LPL RESEARCH

WEEKLY MARKET COMMENTARY

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FADING MOMENTUM

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KEY TAKEAWAYS

U.S. stocks have rallied back near all-time highs in an impressive feat of momentum.

This momentum could fade as stocks grapple with overbought conditions and mixed signals.

Overall, we expect the S&P 500 to move higher after a period of consolidation.

All data are as of April 18, 2019, unless otherwise stated.

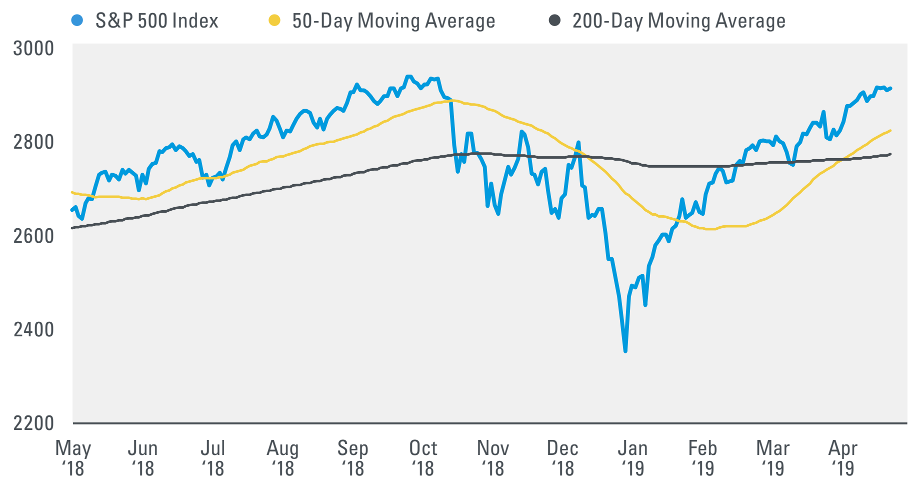
U.S. stocks are sitting at the same levels they were seven months ago, but the path hasn't been straight. Equity investors have been on a bumpy ride since September 2018, and investors' resolve has been tested amid back-and-forth in trade negotiations, a historic government shutdown, Brexit, the Federal Reserve's (Fed) U-turn in policy, and signs of a global slowdown.

Fortunately, the S&P 500 Index weathered a steep decline late last year and has found its way back around record highs. Stocks' historically strong start to the year has been promising, but there are still signals that more weakness could be in store before the S&P 500's next leg higher.

WHERE WE'VE BEEN

On September 20, 2018, the S&P 500 closed at a record high of 2930.75. Fast forward to today, and U.S. stocks are about 1% from that peak. However, over the last seven months, investors have experienced severe market whiplash: a near-bear market in stocks' worst fourth quarter since the financial crisis, followed by a sharp V-shaped recovery and the best first quarter for the S&P 500 since 1998. In fact, we've now climbed more than 20% from the lows on December 24, 2018, and the volatility that accompanied much of last year has been largely absent [Figure 1].

1 THE V-SHAPED RECOVERY



Source: LPL Research, Bloomberg 04/18/19

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

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We've maintained that the late-2018 sell-off was overdone, and we see a compelling case for equities near these levels based on sound economic fundamentals. However, the recovery has been arguably a bit fast considering that many of the reasons for the decline have yet to be resolved. First quarter earnings growth will likely be flat, U.S.-China trade negotiations are still ongoing, and structural challenges in Europe and Japan will likely persist. We believe short-term trade and political headwinds will subside as the year progresses, but there is still considerable global uncertainty weighing on economic activity. Stocks' overbought conditions, along with slightly weaker economic and corporate profit outlooks, could hinder gains in the short term.

We recently recommended dialing back equity allocations to market weight for suitable investors because of this.

A STRONG FIRST QUARTER

Stocks' strong start to a year typically sets the stage for more gains, according to history [Figure 2]. In fact, nine of the past 10 times the S&P 500 was up at least 10% during the first quarter, the rest of the year was also positive.

However, it's important to note that in these occurrences, stocks' momentum tapered off over the following months. When the S&P 500 has

2 A GOOD START TO THE YEAR CAN HAVE BULLS SMILING

S&P 500 Index Returns When Q1 Gains >10% (1950–Current)

Year	S&P 500 Index	Q1 Return	Final Three Quarters	Full Year Return	Max Gain Final Three Quarters	Max Pullback Final Three Quarters
1961	65.06	12.0%	10.0%	23.1%	12.8%	-4.4%
1967	90.20	12.3%	7.0%	20.1%	10.6%	-6.6%
1975	83.36	21.6%	8.2%	31.5%	19.0%	-14.1%
1976	102.77	13.9%	4.6%	19.1%	9.3%	-8.4%
1986	238.90	13.1%	1.4%	14.6%	11.1%	-9.4%
1987	291.70	20.5%	-15.3%	2.0%	21.0%	-33.5%
1991	375.22	13.6%	11.2%	26.3%	13.2%	-5.6%
1998	1,101.75	13.5%	11.6%	26.7%	29.7%	-19.3%
2012	1,408.47	12.0%	1.3%	13.4%	14.7%	-9.9%
2013	1,569.19	10.0%	17.8%	29.6%	19.9%	-5.6%
2019	2834.40	13.1%	?	?	?	?
	Average		5.8%	20.7%	16.1%	-11.7%
	Mean		7.6%	21.6%	14.0%	-8.9%
	Count		10	10		
	Higher		9	10		

Average Year For S&P 500 Index (1950–2018)

	Final Three Quarters	Full Year Return	Max Gain Final Three Quarters	Max Pullback Final Three Quarters
Average	6.3%	8.8%	17.5%	-12.1%
Median	7.3%	11.4%	14.3%	-9.6%
% Higher	72.5%	71.0%		

Source: LPL Research, FactSet 04/22/19

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

All data are as of 03/29/19.

climbed 10% in the first quarter, the average return for the final three quarters of the year has been 5.8%, lower than the 6.3% gain in the final three months of the average year. Stocks have also been more susceptible to midyear volatility after a strong start. In these years, the S&P 500 has sold off an average of 8.9% en route to gains in the last three months. The S&P 500 has yet to endure a 3% pullback over the course of its recovery this year, so based on history, it could be wise to temper expectations for stocks over the next few months.

MIXED SIGNALS

Fixed income markets are also sending pessimistic signals on the economic outlook. While we believe long-term rates have likely bottomed for the year, the 10-year Treasury yield has struggled to rebound from a 15-month low as bond investors position for more weakness. Lower yields have conflicted with other signs of global economic strength: Copper is outperforming gold, cyclicals have outperformed defensive sectors over recent weeks, and equities around the globe are rallying. We believe lower Treasury yields are more of a consequence of higher international demand for U.S. debt amid lower global rates. However, the bond market's conflicting signals hint to the complicated environment investors are facing.

CONCLUSION

We still believe stocks are set for continued gains in 2019. However, given the increased risk of a pullback in the near term, we believe that a market weight stance for equities within diversified portfolios is prudent. On any such pullback, we would expect the 2815 level of the S&P 500 to act as potential support.

While market volatility can be painful at times, we encourage suitable investors to view pullbacks as opportunities to rebalance or add to current positions at cheaper prices. Investors who have stayed the course over these past several months have been rewarded with higher prices, just as they have been in other parts of this bull market.

Overall, we still believe the S&P 500's fair value is around 3,000 based on sound fundamentals. However, with the index about 3% from that target just four months into the year, we expect more volatility in the near term as market momentum fades. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The economic forecasts set forth in this material may not develop as predicted.

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

Rebalancing a portfolio may cause investors to incur tax liabilities and/or transaction costs and does not assure a profit or protect against a loss.

All information is believed to be from reliable sources; however LPL Financial makes no representation as to its completeness or accuracy.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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