FMA ADVISORY INC
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Friday, October 12th, 2018

Good morning friends and clients:

As you are probably aware, the last several trading sessions have seen tremendous volatility, with the major averages down about 5%. To put in perspective how oversold the market is right now, we look back to earlier in the year - when corporate tax cuts went into effect and corporate earnings soared on lower tax rates - lifting stock prices sharply off the mid-winter low when we had the last correction. The spring and summer months were excellent to equity investors.

Recently, we have noted the pronounced rise in interest rates, we have observed President Trump attack the Federal Reserve, and we have heard Fastenal Corp. announce that tariffs were beginning to bite into their margins. On the international front, we have seen Chinese markets come under tremendous pressure and Italy's fiscal problems bubble to the surface once again. The question we always ask ourselves is whether any of these concerns will impact S&P 500 earnings.

In our experience, the banks are akin to the canary in the coal mine; this morning JP Morgan reported very solid loan growth of 6% - well above Wall Street's expectations for sluggish 2 to 4% growth. It was a back to basics quarter for JP Morgan, with growth coming from loans and not trading. We believe this confirms that economic growth remains intact. JPM's third quarter loan growth was booked despite rising rates, and credit continues to improve. The firm's delinquency rates fell to levels below what were already thought to be the floor in this credit cycle, as consumers seem to be keeping up with their bills.

While this is all good news amidst what we think is an oversold market, we remain concerned with the strength of the dollar and the long-term effects of the trade war with China. We do not expect Fastenal to be a one-off victim of the effects of tariffs on the global supply chain. We are hopeful of a resolution to the trade dispute, and at a minimum some progress when the G-20 meets again in November.

We are also reminded of the fundamentals of valuation: while rising rates may be good for bank margins, they are still a negative for the quantitative assessment of future earnings streams, as well as the valuation of assets of financial companies like banks and insurance companies. Accordingly, we expect the economy to begin to slow in 2019. The Federal Reserve's response to any slowdown will be critical to the extension of this economic cycle and this bull market. For now, volatility has returned. We expect more swings in the market as we enter third quarter 2018 earnings season.

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