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Dear Valued Investor:

After more than 18 months of nearly uninterrupted advances, the U.S. equity markets started declining last week, with a large sell-off on February 5, 2018. Although it is always difficult to endure these declines when they're occurring, it's important to focus on the underlying fundamentals of the economy and the markets, which are pointing to the potential for continued growth in 2018 and beyond.

There are several conditions that help explain this current sell-off. The biggest factor is a stronger than expected January jobs report showed rising wage pressures, which has increased concerns about inflation and possible changes to monetary policy. Certainly, employee costs make up the largest percentage of business expenses, which are typically passed on to consumers in the form of higher prices. Inflation can also subtract from the "fixed" income offered by bonds, causing investors to demand higher yields. In these instances, the Federal Reserve (Fed) usually attempts to slow down demand by raising interest rates. Thus, investors may now fear that monetary policymakers will increase rates more than expected in 2018.

As market interest rates started to climb in response to the wage growth concerns, this triggered further selling among some of the crowded trades. Also contributing to overall investor concerns, further deficit spending measures loom as federal budget negotiations continue, with the potential for another government shutdown set for February 8, 2018. Finally, several leading technology and energy companies reported disappointing profits, despite an otherwise strong earnings season.

While market volatility is never pleasant, it is important for investors to appreciate that market pullbacks are a normal part of investing, and we have not experienced even a 5% drop in the S&P 500 Index since the Brexit vote in June 2016. Indeed, the markets have produced a series of record-setting gains recently amid an absence of volatility. Also consider that volatility has historically increased in midterm election years and the market has a propensity to test new Fed chairman. Given these developments, this market weakness may have been overdue.

LPL Research continues to expect the Fed to increase rates three times this year. As a reminder, although interest rates have begun their climb from historically low levels, the benchmark 10-year Treasury yield has only begun to breach LPL Research's projected trading range of 2.75–3.25% for 2018. In addition, the Treasury yield curve actually *steepened* by more than 0.2% last week, a sign of investors' confidence in the future growth prospects of the economy; there is also a lack of stress in credit markets. As always, fixed income remains a critical part of diversified portfolios, providing liquidity, income, and an ability to help mitigate portfolio risk during periods of equity market weakness.

Investors are encouraged to focus on the many solid fundamentals supporting economic and profit growth. The *LPL Research Outlook 2018: Return of the Business Cycle* highlighted the transition from monetary to fiscal leadership as a powerful tailwind consisting of tax reform, government spending, and reduced regulation. This combination may support growth in personal consumption and business investment, enabling U.S. gross domestic product (GDP) growth to climb to 3.0% in 2018. Global growth also appears strong, projected to potentially rise 3.7%, as emerging markets continue to benefit from increased investment and Europe continues to improve.

One thing that we all have to remember, as investors, is that market volatility can still occur in healthy markets. It's important to try and resist the urge to react or let our emotions take hold. Remaining focused on the underlying fundamentals supporting the economy and markets, while maintaining a long-term view, is a valuable strategy toward a better position for potential success.

As always, I encourage you to contact me with any questions.

Sincerely,

John P. Napolitano, CFP®, CPA, PFS, MST
Chairman & CEO

Important Information

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. 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.

Economic forecasts set forth may not develop as predicted.

All market indexes discussed are unmanaged and are not illustrative of any particular investment. Indexes do not incur management fees, costs and expenses, and cannot be invested into directly.

The S&P 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.

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.

Additional descriptions and disclosures are available in the *Outlook 2018: Return of the Business Cycle* publication.

This research material has been prepared by LPL Financial LLC.

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