



February 9, 2018

Stable fundamentals suggest markets will rebound

Dear Clients and Friends,

As many of you have likely seen, global stock markets have become more volatile over the past week, ending a long stretch of unusually calm, rising markets. While these periods of volatility are fairly common, this particular episode came on quickly with some extreme sharp swings in the major indices, leading many investors to rethink their assumptions.

What happened?

As we wrote in our fourth quarter letter, the early factors of the “cascade effect” - rising wage inflation, leading to higher inflation assumptions, and potentially leading to more frequent interest rate rises, has begun to play out in risk assets. Additionally, a big part of the choppy market action stems from the comment above about a long period of surprisingly calm market activity. A small group of investors over the past year have made speculative bets that markets would remain calm indefinitely, and while it lasted, low volatility rewarded their investment positions. It is our belief that the unwinding of many of these trades during this market correction has led to the extreme intra-day moves in markets over the past week.

To provide some context, historically, markets decline about 10% every 33 weeks, but as of late January, the S&P 500 had avoided a 10% correction for nearly 100 weeks. As of the market close on February 8, the S&P is down 10% from the prior peak. Though the sell-off is deep, the fundamental picture remains strong. We do not see a systemic reason at this time for the correction beyond the fact that market corrections of this magnitude are the norm and to be expected on a fairly regular basis.

Where to from here?

Market participants are now pricing in higher volatility than we've seen in over a year. As painful as this 10% market correction has been, our sense is this type of market movement is more about the inherent uncertainty of financial markets, rather than a reflection of a worsening economy. In fact, we would argue that most parts of the economy, including corporate earnings, gross domestic product (GDP), manufacturing, jobs, and inflation are stable or improving in the near term.

If our take on the overall economy is directionally correct, then we would suspect this market action to be more in line with a normal market correction rather than the signal of something deeper like a recession. In fact, steady economic growth, surging corporate profits, and fairly attractive stock prices suggest the overall market has a good shot of ending the year above current levels.

All information contained in this document is obtained from sources believed to be accurate and reliable. All opinions expressed in this newsletter are subject to change without notice and are not intended to be a guarantee or forecast of future events. This document does not constitute a solicitation to buy or sell securities nor is it a complete description of our investment policy, the markets, or any securities referred to in the newsletter. Opinions expressed herein are not intended to be used as investment advice and are subject to change without notice based on market and other conditions. No client or prospective client should assume that any information presented here serves as the receipt of, or a substitute for, personalized individual advice from FBB Capital Partners, its research team or its portfolio managers. The value of investments and the income from them may fluctuate and can fall as well as rise. Past performance is not a guarantee of future results.



How is FBB positioning amid the market correction?

FBB continues to look for opportunities to position client portfolios as share prices come in, while earnings grow and valuation becomes more attractive. We remain comfortable with our tactical response to the current volatility as we've been adding exposure to the consumer discretionary sector. By getting closer to market weight in this sector, clients should benefit from the stable economy and a trickle-down effect to consumers.

FBB has taken advantage of broader market changes over the past year to own more cyclical companies that benefit from a growing economy and rising interest rates (financials), while reducing holdings of interest rate sensitive sectors (utilities and real estate), which generally underperform as rates increase.

As we look beyond the market correction, we continue to look for investments where near-term volatility or sentiment changes may obscure a high quality business trading at a discounted valuation. To that end, we believe the current market moves may open up additional opportunities for FBB clients.

As always, thank you for the trust and confidence that you place in the FBB team. Should you have any questions about your specific asset allocation we encourage you to reach out to your portfolio manager directly.

Sincerely yours,

FBB Capital Partners' Investment Committee