ARX

MANAGEMENT, LLC

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OCTOBER 2018 MARKET COMMENTARY *"Pain"*

It's safe to say the US markets entered a different realm last month. After rallying in the face of massive liquidity being ripped out of the system by the Fed the past couple of years, US stocks were finally hit hard in October. The S&P 500 lost 7% of its value and the tech-heavy NASDAQ lost over 9%, as rising interest rates and volatility in the bond markets finally got investors' attention. So what happened?

Years of Fed tightening has finally caught the attention of the markets.

The highly accommodative and unconventional policies implemented by the Federal Reserve during the financial crisis have basically backstopped investors for nearly a decade. Cutting interest rates to zero and buying over $4 Trillion of government bonds (*Quantitative Easing*) pumped unprecedented levels of liquidity into the system, forcing investors to seek returns in risky assets such as stocks and real estate. Instead of removing these unconventional measures once the crisis was averted, the Fed left this accommodation in place until 2016, which is one reason stocks have tripled while US economic growth has grown just ~25% since 2009. Inflation ran well below the Fed's 2% target during this period, providing cover to keep the Fed Funds rate at zero until a few years ago.

Investors have become nervous about how the removal of cheap money will affect expensive equity valuations, despite strong earnings and economic data. With the Fed in tightening mode, which is encountering resistance from the President and a few vocal market pundits, we are in an odd market where "good news is bad news". The rationale being that strong economic data provides more cover for the Fed to fight inflation, but that it may overstep and push the economy into recession. Combine these concerns with potential risks such as a trade war, sharply decelerating Chinese growth, and trouble in emerging markets and Italy, and investors have to wonder if it's worth picking up the last few pennies off the track.

The bond markets were the primary catalyst for the selloff in October, with rates across the yield curve rising 10-20 basis points. This move is interesting because it was led by longer maturities, which are more sensitive to inflation, instead of short-term bonds which tend to be more directly linked to the Fed policy. Yields on 10- and 30-year US Treasuries have increased 30 and 40 basis points, respectively, over the past two months, breaking above key resistance levels and possibly signaling the beginning of a secular bear market for bonds. With an exploding national debt and a Fed committed to reducing its massive government bond portfolio, the path of least resistance for interest rates is higher.

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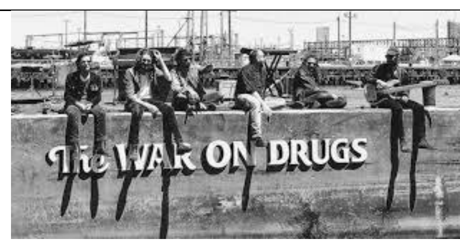
Outlook:

We expect more volatility in both equity and fixed income markets going forward, as the impact of tighter monetary policy takes hold and the Fed's path becomes more data dependent. Our call is for one more rate hike in December and several more next year before pausing around 3%. Short term bonds, where "risk-free" government securities are already priced near this level, offer the best risk/return characteristics and will offer safety in the choppy markets ahead. ARX actively managed Qualified Settlement Funds are well positioned to take advantage of this unique opportunity.

Market Snapshot:

	9/30/18	10/31/18	Change
Fed Funds Target Rate	2.00-2.25%	2.00-2.25%	UNCH
3-month US Treasury	2.18	2.34	+16
2-year US Treasury	2.81	2.88	+7
10-year US Treasury	3.05	3.15	+10
30-year US Treasury	3.20	3.39	+19
S&P 500	2,914	2,712	-6.9%
Stock Mkt Volatility (VIX)	12.12	21.23	+9.11
US Dollar (DXY)	$95.13	97.08	+2.1%
Oil	$73.56	64.95	-11.7%
Gold	$1,196	1,217	+1.8%
Bitcoin	$6,567	6,300	-4.1%

ARX Spotify Playlist



PAIN by The War on Drugs

About ARX Management:

Established in 2011 by professionals with direct experience in complex litigation and institutional investment management, ARX offers an unmatched mix of capabilities relevant to managing 1.468B Qualified Settlement Funds. Our expertise investing conservative capital preservation products is directly related to the management of institutional QSFs. Contact us today at arxadmin@arxmgmt.com to discuss a customized QSF for your settlement.