Market insights

February 2018

Clark D. Wagner

President, *Foresters Investment Management Company, Inc.* and Chief Investment Officer, *Foresters Financial*

The end of tranquility

Key highlights:

- A correction hits the equity market, but we remain positive on long-term prospects due to strong company fundamentals and the economic backdrop.
- Interest rates, driven, in part, by the increasing threat of inflation, are rising.
- Remain calm and stay diversified!

What happened in stocks?

The ongoing rally in the stock market suffered a setback over the last several trading days. It was triggered mainly by a combination of rising interest rates and inflation fears creeping into the market based on last week's Federal Reserve meeting and the positive jobs report. Exhibit 1 illustrates a pick-up in volatility that has been building for some time, suggesting market uncertainty had been growing as we entered the new year. It looks like the age of tranquility is coming to an end.

Exhibit 1: Volatility increasing since end of 2017

Source: CBOE, 2/2/18, VIX daily closing.

Some perspective on recent events

To put recent market events into a wider context, year to date, there have already been four instances when the equity market moved 1% or more compared to ten in all of 2017[1], again perhaps foreshadowing some swings in financial markets. At this point, it is unclear how steep or sustained this correction will be; however, there are several factors that may act as counterweights to a sustained downturn in equities. Strong GDP growth, continuing strength in corporate earnings and residual momentum provided by the new tax legislation all create a positive fundamental environment for stocks.

Interest rates rising and Fed policy may be turning hawkish

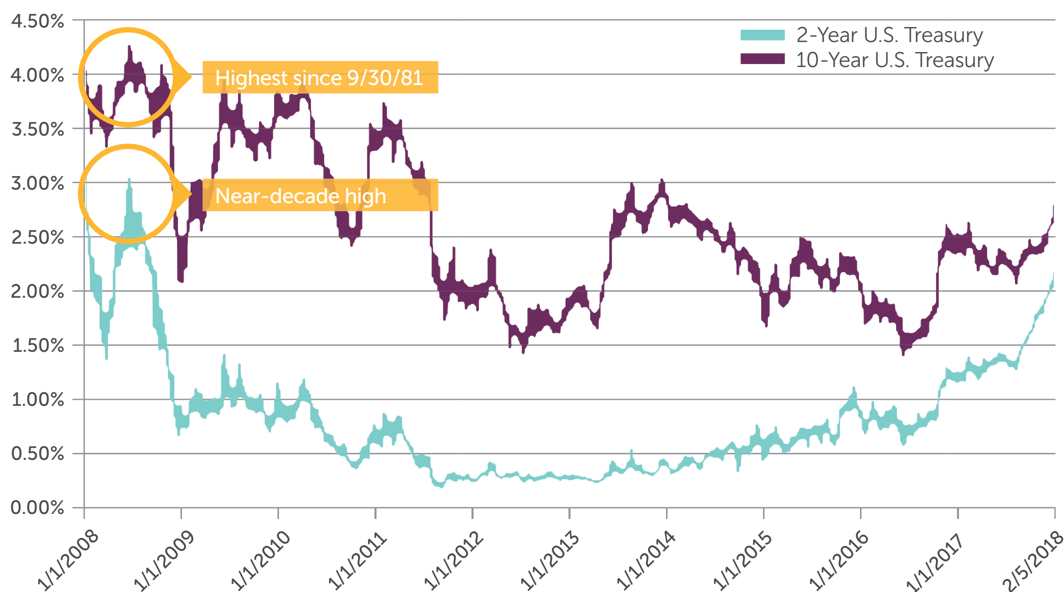
Also appearing on the domestic landscape is the long-awaited shift in interest rates. Exhibit 2 shows the upward trend in the yields of the 10-year and 2-year U.S. Treasurys, with both benchmarks hitting multi-year highs recently. The Tax Cuts and Jobs Act of 2017 has been a key catalyst in driving rates higher in 2018, as its

Foresters Financial

Continued >

enactment has poured gasoline on the fire of economic expansion. Fed rate hikes, at least in the short term, have also helped the yield curve rise, along with some evidence, primarily through wage data, that inflations is starting to trickle into the economy. Global growth has been strong as well, leading central banks to consider removing their own quantitative easing measures and to start raising rates around the world. Most recently, the Federal Reserve stated at its meeting last week that it would "carefully monitor" inflation, raising the issue of a potentially overheating economy for some investors. Such concern has typically led to tighter monetary policy by the Fed and many market participants now expect up to four rate hikes this year. In addition, strong January employment numbers on Friday showed wage growth at its highest level since 2009.

Exhibit 2: Interest rates moving upwards



Source: Bloomberg, 2/5/18.

Remain calm and stay invested

We have thought for some time, given market valuations (the current forward 12-month price-to-earnings ratio for the S&P 500 is 17x compared to its 5-year average of 16.5x)[2], that a correction was likely and could even serve as a helpful catalyst in transitioning the market towards a more normal environment, and possibly extending the bull market. Additionally, the return to a more normal market—and the end of tranquility—is a good reminder that a diversified portfolio is a time-tested way to provide some protection from market volatility. This is an occasion for investors to remain calm, bringing any of their concerns to their financial advisors before making changes to their portfolios.

[1] Source: Morningstar Direct, 2/5/18.
[2] Source: Bloomberg, 2/5/18.

These views represent the opinions of the Chief Investment Officer and are not intended as investment advice or to predict or depict the performance of any investment. These views are as of the close of business on February 5, 2018, based on the information available at the time and are subject to change at any time based on market or other conditions. We disclaim any responsibility to update such views.

The **Standard & Poor's 500 Value Index (S&P 500 Value)** is a capitalization-weighted index of 500 stocks that exhibit strong value characteristics. **VIX** is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. One cannot invest directly in an index. **Price/earnings (P/E)** is the price of a stock divided by its earnings per share. Sometimes called the multiple, P/E gives investors an idea of how much they are paying for a company's earning power. The higher the P/E, the more investors are paying, and therefore the more earnings growth they are expecting.

All investing involves risk, including possible loss of principal. Equities are subject to market risk (the risk that the entire stock market will decline because of an event such as deterioration in the economy or a rise in interest rates), as well as special risks associated with investing in certain types of stocks, such as small-cap, global and international stocks. International investing may be volatile and involve additional expenses and special risks including currency fluctuations, foreign taxes and geopolitical risks. Emerging and developing markets may be especially volatile. Fixed income investing includes interest rate risk and credit risk. Interest rate risk is the risk that bonds will decrease in value as interest rates rise. As a general rule, longer-term bonds fluctuate more than shorter-term bonds in reaction to changes in interest rates. Credit risk is the risk that bonds will decline in value as the result of a decline in the credit rating of the bonds or the economy as a whole, or that the issuer will be unable to pay interest and/or principal when due. There are also special risks associated with investing in certain types of bonds, including liquidity risk and prepayment and extension risk, or investing in high yield (junk) bonds. There are additional risks associated with the use of derivatives. **Past performance does not guarantee future results.**

First Investors Funds are managed by Foresters Investment Management Company, Inc. and distributed by Foresters Financial Services, Inc.; each is a wholly owned subsidiary of Foresters Financial Holding Company, Inc. (FFHC).

Foresters Financial™ and Foresters™ are the trade names and trademarks of The Independent Order of Foresters, a fraternal benefit society, 789 Don Mills Road, Toronto, Canada M3C 1T9 and its subsidiaries, including FFHC.

Foresters Financial

Foresters Financial Services, Inc. | 40 Wall Street | New York, NY 10005 | 800 423 4026 | foresters.com 18-00098