

Market Review

Should the equity markets continue their trips south whenever a Forbes Cruise sets sail, we may have to think twice about future participation! Of course, the inevitable periods of volatility are precisely the time to remind folks that the secret to success in stocks is not to get scared out of them, and that ups and downs are hardly unusual. In fact, from the recent high of 2930.75 on the S&P 500 set on Sept. 20 to the Oct. 11 close of 2728.37, that widely-followed index had dropped “only” 6.91%.

Certainly, we do not mean to minimize the paper losses suffered, but nine decades of market history shows that pullbacks of at least 5% have happened more than twice a year on average and even 7.5% setbacks have occurred every 0.6 years on average.



Selloffs, downturns, pullbacks, corrections and even Bear Markets are events that equity investors always have had to endure on their way to the best long-term performance of any of the financial asset classes.

Advancing Markets						
Minimum Rise %	Average Gain	Average # Days	Count	Frequency (in Years)	Last Start	Last End
20.0%	107.9%	916	26	3.5	3/9/2009	9/20/2018
17.5%	67.6%	585	37	2.4	10/3/2011	9/20/2018
15.0%	67.2%	567	43	2.1	10/3/2011	9/20/2018
12.5%	44.1%	334	70	1.3	2/11/2016	9/20/2018
10.0%	35.0%	248	104	0.9	2/8/2018	9/20/2018
7.5%	23.4%	147	153	0.6	2/8/2018	9/20/2018
5.0%	14.7%	73	296	0.3	4/2/2018	9/20/2018

Declining Markets						
Minimum Decline %	Average Loss	Average # Days	Count	Frequency (in Years)	Last Start	Last End
-20.0%	-34.3%	371	25	3.6	1/6/2009	3/9/2009
-17.5%	-30.6%	225	36	2.5	4/29/2011	10/3/2011
-15.0%	-28.5%	195	42	2.1	4/29/2011	10/3/2011
-12.5%	-22.7%	140	69	1.3	5/21/2015	2/11/2016
-10.0%	-19.2%	102	103	0.9	1/26/2018	2/8/2018
-7.5%	-15.4%	65	152	0.6	1/26/2018	2/8/2018
-5.0%	-10.9%	37	296	0.4	9/20/2018	10/11/2018

From 02.20.28 through 10.11.18. Price return series. We defined a Declining Market as an instance when stocks dropped the specified percentage or more without a recovery of equal magnitude, and an Advancing Market as in instance when stocks appreciated the specified percentage or more without a decline of equal magnitude. SOURCE: AFAM Capital using data from Bloomberg, Morningstar and Ibbotson Associates

LONG-TERM RETURNS		
	Annualized Return	Standard Deviation
Value Stocks	13.4%	25.9%
Growth Stocks	9.6%	21.4%
Dividend Paying Stocks	10.6%	18.0%
Non-Dividend Paying Stocks	8.9%	29.5%
Long-Term Corporate Bonds	6.0%	7.5%
Long-Term Gov't Bonds	5.4%	8.5%
Intermediate Gov't Bonds	5.1%	4.4%
Treasury Bills	3.3%	0.9%
Inflation	3.0%	1.8%

From 06.30.27 through 07.31.18. Growth stocks = 50% small growth and 50% large growth returns rebalanced monthly. Value stocks = 50% small value and 50% large value returns rebalanced monthly. Dividend payers = 30% top of dividend payers, 40% of middle dividend payers, and 30% bottom of dividend payers rebalanced monthly. Non-dividend payers = stocks that do not pay a dividend. Long term corporate bonds represented by the Ibbotson Associates SBBI US LT Corp Total Return index. Long term government bonds represented by the Ibbotson Associates SBBI US LT Govt Total Return index. Intermediate term government bonds represented by the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills represented by the Ibbotson Associates SBBI US 30 Day TBill Total Return index. Inflation represented by the Ibbotson Associates SBBI US Inflation index. SOURCE: AFAM Capital using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

That does not mean that waterfall sell-offs, as was endured on Oct. 10 when the Dow Jones Industrial Average plunged 832 points, are not disconcerting, but we always strive to maintain proper perspective. Indeed, the Dow has now had three days with losses of at least 3.14% just in 2018 (Feb. 5, Feb. 8 and Oct. 10),...



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Giant Single Day Dow Price Moves

Days like 10.10.18, are rare, but since 1927 there have been 250+ times when the Dow has lost at least 3.14% in one trading session.

	1920's	1930's	1940's	1950's	1960's	1970's	1980's	1990's	2000's	2010's	Totals
Years Ending in 0		15	6	2	0	1	0	1	4	3	32
Years Ending in 1		28	0	0	1	0	0	1	3	6	39
Years Ending in 2		44	0	0	1	0	1	0	4	0	50
Years Ending in 3		22	1	0	0	2	0	0	1	0	26
Years Ending in 4		2	0	0	0	1	0	0	0	0	3
Years Ending in 5		0	0	1	0	0	0	0	0	1	2
Years Ending in 6		2	4	0	0	0	2	0	0	1	9
Years Ending in 7		13	1	0	0	0	8	1	1	0	24
Years Ending in 8	1	7	2	0	0	0	2	4	18	3	37
Years Ending in 9	19	3	0	0	0	0	1	0	8		31
Totals	20	136	14	3	2	4	14	7	39	14	253

From 12.31.27 though 10.10.18. Days of index price return drops of more than 3.14%. SOURCE: Al Frank using data from Bloomberg

	1920's	1930's	1940's	1950's	1960's	1970's	1980's	1990's	2000's	2010's	Totals
Years Ending in 0		10	3	0	0	2	1	0	3	1	20
Years Ending in 1		24	1	0	0	1	0	1	4	3	34
Years Ending in 2		40	0	0	3	0	5	0	7	0	55
Years Ending in 3		30	0	0	1	2	0	0	3	0	36
Years Ending in 4		3	0	0	0	7	0	0	0	0	10
Years Ending in 5		0	0	0	0	1	0	0	0	1	2
Years Ending in 6		0	2	0	0	0	0	0	0	0	2
Years Ending in 7		5	0	1	0	0	5	2	0	0	13
Years Ending in 8	1	11	0	0	0	1	3	4	17	0	37
Years Ending in 9	8	3	0	0	0	0	1	0	6		18
Totals	9	126	6	1	4	14	15	7	40	5	227

From 12.31.27 though 10.10.18. Days of index price return gains of more than 3.14%. SOURCE: Al Frank using data from Bloomberg

...while 90 years of data show that there have also been 250 other such occurrences. Believe it or not, that means that we have seen the equivalent of an 832-point Dow hit more than twice a year, on average, while that number jumps to more than seven times a year for losses on the S&P 500 equal to or greater than the 2.05%+ downturn suffered on Oct. 11.



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Big Single Day S&P 500 Price Moves

Days like 10.11.18, are rare, but since 1927 there have been 750 times when the S&P 500 has lost at least 2.05% in one trading session.

	1920's	1930's	1940's	1950's	1960's	1970's	1980's	1990's	2000's	2010's	Totals
Years Ending in 0		31	11	7	1	4	6	7	18	10	95
Years Ending in 1		54	5	1	1	0	2	2	13	19	97
Years Ending in 2		67	2	0	6	0	5	0	29	3	112
Years Ending in 3		41	4	2	1	5	1	1	5	2	62
Years Ending in 4		25	1	1	0	14	0	1	0	4	46
Years Ending in 5		7	5	5	0	2	0	0	0	6	25
Years Ending in 6		10	14	0	3	0	6	3	0	5	41
Years Ending in 7		33	5	4	0	0	19	6	10	0	77
Years Ending in 8	4	27	7	1	0	0	5	12	40	9	105
Years Ending in 9	28	21	3	1	0	1	2	9	25		90
	32	316	57	22	12	26	46	41	140	58	750

From 12.31.27 through 10.11.18. Days of index price return drops of more than 2.05%. SOURCE: Al Frank using data from Bloomberg

	1920's	1930's	1940's	1950's	1960's	1970's	1980's	1990's	2000's	2010's	Totals
Years Ending in 0		18	8	2	0	7	3	5	18	12	73
Years Ending in 1		33	3	0	0	1	3	6	12	13	71
Years Ending in 2		62	4	0	6	0	10	0	22	2	106
Years Ending in 3		52	3	1	1	7	3	0	10	2	79
Years Ending in 4		24	1	0	0	16	7	1	0	1	50
Years Ending in 5		14	1	6	1	7	1	0	0	4	34
Years Ending in 6		7	12	2	2	0	2	0	2	3	30
Years Ending in 7		17	2	3	0	0	20	7	6	0	55
Years Ending in 8	1	44	3	0	1	3	10	10	31	1	104
Years Ending in 9	18	17	1	0	1	1	2	14	27		81
Totals	19	288	38	14	12	42	61	43	128	38	683

From 12.31.27 through 10.11.18. Days of index price return gains of more than 2.05%. SOURCE: Al Frank using data from Bloomberg

No doubt, as investors await the start of Q3 earnings reporting season, there is renewed concern about world-wide economic growth, given a host of Wall Street analyst individual stock downgrades, a few less-than-grand earnings and sales warnings from multi-national corporations, and a reduction in the global GDP forecasts by the International Monetary Fund (IMF).



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IMF World Economic Outlook – Oct '18

IMF Global Growth Projections

	2017	IMF WEO Projections			Difference from 7/18	
		2018	2019	2018	2019	
World Output	3.7	3.7	3.7	-0.2	-0.2	
Advanced Economies	2.3	2.4	2.1	0.0	-0.1	
United States	2.2	2.9	2.5	0.0	-0.2	
Euro Area	2.4	2.0	1.9	-0.2	0.0	
Germany	2.5	1.9	1.9	-0.3	-0.2	
France	2.3	1.6	1.6	-0.2	-0.1	
Italy	1.5	1.2	1.0	0.0	0.0	
Spain	3.0	2.7	2.2	-0.1	0.0	
Japan	1.7	1.1	0.9	0.1	0.0	
United Kingdom	1.7	1.4	1.5	0.0	0.0	
Canada	3.0	2.1	2.0	0.0	0.0	
Emerging Market/Developing Econ	4.7	4.7	4.7	-0.2	-0.4	
Commonwealth of Independent States	2.1	2.3	2.4	0.0	0.2	
Russia	1.5	1.7	1.8	0.0	0.3	
Emerging and Developing Asia	6.5	6.5	6.3	0.0	-0.2	
China	6.9	6.6	6.2	0.0	-0.2	
India	6.7	7.3	7.4	0.0	-0.1	
Emerging and Developing Europe	6.0	3.8	2.0	-0.5	-1.6	
Latin America and the Caribbean	1.3	1.2	2.2	-0.4	-0.4	
Brazil	1.0	1.4	2.4	-0.4	-0.1	
Mexico	2.0	2.2	2.5	-0.1	-0.2	

Source: International Monetary Fund, World Economic Outlook Update, October 2018

Global growth for 2018–19 is projected to remain steady at its 2017 level, but its pace is less vigorous than projected in April and it has become less balanced. Downside risks to global growth have risen in the past six months and the potential for upside surprises has receded. Global growth is projected at 3.7 percent for 2018–19—0.2 percentage point lower for both years than forecast in April. The downward revision reflects surprises that suppressed activity in early 2018 in some major advanced economies, the negative effects of the trade measures implemented or approved between April and mid-September, as well as a weaker outlook for some key emerging market and developing economies arising from country-specific factors, tighter financial conditions, geopolitical tensions, and higher oil import bills.

Ironically, a week ago, U.S. stock investors were fretting about U.S. economic growth coming in too strong, so we hardly think that a 3.7% IMF global GDP growth projection is cause for alarm. Indeed, we think that the relatively healthy economies around the world still are providing a tailwind for corporate profits. Yes, we respect that trade remains a significant wildcard, while investors will be keenly focused on the outlooks offered by management teams as they report quarterly results in the weeks ahead, but we can't forget that Corporate America still is expected to show handsome earnings growth over the balance of 2018 and into 2019,...



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S&P 500 Earnings Per Share		
Quarter Ended	Bottom Up Operating	Bottom Up Operating
	EPS 3 Month	EPS 12 Month
ESTIMATES		
12/31/2019	\$46.96	\$176.52
9/30/2019	\$44.84	\$171.67
6/30/2019	\$43.72	\$166.87
3/31/2019	\$41.00	\$161.80
12/31/2018	\$42.11	\$157.34
9/30/2018	\$40.04	\$149.08
ACTUAL		
6/30/2018	\$38.65	\$140.37
3/31/2018	\$36.54	\$132.23
12/31/2017	\$33.85	\$124.51
9/30/2017	\$31.33	\$118.56
6/30/2017	\$30.51	\$115.92
3/31/2017	\$28.82	\$111.11
12/31/2016	\$27.90	\$106.26
9/30/2016	\$28.69	\$101.42
6/30/2016	\$25.70	\$98.17
3/31/2016	\$23.97	\$98.61
12/31/2015	\$23.06	\$100.45
9/30/2015	\$25.44	\$104.14
6/30/2015	\$26.14	\$108.30
3/31/2015	\$25.81	\$111.50
12/31/2014	\$26.75	\$113.01

Source: Standard & Poor's. As of 10.4.18

History shows that stock prices generally have followed earnings, so it is nice to see actual and projected EPS moving up, even as earnings forecasts often turn out to be too rosy. Happily, the number of companies (80.0%) exceeding expectations in Q2 2018 was far better than the average beat-rate over the prior 5 years.

	S&P 500 Quarterly Earnings Comparisons						
	BEAT	MISSED	MET	BEAT	MISSED	MET	
Q2 2018	80.0%	14.8%	5.2%	Q3 2015	67.9%	23.0%	9.0%
Q1 2018	77.0%	17.2%	5.8%	Q2 2015	69.8%	22.0%	8.3%
Q4 2017	75.0%	16.4%	8.6%	Q1 2015	67.7%	22.9%	9.4%
Q3 2017	72.6%	19.1%	8.3%	Q4 2014	68.6%	21.0%	10.4%
Q2 2017	70.2%	20.1%	9.7%	Q3 2014	73.7%	17.2%	9.0%
Q1 2017	74.0%	18.9%	7.2%	Q2 2014	65.7%	21.2%	13.0%
Q4 2016	67.3%	22.0%	10.8%	Q1 2014	67.1%	22.6%	10.2%
Q3 2016	70.5%	21.1%	8.4%	Q4 2013	63.9%	25.3%	10.8%
Q2 2016	70.2%	20.9%	8.9%	Q3 2013	66.1%	23.2%	10.6%
Q1 2016	72.3%	20.6%	7.0%	Q2 2013	65.4%	26.8%	7.8%
Q4 2015	68.8%	21.6%	9.7%	AVERAGE	70.2%	20.9%	9.0%

Source: Standard & Poor's

...which is likely to continue to propel dividend payouts higher,...



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THE PRUDENT SPECULATOR Dividends Have Grown Over Time

While dividends are never guaranteed, the historical evidence suggests that Corporate America has a long history of raising quarterly payouts, whereas the coupons on most debt instruments are fixed.

COUNT OF S&P 500 DIVIDEND ACTIONS				
	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2018 YTD	288	3	2	0
2017	351	5	9	2
2016	344	7	19	2
2015	344	7	16	3
2014	375	8	8	0
2013	366	15	12	0
2012	333	15	11	1
2011	320	22	5	0
2010	243	13	4	1
2009	151	6	68	10
2008	236	5	40	22
2007	287	11	8	4
2006	299	6	7	3
2005	306	10	9	2

Source: Standard & Poor's. As of 10.4.18

S&P 500 DIVIDENDS PER SHARE	
2019 (Est.)	\$58.66
2018 (Est.)	\$54.27
2017	\$50.47
2016	\$46.73
2015	\$43.49
2014	\$39.44
2013	\$34.99
2012	\$31.25
2011	\$26.43
2010	\$22.73
2009	\$22.41
2008	\$28.39
2007	\$27.73
2006	\$24.88
2005	\$22.22

Source: Bloomberg. As of 10.10.18

...keeping the income offered by equities competitive with that of fixed income instruments, even with the recent rise in interest rates. Oops, check that - believe it or not, interest rates actually have declined over the past six-day equity market plunge, with the yield on the 10-year U.S. Treasury dipping to 3.15% on Oct. 11, versus 3.18% on Oct. 3! This means that the October rout has made the earnings yield on stocks even more intriguing today than it was eight days ago.

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Fed Model: Favorable Earnings Yield

The so-called Fed Model suggests that the yield on 10-Year Treasuries should be similar to the S&P 500 Earnings Yield, which is the inverse of the P/E ratio. If the 10-Year is greater than the S&P Earnings Yield, a market is overvalued and if the reverse is true, as it is today, a market is undervalued. Though some argue that the Fed Model is no longer an effective tool, we like today's relatively rich earnings yield of 5.07%.



Of course, as is often the case, when Wall Street holds a sale, investors tend to run away, as evidenced by the good folks at AII dramatically changing their tune, becoming downright Bearish as of Oct. 10. Given that AII participants had become quite Bullish the week prior, we note that the Sentiment Survey is often viewed as a solid contrarian indicator, so we are happy to see the sharp shift toward pessimism.



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Buying High and Selling Low

AAll Investor Sentiment Survey

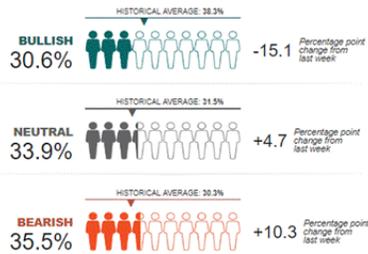
Since 1987, AAll members have been answering the same simple question each week:

Do you feel the direction of the market over the next six months will be up (bullish), no change (neutral) or down (bearish)?

The results are compiled into the AAll Investor Sentiment Survey, which offers insight into the mood of individual investors.

Survey Results for Week Ending 10/10/2018

Data represents what direction members feel the stock market will be in next 6 months.



The AAll Investor Sentiment Survey has become a widely followed measure of the mood of individual investors. The weekly survey results are published in financial publications including Barron's and Bloomberg and are widely followed by market strategists, investment newsletter writers and other financial professionals.

Stunningly, a third of the Bulls at AAll decided in the Oct. 10 Sentiment Survey that they didn't like stocks despite significantly lower prices, while U.S. stock fund and ETF investors were back in redemption mode after a brief flurry of buying right near record equity highs.

Combined Estimated Long-Term Fund Flows and ETF Net Issuance

Millions of dollars

Week Ended	10/3/2018	9/26/2018	9/19/2018	9/12/2018	9/5/2018
Total Equity	-4,284	-1,182	10,193	-3,371	-5,551
Domestic	-4,808	930	10,544	-3,829	-7,009
World	524	-2,112	-351	458	1,458
Hybrid	-2,100	-1,767	-1,299	-1,673	-1,754
Total Bond	6,525	1,702	4,339	7,188	3,510
Taxable	6,527	2,087	4,223	7,158	3,506
Municipal	-2	-385	116	30	4
Commodity	-188	253	-91	-57	-411
Total	-47	-994	13,142	2,088	-4,205

Source: Investment Company Institute

So, while we are left to grin and bear it in terms of stock market volatility, we are more (not less) optimistic today than we were on Oct. 3 about the long-term prospects of our broadly diversified portfolios of what we believe are undervalued stocks.