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Chris Hyzy: Hello, this is Chris Hyzy. Equities around the world were pressured in the last couple of days with US stocks falling by almost 2%. Strong earnings by Bellwether companies were not enough to stem the worries that began around midday Tuesday. Although earnings for the first quarter had been very strong with profits tracking above expectations at an 18% growth rate and net profit margins at 11%, which is the highest we've seen in almost a decade, four primary concerns have developed this week and one lingering worry has not faded.

What are the new concerns? First, input costs are rising as commodity prices have turned higher and labor costs have shown signs of creeping higher as well. The question on investors' minds now is first quarter earnings as good as it gets, that has been a new worry in the last couple of days. Secondly, 10-year treasury yields pierced the 3% level for the first time since 2014 creating concerns of higher interest costs for a variety of debt. Third, with the potential of rising labor and input costs are higher yields indicating inflation is just around the corner. Finally, the one lingering worry that has not faded has been the trade cold war with China. The on-again, off-again negotiations seem to be more saber rattling for now versus constructive discussions, but it still remains in overhang on the broader market.

These concerns collectively are causing market participants to question economic growth in the second half of this year. It's also causing them to question the magnitude of Fed tightening, the level of corporate earnings for the rest of the year, and whether interest rates are going to head past 3.5% on the 10-year treasury. We understand the concerns and believe that it is natural to step back and think about the implications of rising cost on the level of growth. This is normal in late cycle environments. However, in our view, we believe we are still too early in the process for the input cost to pinch overall growth, push yields sharply higher and prompt corporations to lower guidance for future quarters.

Some key globally oriented companies are trying to keep guidance grounded and have not projected out the same level of growth rate they have experienced in the first quarter for the rest of the year, but they have not lowered guidance. We expect second quarter through fourth quarter of this year to remain strong. We still have not also had the stimulus from the tax package filter into the broader economy as well as corporate earnings overall. The emerging markets are still early in their economic cycle and their buying power is just gathering momentum. Europe is pausing, but not heading below trend. US stock buy-back trends are suggesting record numbers for the full year. Credit spreads are still stable and low. Investor sentiment, as measured by the American Association of Institutional Investors, has now fallen back to September 2017 levels, when the S&P was just around 2,500.

Equity valuations in our view are not excessive. The earnings yield of the S&P in fact, which is the inverse of the price to earnings multiple is around 6%, backing out the 10-year treasury which is 3%, you get a spread level, which is the lowest in years. Having said this, the recent bond yield rise has made fixed income more competitive with equities for income oriented driven investors. The US two-year yield is now 2.5% which is about 50 basis points above the dividend yield of the S&P 500 and 10-year investment grade corporate bond yields average approximately 4%. So, portfolio rebalancing by more income oriented investors is occurring. This can create a saw tooth market pattern.

In addition, index dominating companies are being used as a source of funds by portfolio managers as they rotate to more cash flow oriented and reflationary stocks. This can weigh on the broader index prices and make it harder for PEs to expand. We think this is another chapter in the book of worries that tend to filter through in the later stages of the cycle. We still expect double digit equity returns from current levels in 2018, but corporate profits are going to have to outperform consensus expectations for the remainder of the year. Ten-year treasury yields will need to stay below 3.5%. Commodity prices, namely oil, can't rise much sharper from current levels and trade negotiations with China need to turn for the better in our opinion.

It's a lot to ask, but with close to 20% earnings growth expected, a patient and transparent Fed and the emerging market buying power still gaining strength, we think there's still time left for this bull market. As we stated in our year ahead strategy, continue to increase portfolio diversification within asset classes. Increase exposure to higher quality relative to lower quality in both equities and fixed income. Use commodity exposure as a hedge on stocks and bonds where appropriate and continue to rebalance within your designated risk budgets when large weak or strong market episodes do develop. Active management should continue to outperform in our opinion as a rotation towards more reflationary industries and away from the index dominating companies within equities continues in the next year. We are still buyers [on weakness] in equities in our preferred themes overall. Thank you.

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