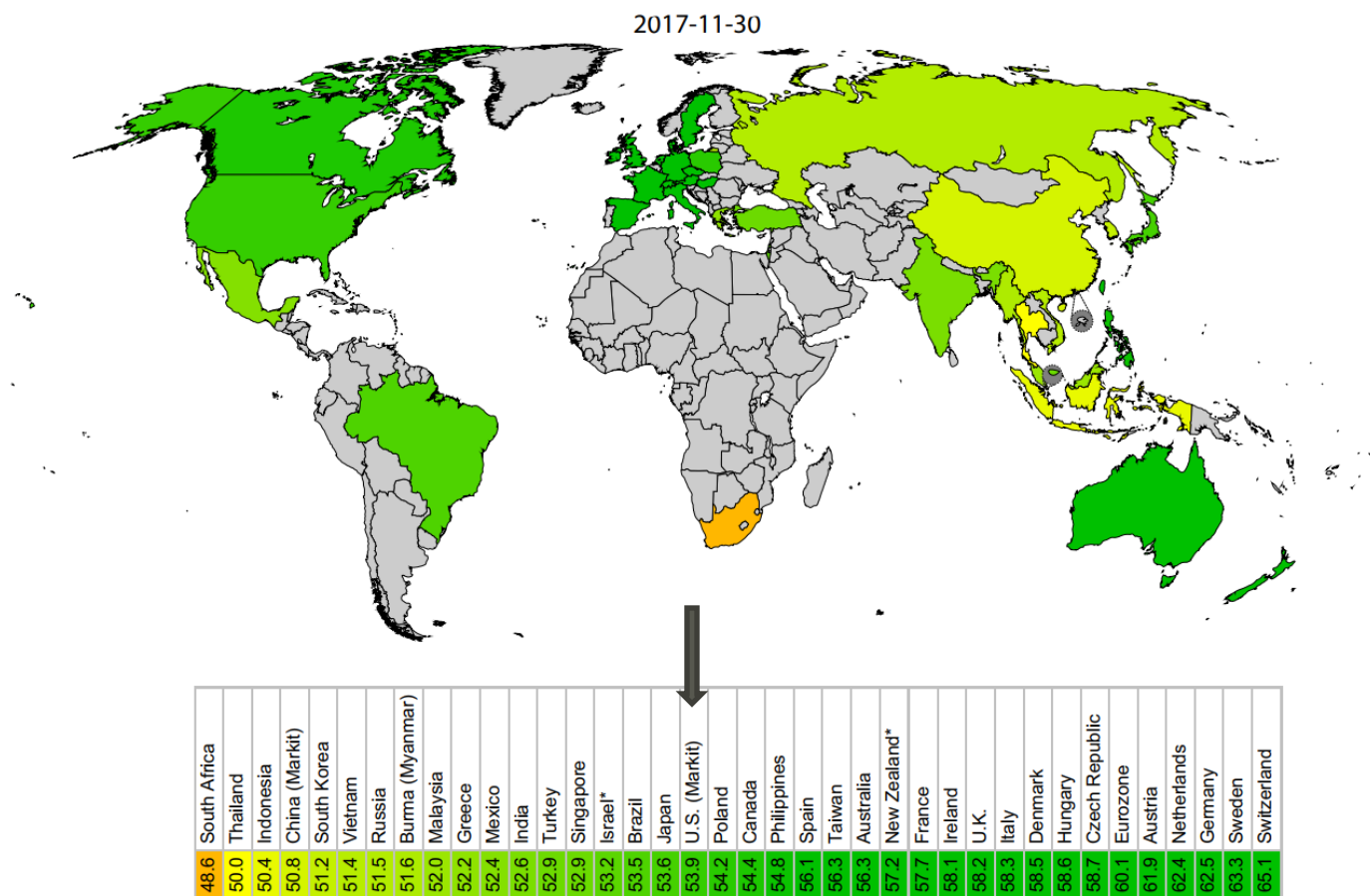


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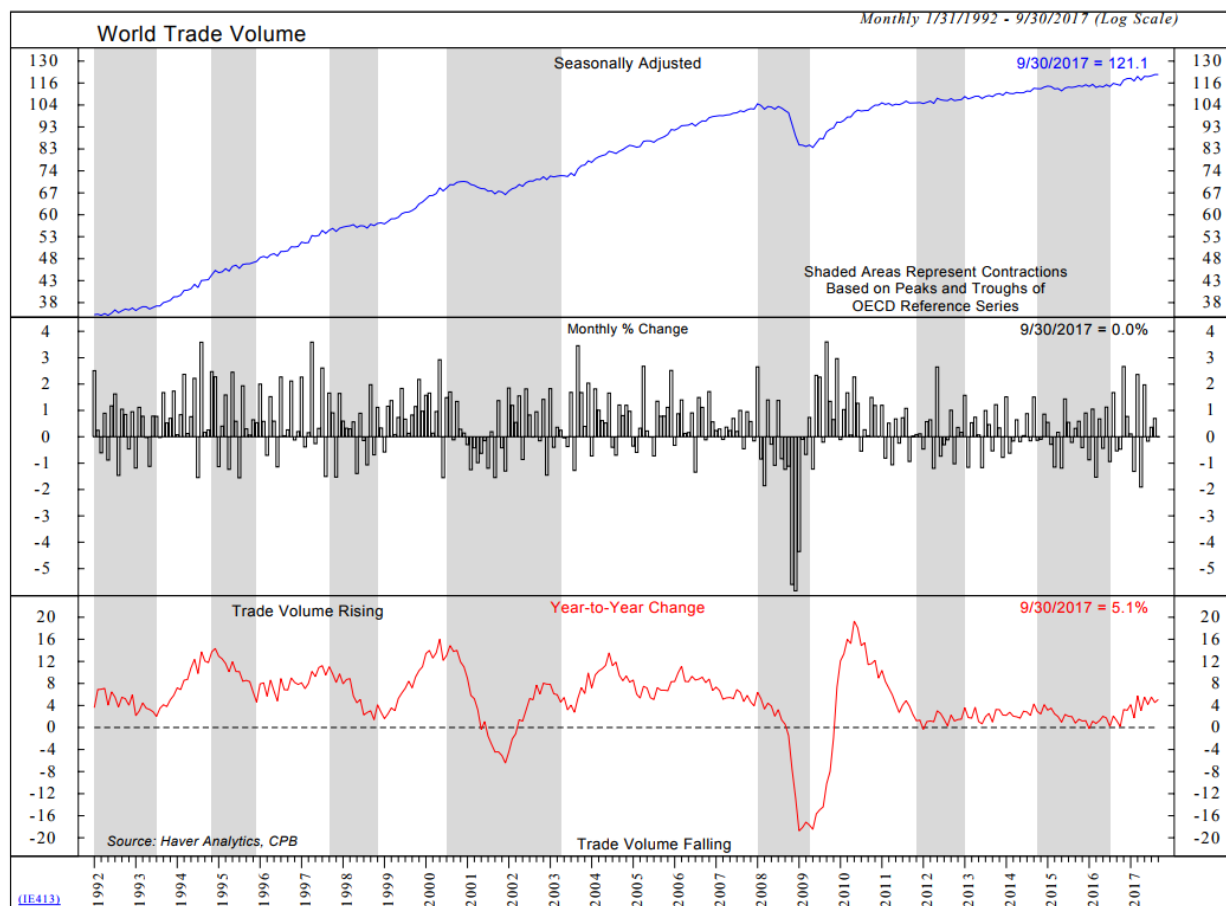
*Entering 2018, almost all areas of the world are seeing economic growth, and the U.S. is by no means leading the charge.*

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*With global growth improving, trade volume is expanding.*

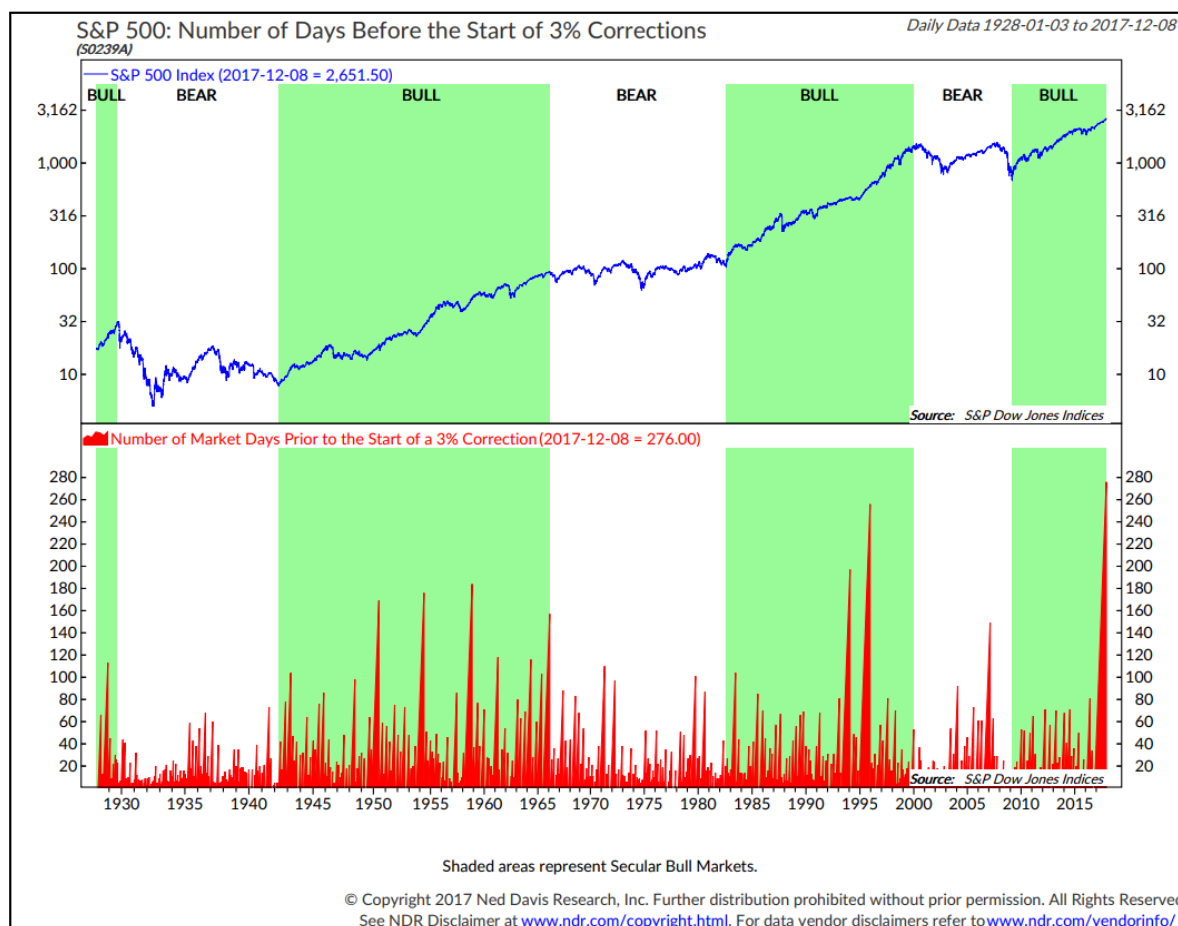
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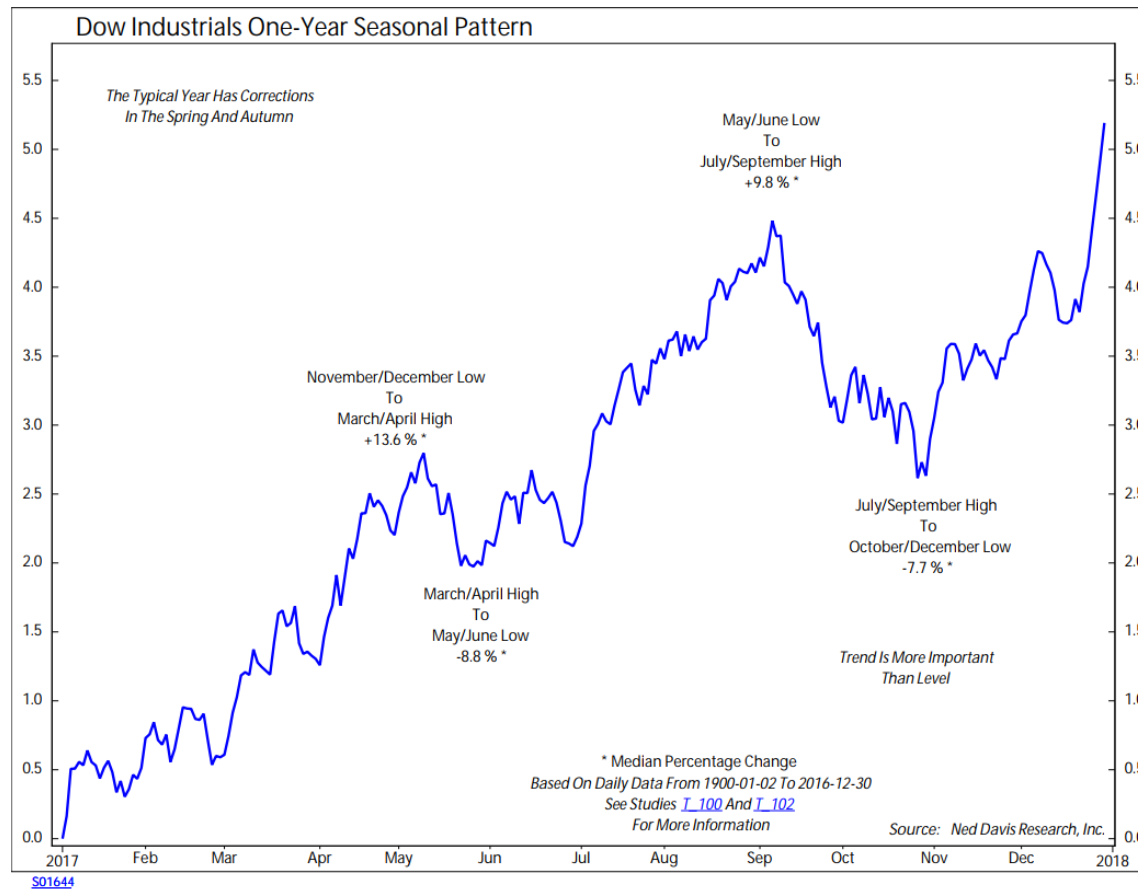
*The stock market experience of 2017 was unique, seeing the longest period on record without even a 3% correction.*

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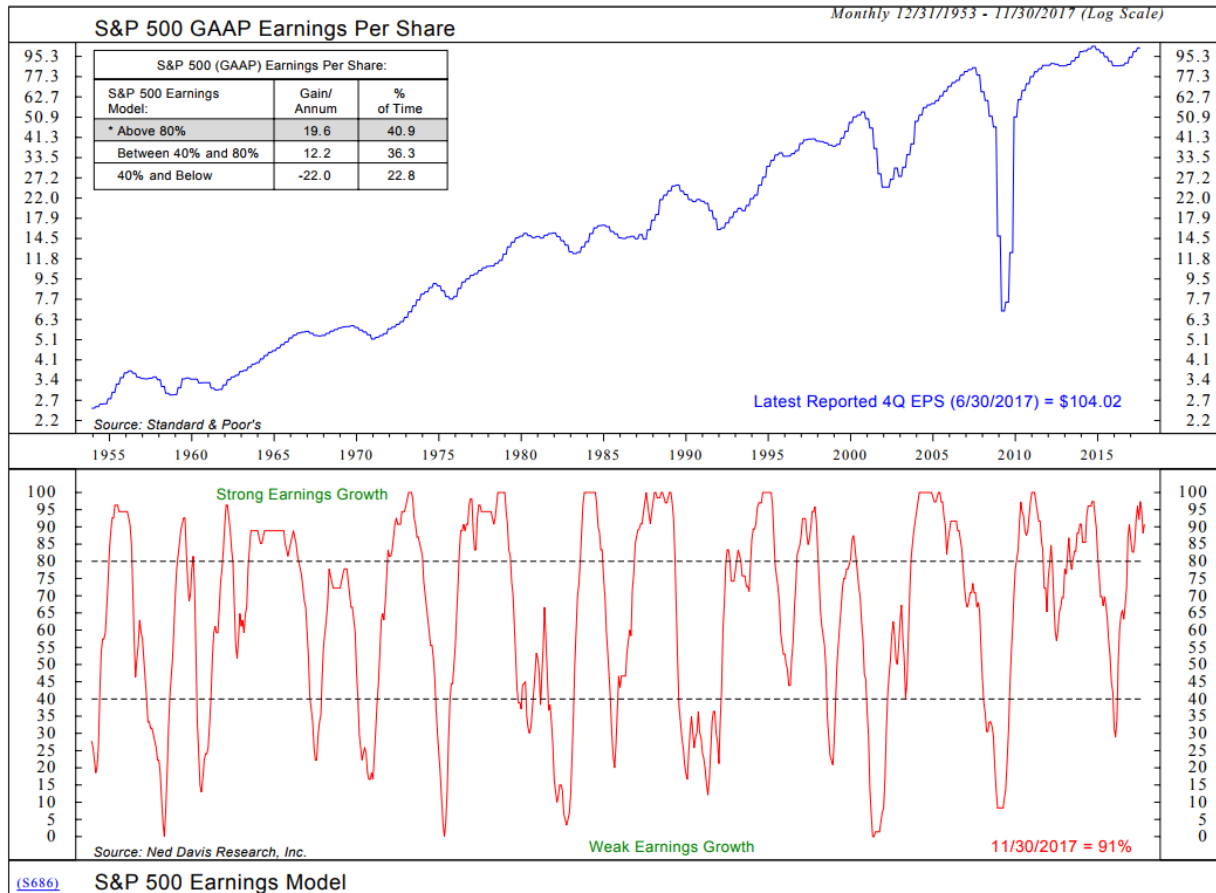
*A more “typical” pattern could be seen in 2018, meaning at least one drawdown approaching double digits would not be surprising.*

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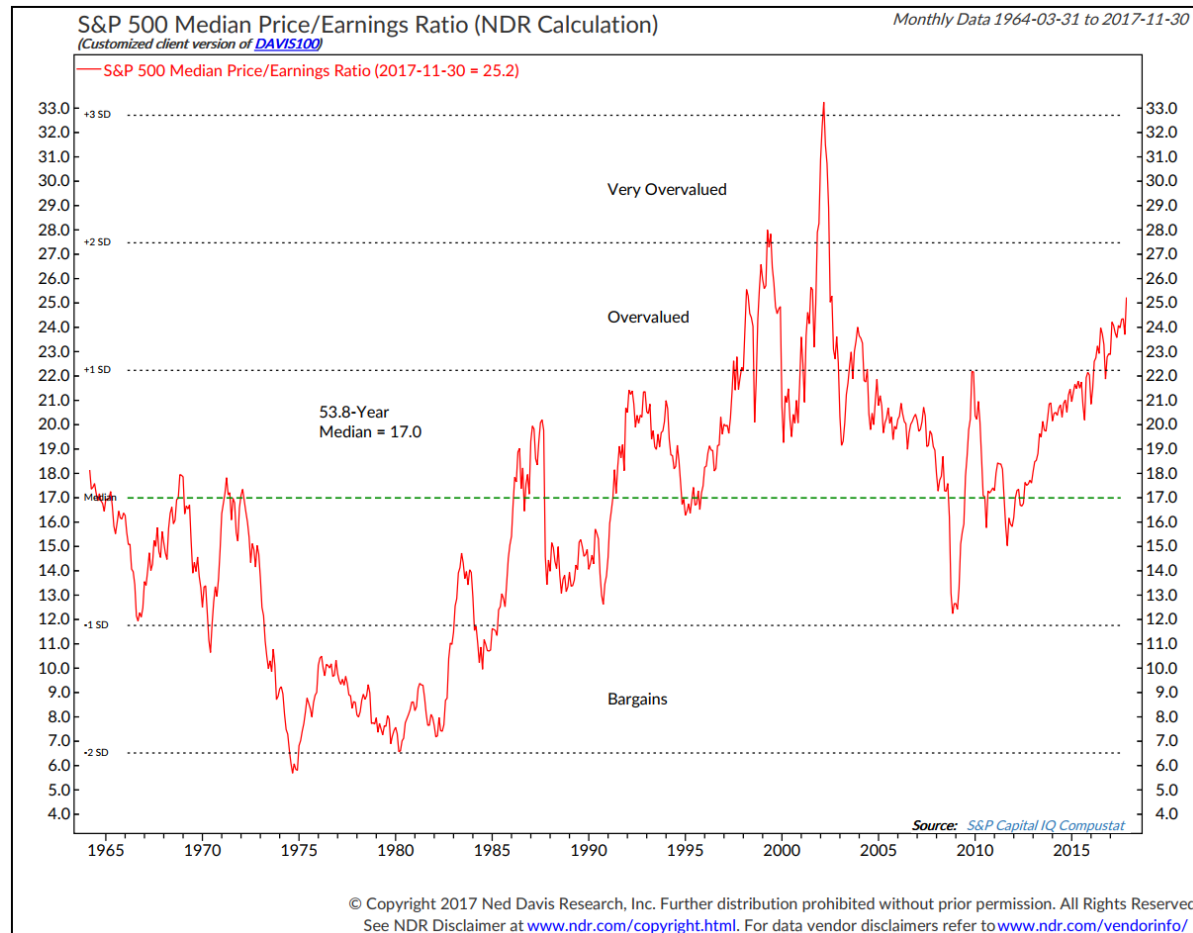
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*The mid-cycle acceleration in earnings growth could be reaching maturity, but this earnings model is not yet showing much deterioration.*

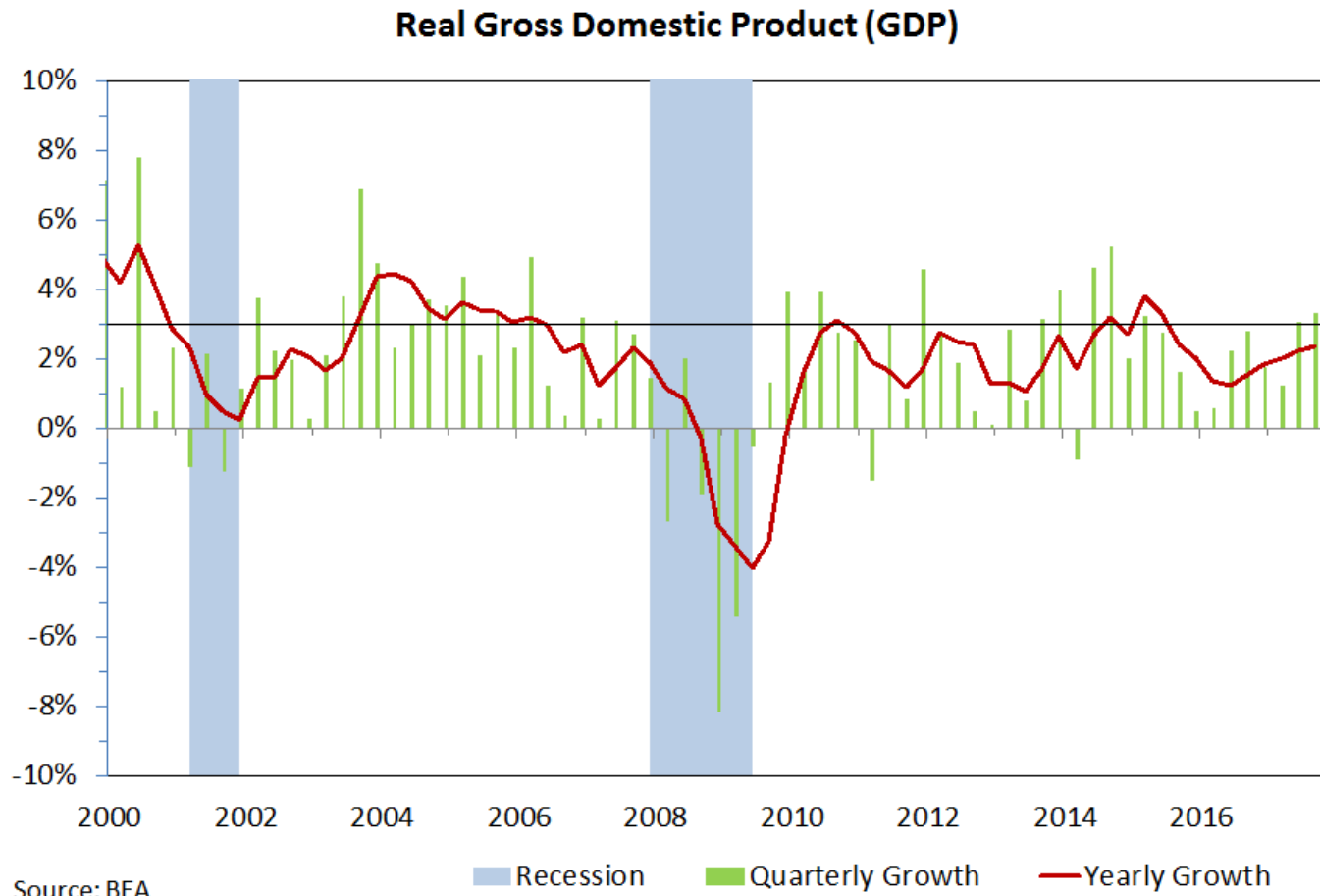


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*Slowing earnings growth could put pressure on prices since valuations suggest stocks are overvalued and priced for perfection.*

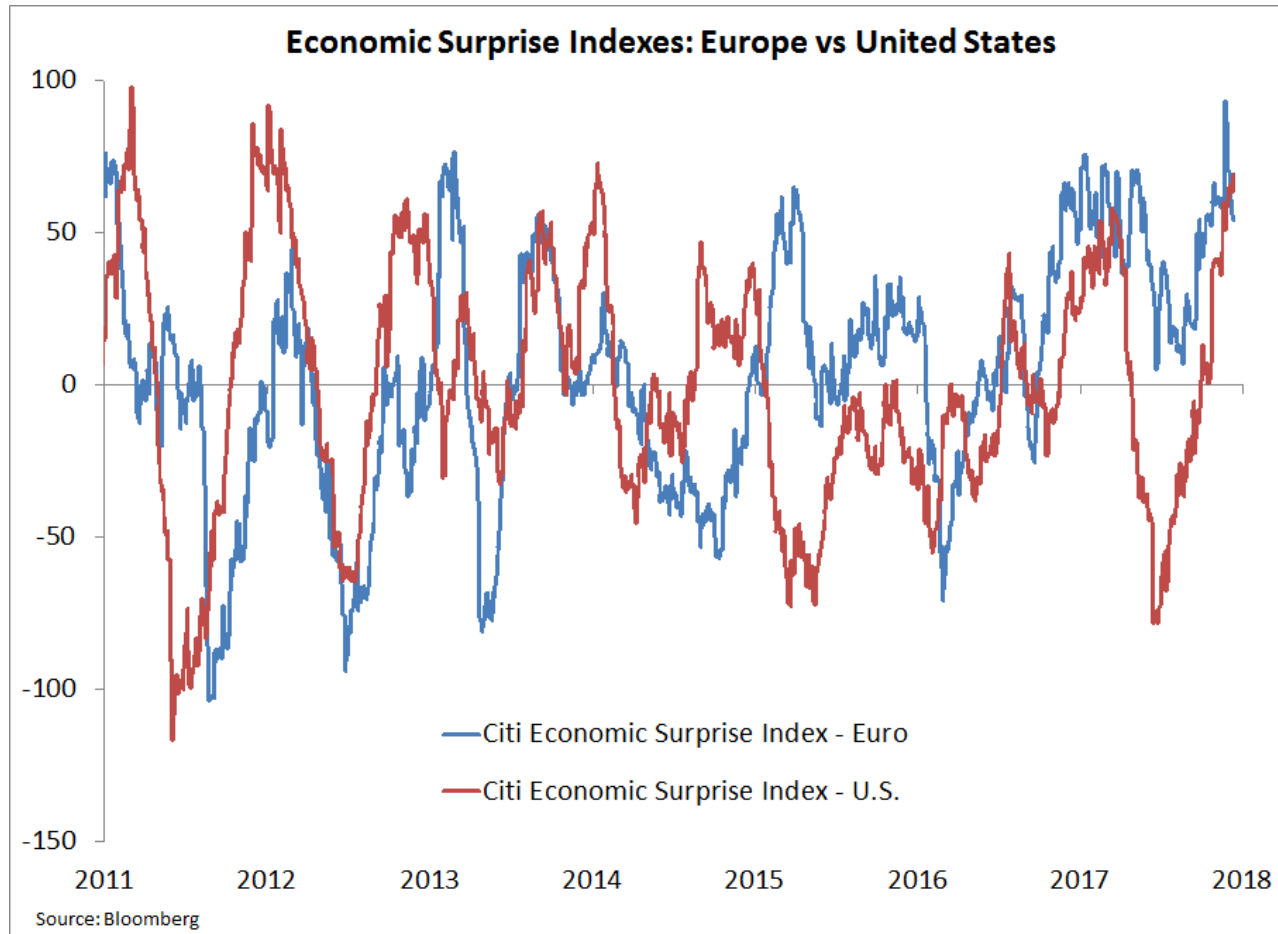


*Accelerating growth could help extend the earnings recovery, and GDP has already put in back-to-back quarters of 3% growth.*

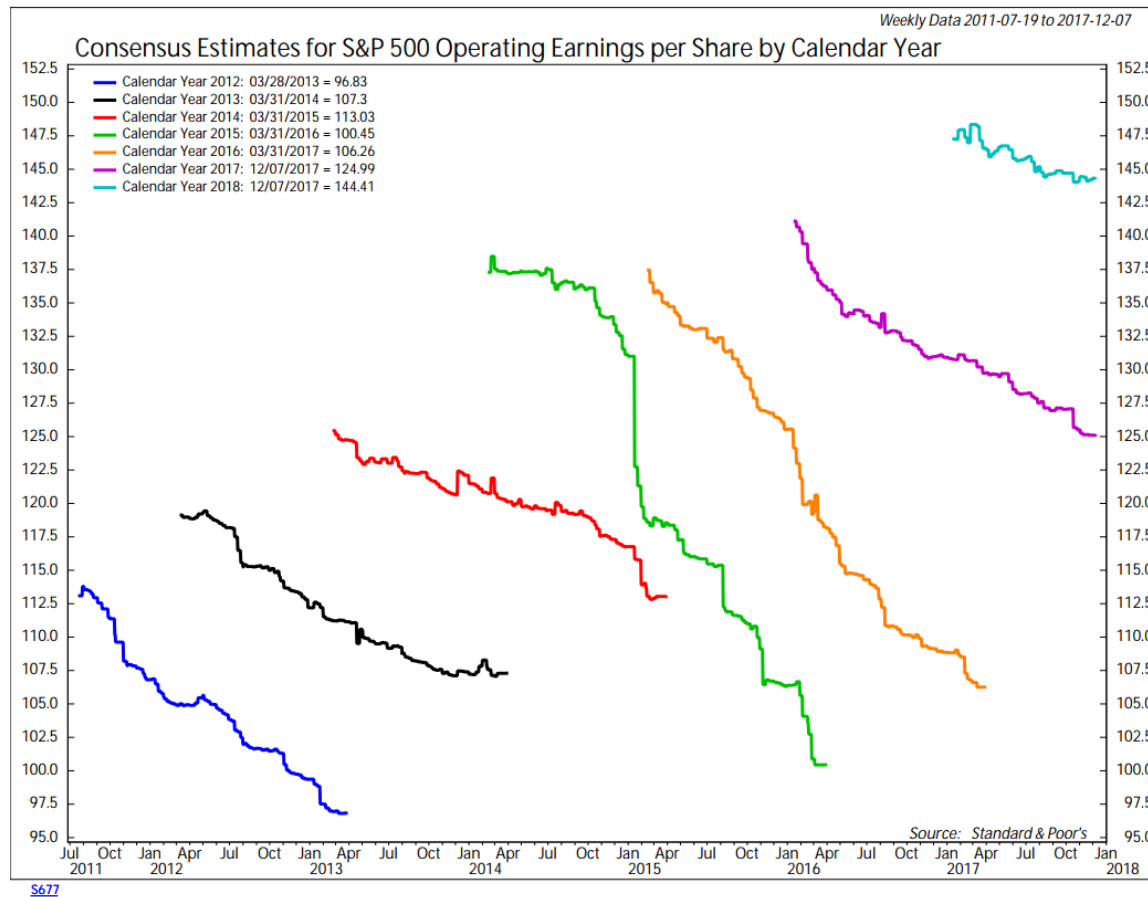




*The economy continues to exceed expectations. The Economic surprise indexes for both the Euro-area and the U.S. remain elevated.*

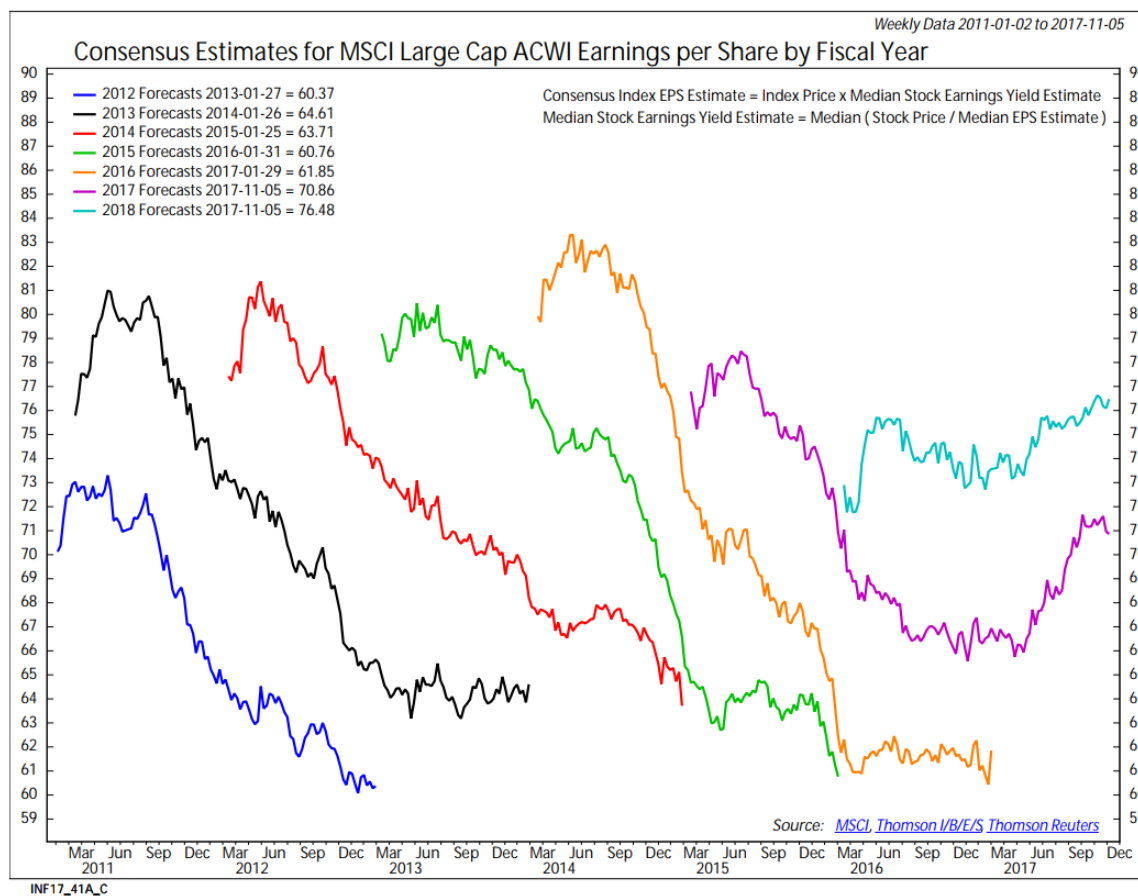


*Upward surprises in the economy could help support upward revisions to earnings expectations. Consensus now is for 15% earnings growth in 2018.*



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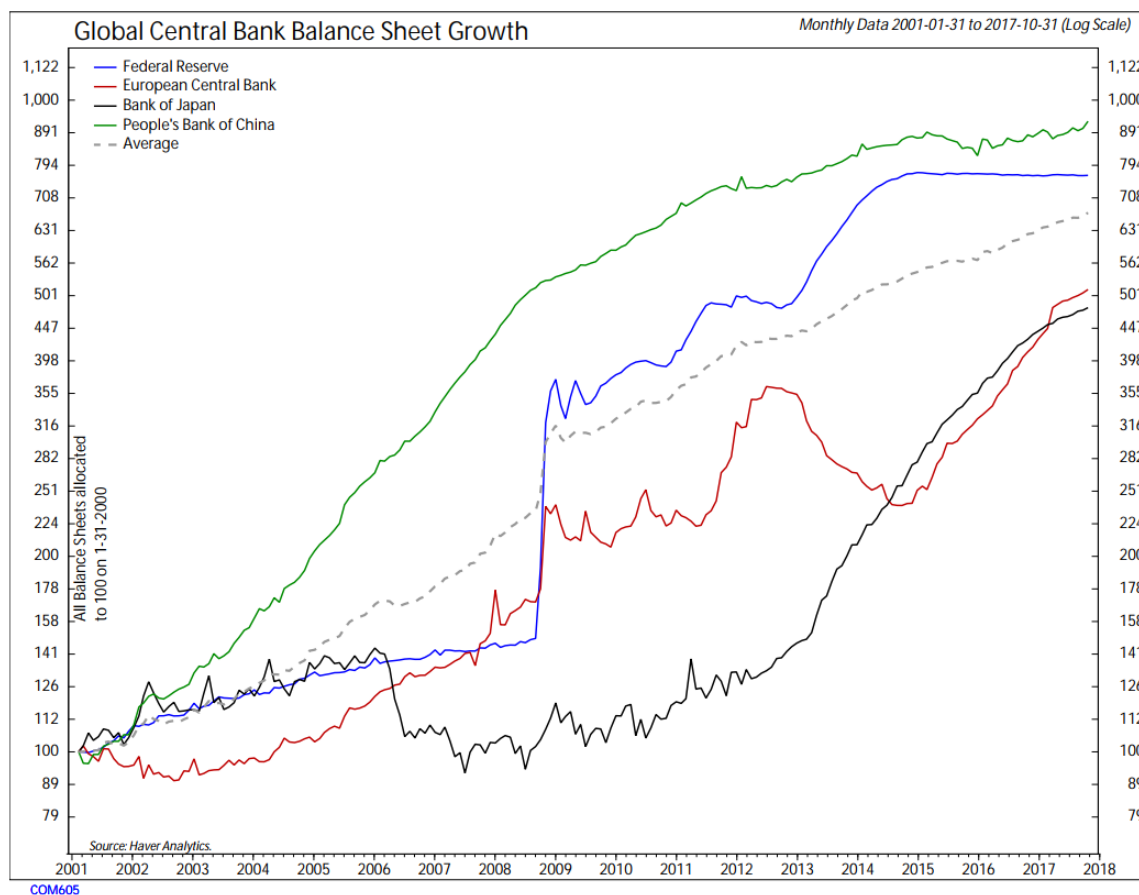
*The pattern of declining earnings expectations over the course of the year has shifted for global earnings. Estimates now are being revised higher.*



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*The effect of the shift (led by the Federal Reserve) from quantitative easing to quantitative tightening is a key unknown for 2018.*

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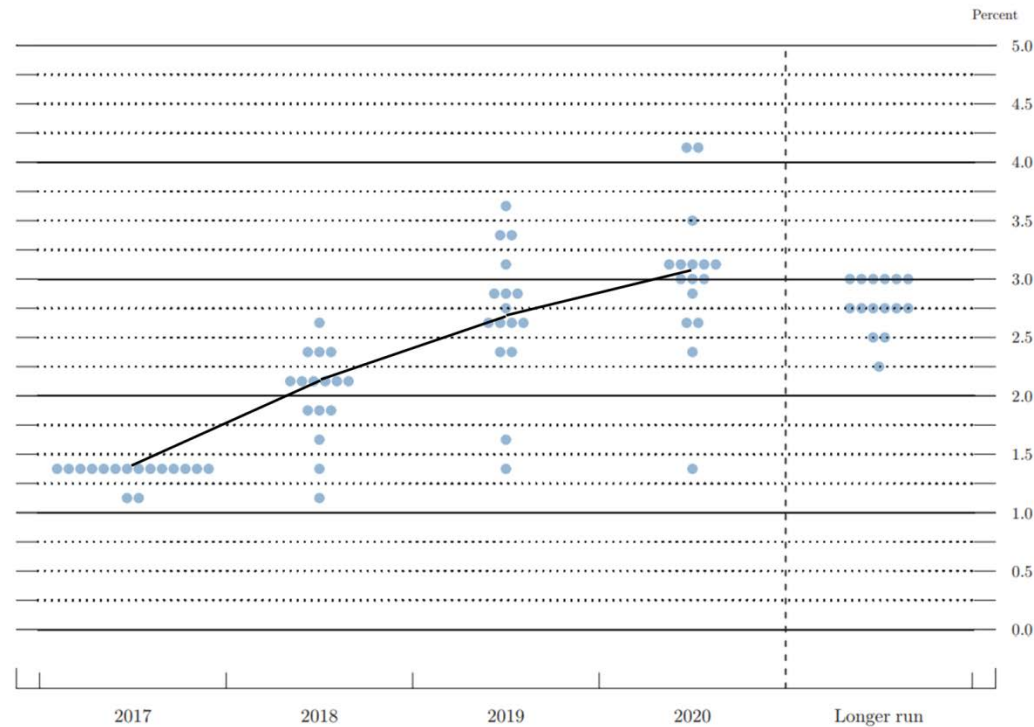
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*After raising rates three times in 2017 (for a total of five rate hikes since 2015), the Fed expects to raise rates by another 0.75% in 2018.*



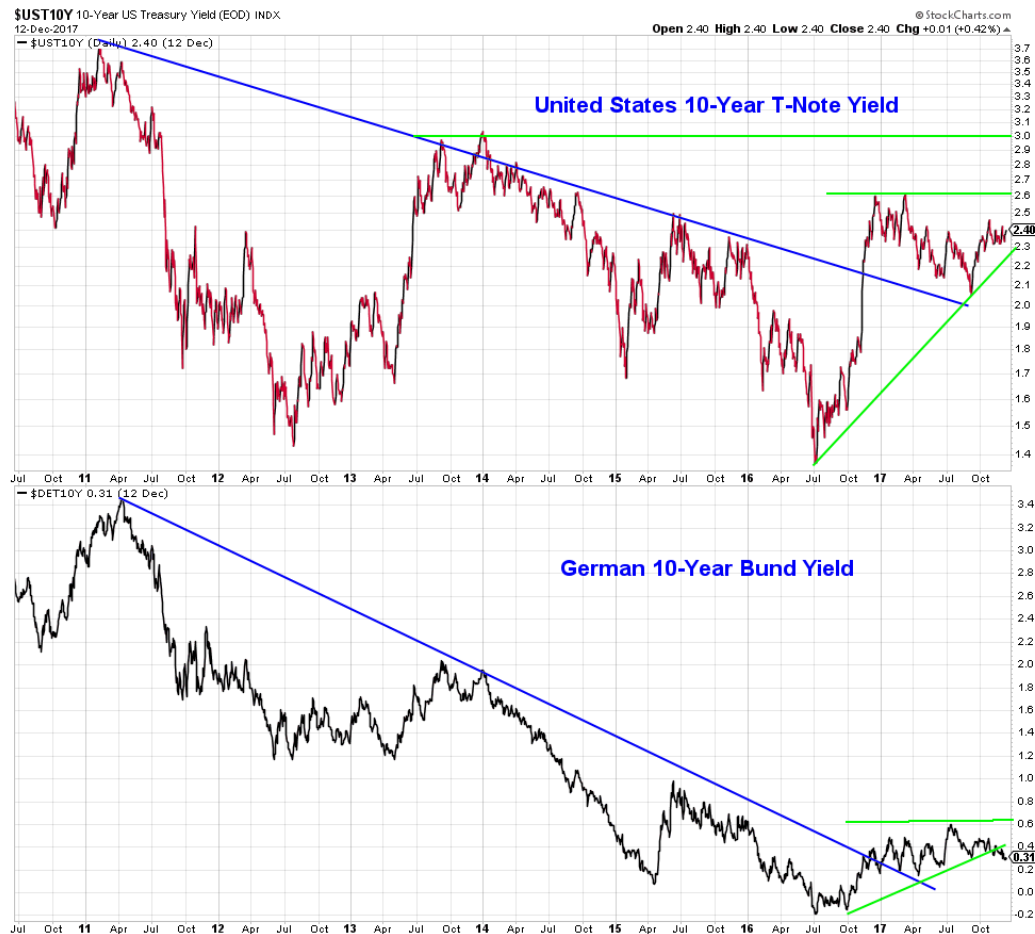
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Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate

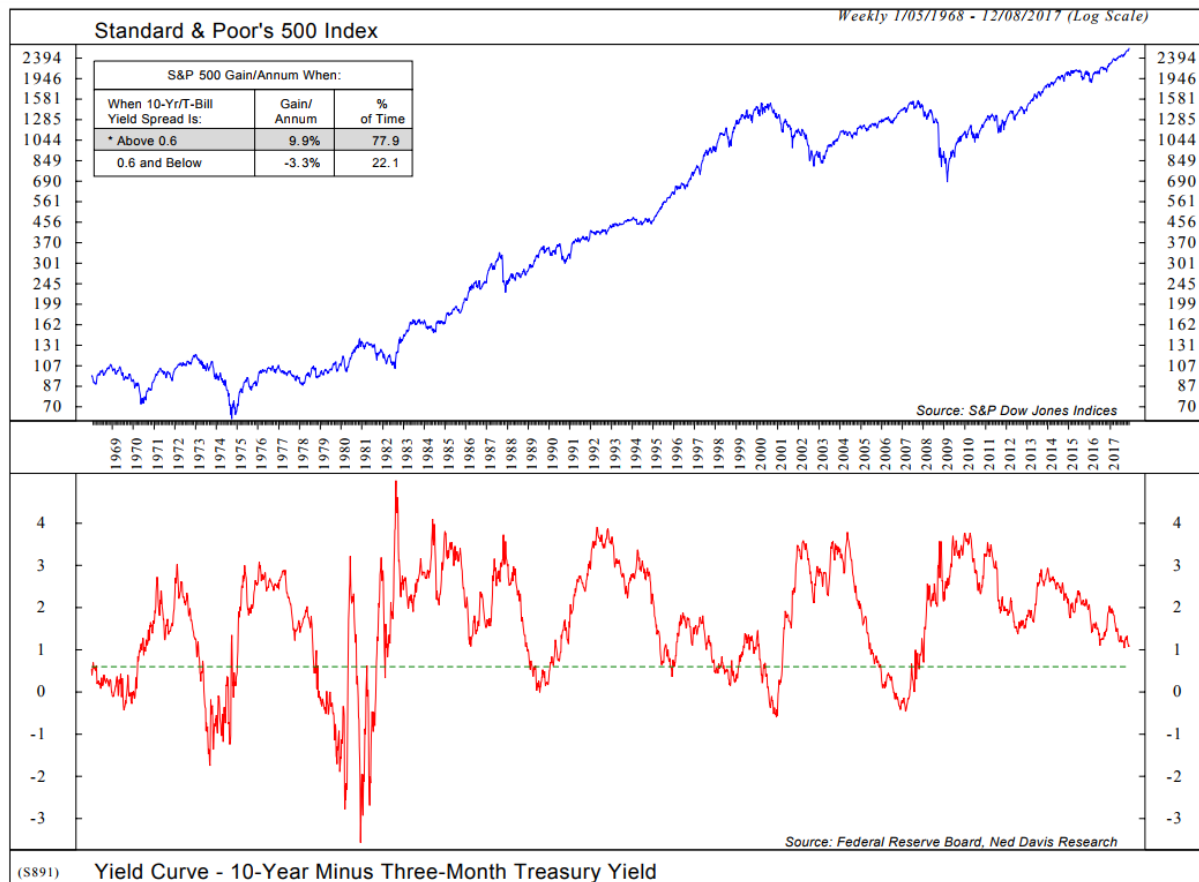


*U.S. Treasury yields where little changed overall in 2017, and could struggle to move higher in 2018 if German yields do not move higher as well.*

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*With the Fed raising short-term rates and long-term yields not moving higher, the yield curve has flattened but not inverted.*

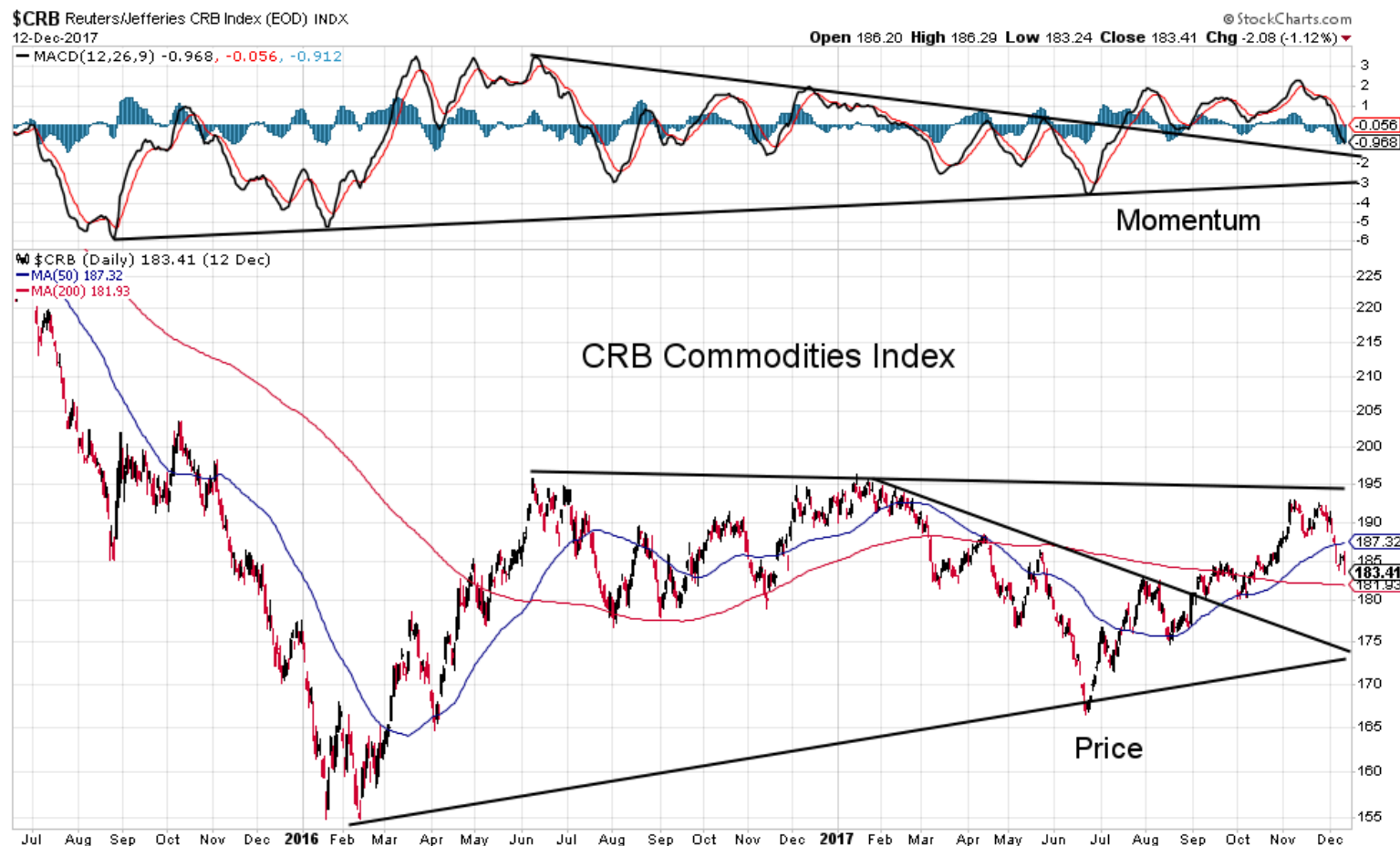


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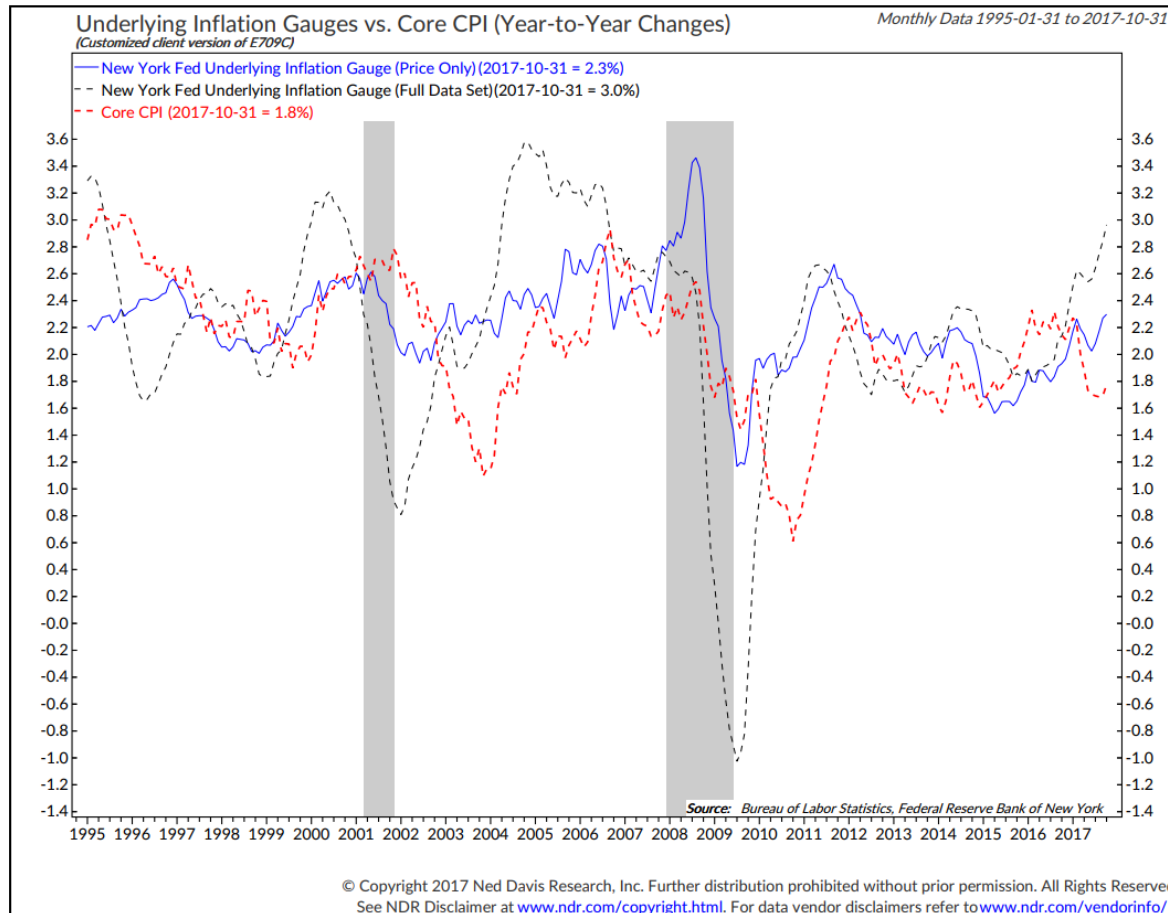
*Rising commodity prices typically signal industrial demand and improving growth, but a break-out on the CRB could get the attention of bond traders.*

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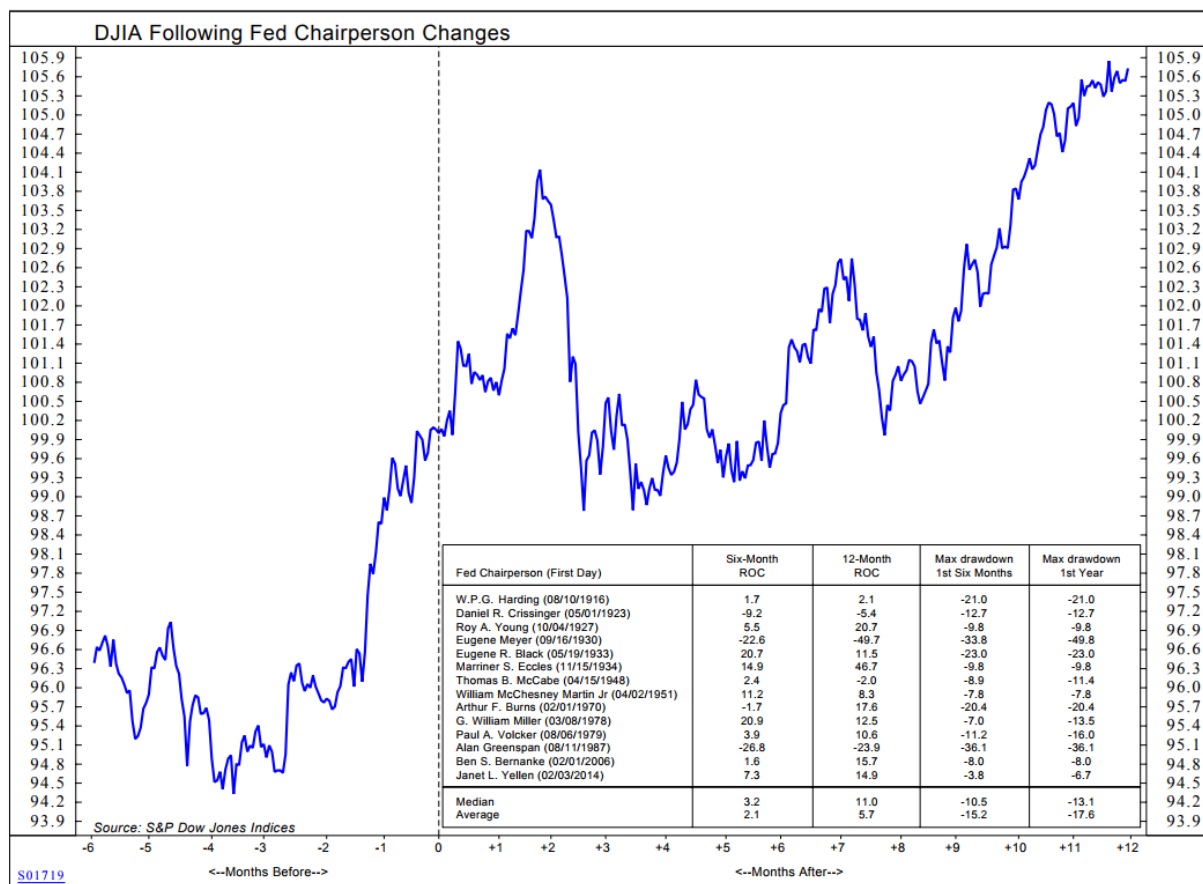
*The New York Fed's Underlying Inflation Gauge moved higher over the course of 2017, suggest inflationary pressures may not be totally dormant.*

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# Turnover at the Fed helm adds to central bank-related uncertainties, and historically the market tests incoming Fed Chairs.

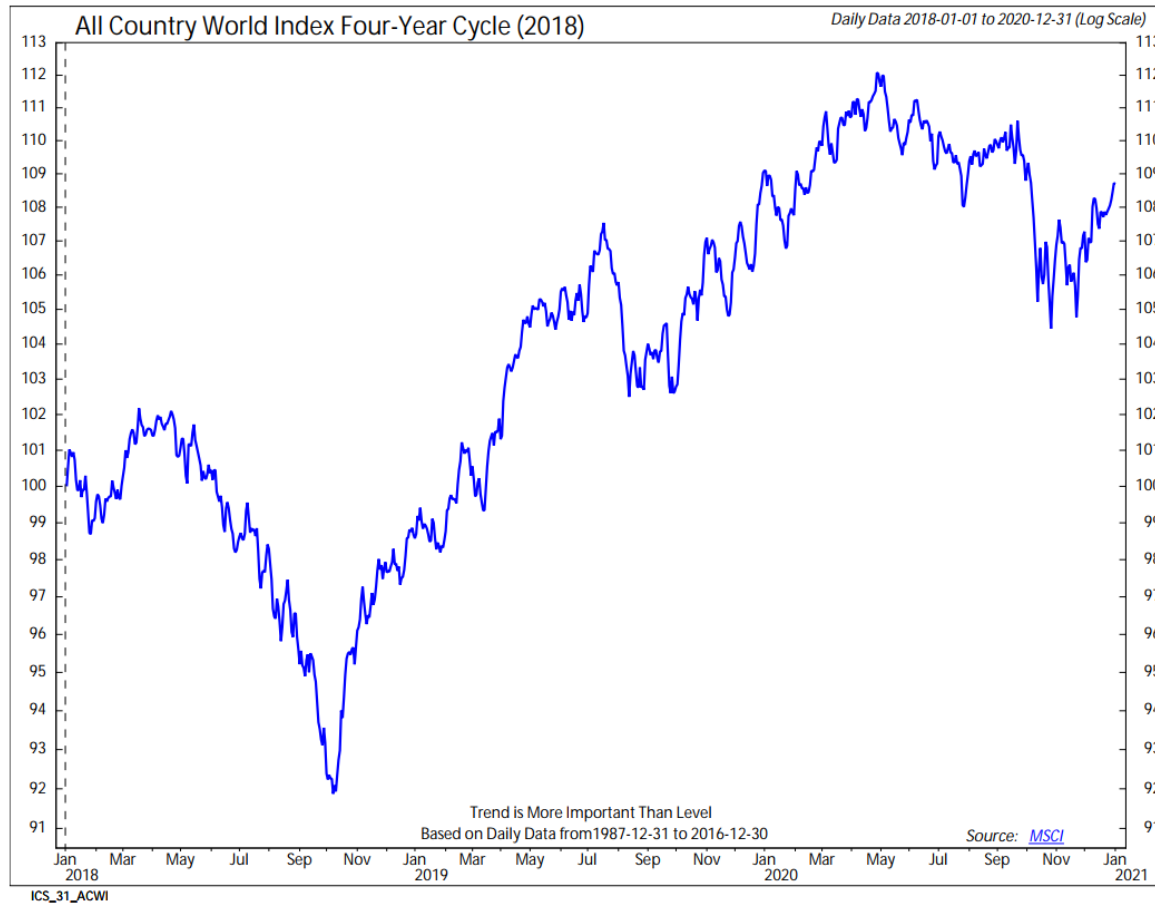
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*The four-year cycle for stocks suggests seasonal patterns will be a headwind in the run-up to next year's mid-term elections.*

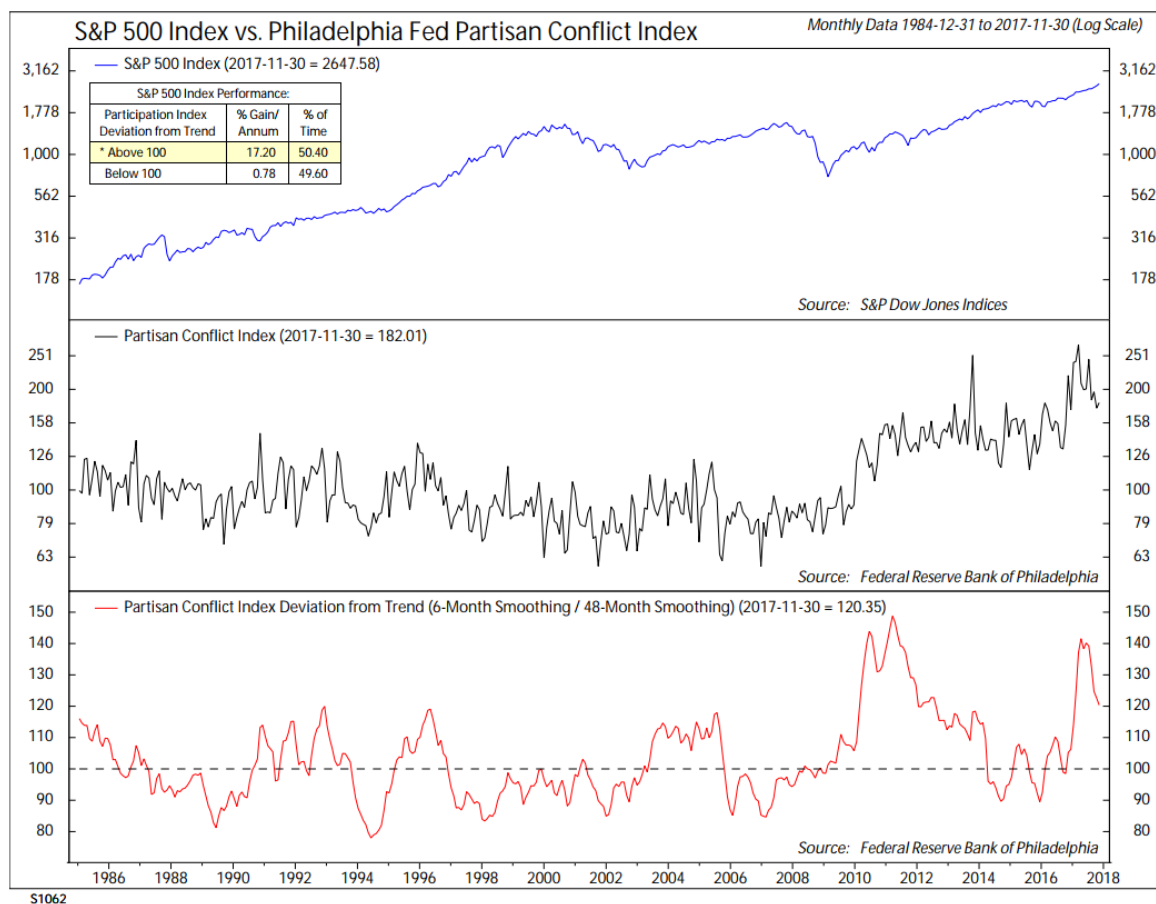
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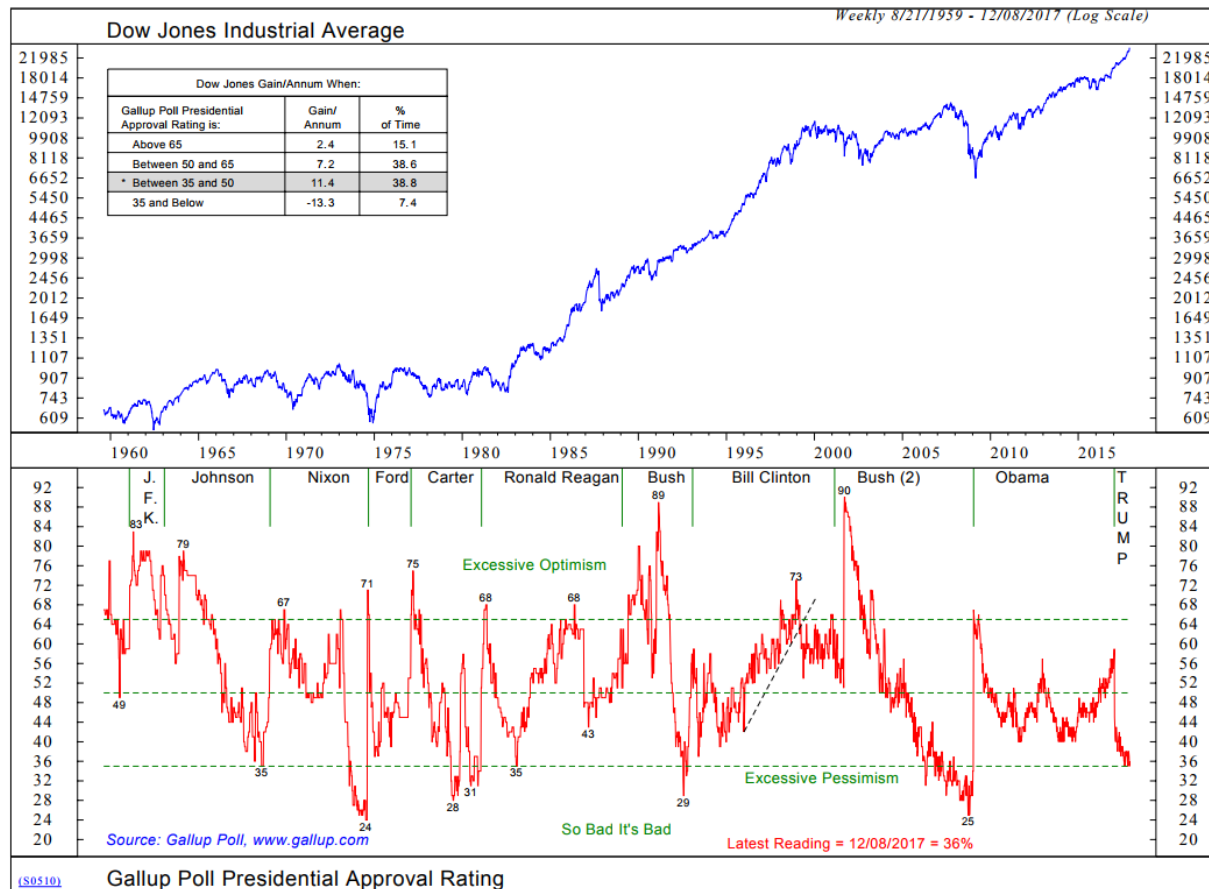
*Partisan conflict is already elevated, but the market could struggle if control of congress is considered up for grabs.*

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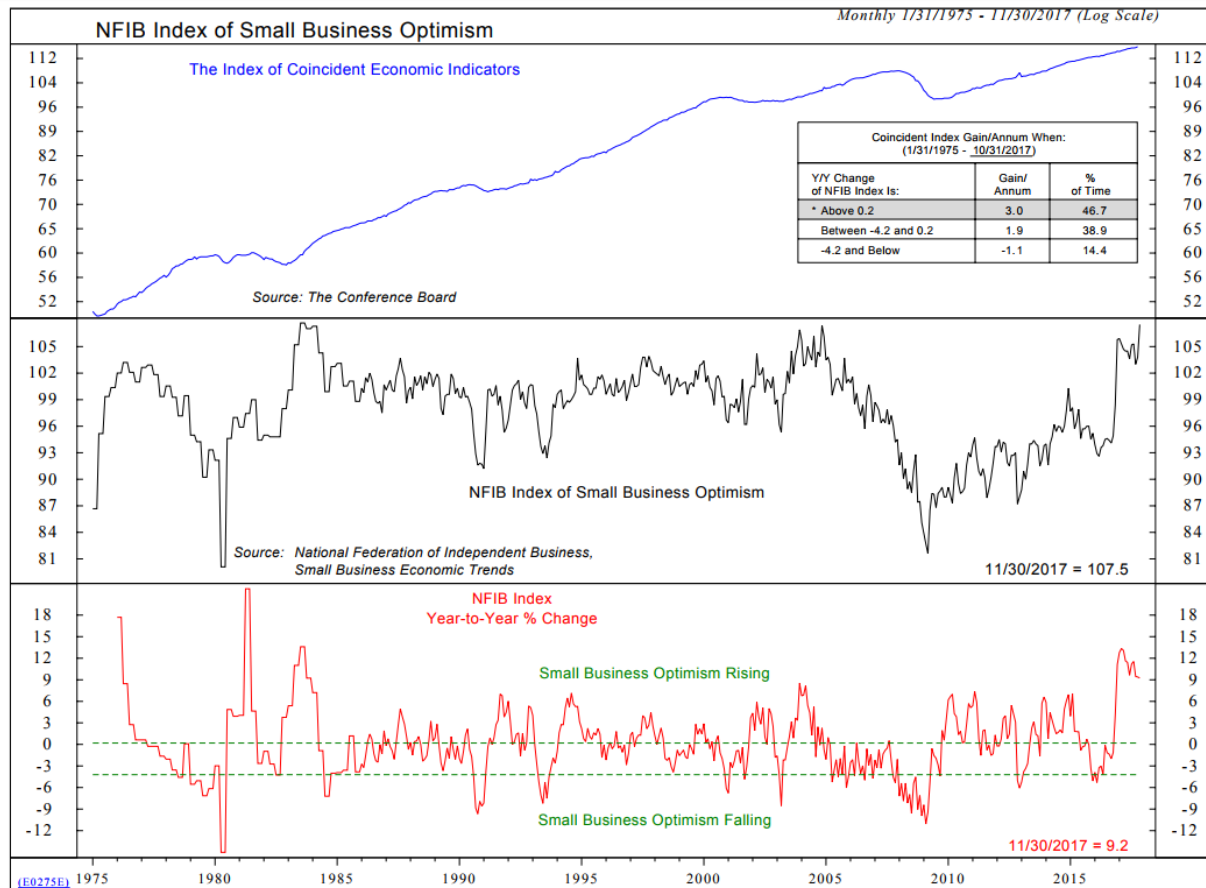
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*President Trump never really enjoyed a honeymoon period based on the Gallup poll data, but the 2018 election could still be framed as a referendum on him.*



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*Political uncertainty has masked a significant shift in economic optimism, from small business owners up to corporate CEOs.*

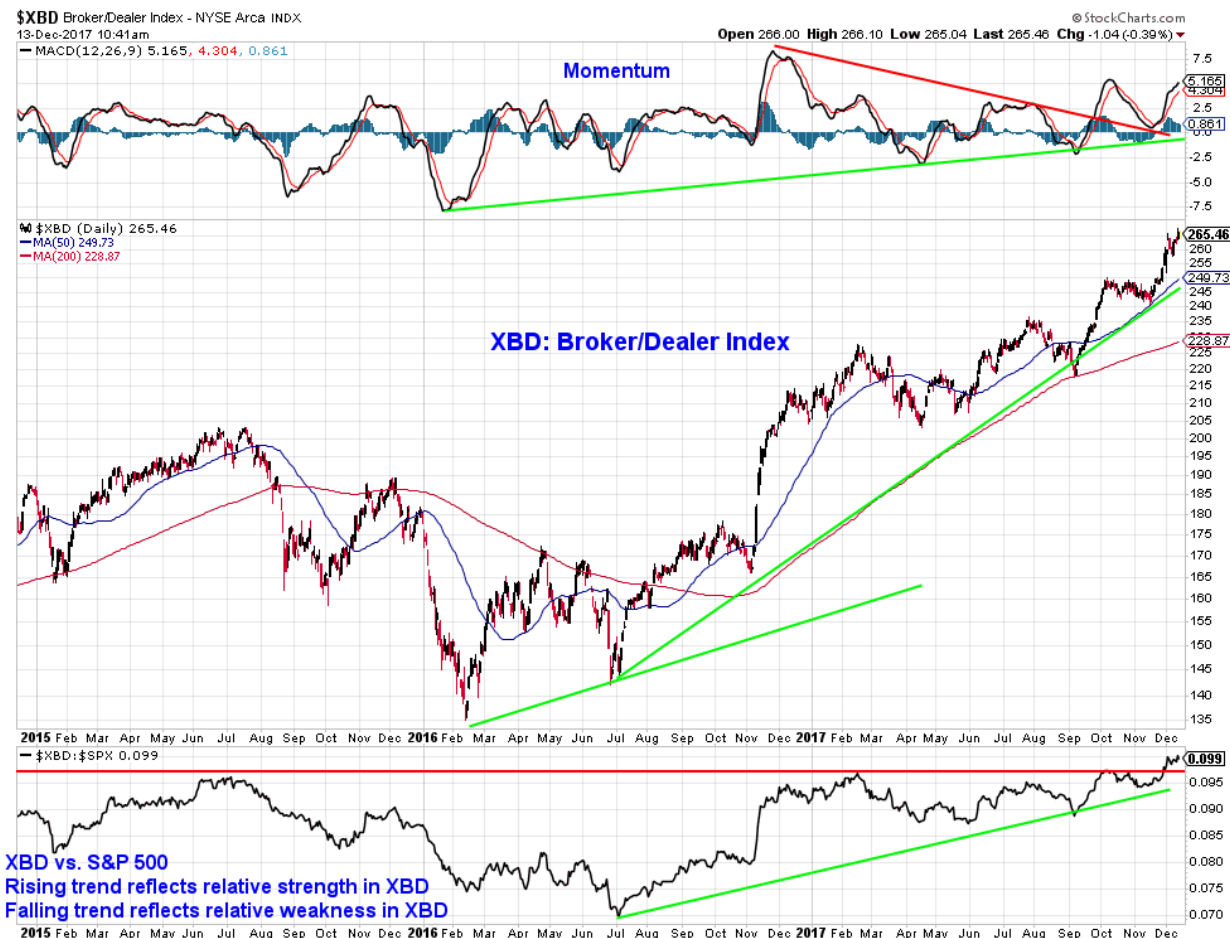


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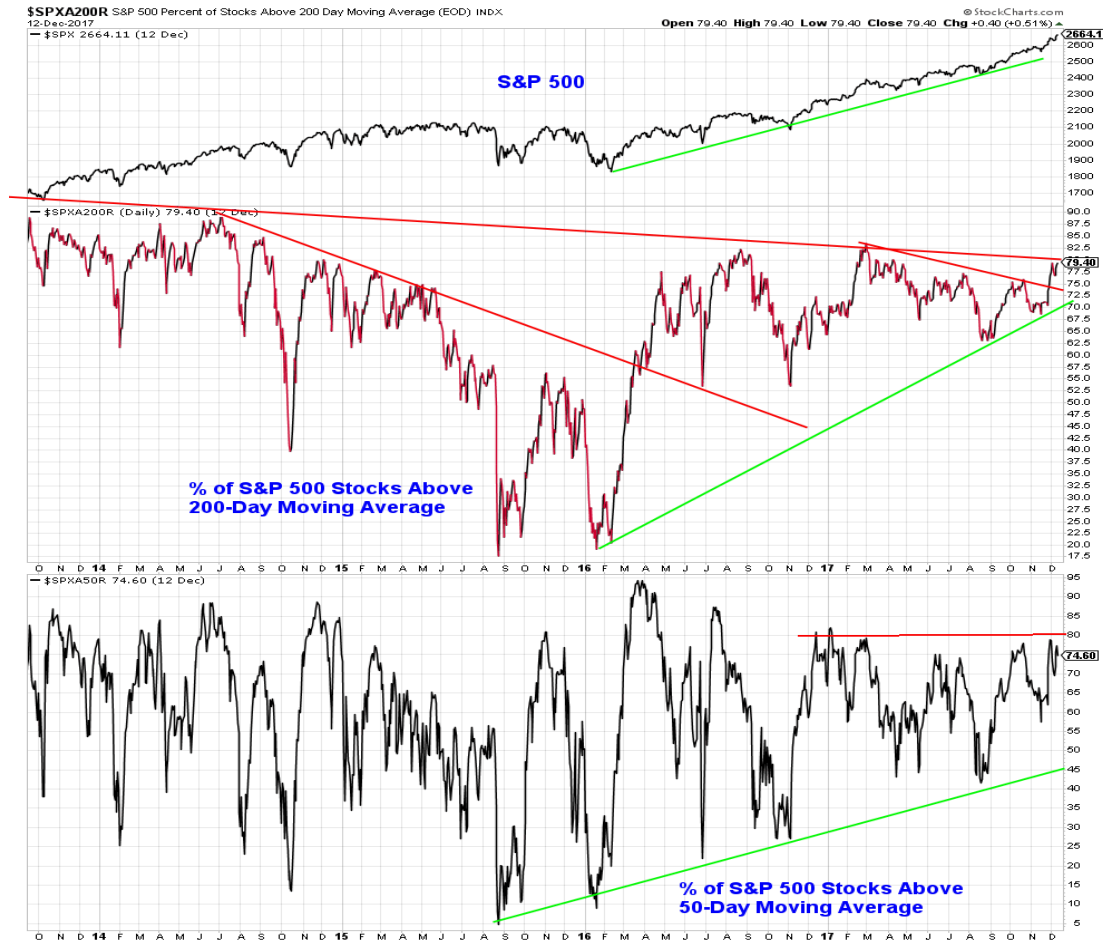


*The move by Broker/Dealers to new absolute and relative price highs is a sign of strength for the market overall.*

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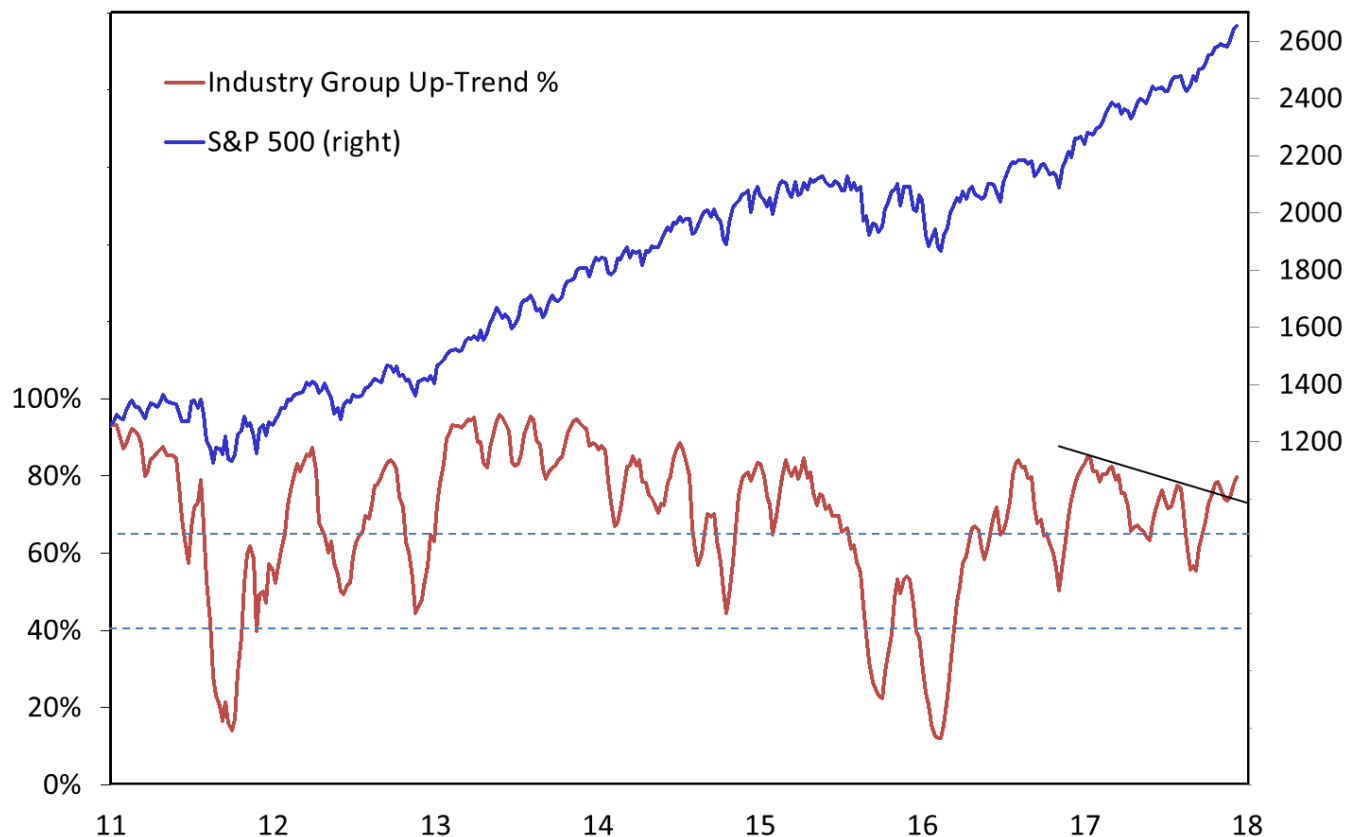
*A breakout in the percentage of stocks trading above their 50-day and 200-day averages would confirm the strength being seen on the S&P 500.*



*The percentage of industry groups in up-trends has expanded over the second half of 2017.*

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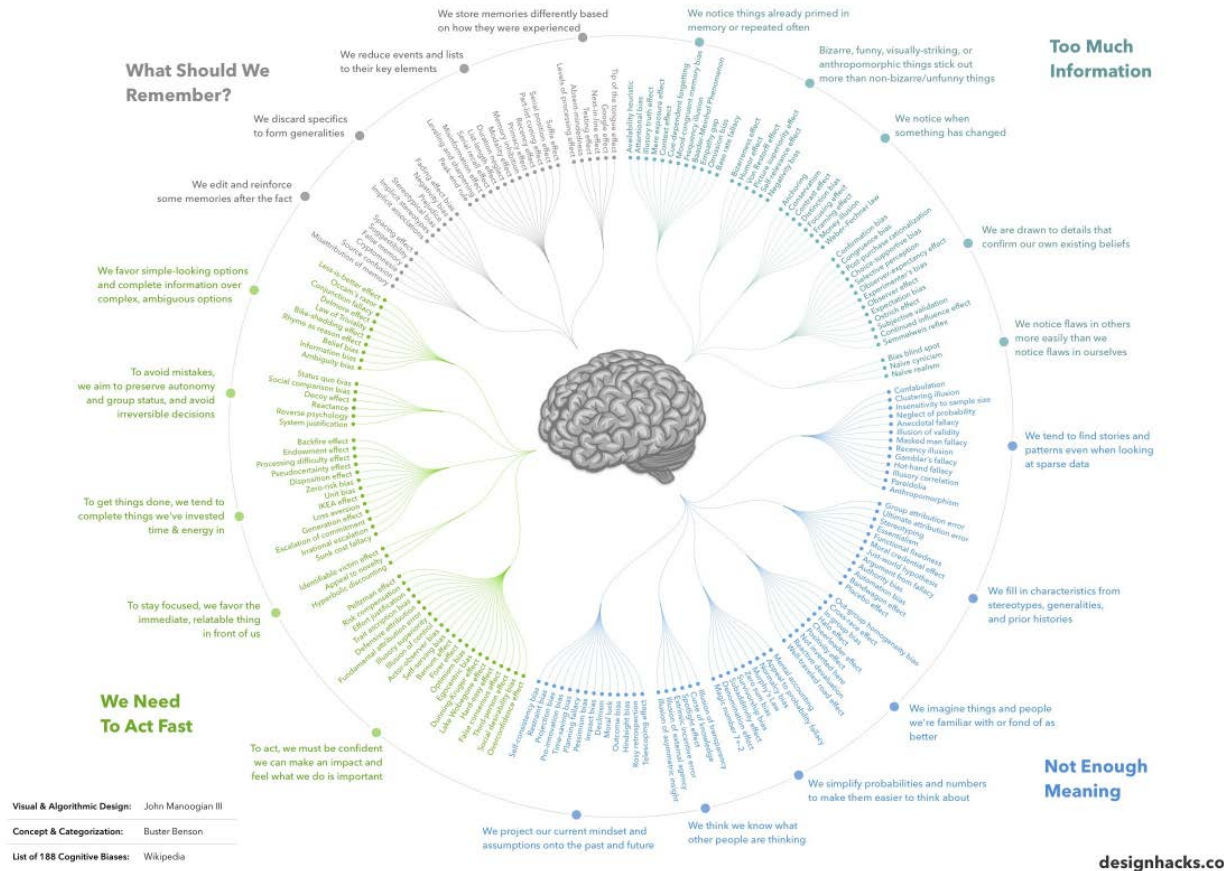
**S&P 500 and Industry Group Breadth**



Source: FactSet, RWB Calculations

*We can all fall prey to a myriad of cognitive biases. Having a disciplined approach to considering the financial markets can help reduce this risk.*

## COGNITIVE BIAS CODEX

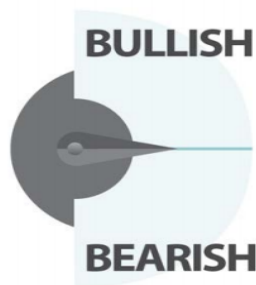


*Our discipline is to consider the weight of the evidence. Entering 2018 it gives the bullish case the benefit of the doubt.*

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FUNDAMENTAL FACTORS (WHAT COULD HAPPEN):

FED POLICY



Messaging remains crucial component of fed policy as market gets to know new regime

ECONOMIC FUNDAMENTALS



U.S. economy working on what could be three consecutive quarters of 3%+ GDP growth for first time in decade

VALUATIONS



Earnings estimates for current quarter seeing smallest downward revisions since Q2 2011

TECHNICAL FACTORS (WHAT IS HAPPENING):

SENTIMENT



Investor complacency and optimism could be challenged if volatility returns as expected in 2018

SEASONAL PATTERNS AND TRENDS



Seasonal patterns favor the bulls heading into 2018, and the cyclical rally is intact

BREADTH



New leadership from Financials and expansion of new high list point to strong rally participation

# Appendix - Important Disclosures

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