Political Risk Has Investors, Market Turning Bearish

A week after writing about the CBOE Volatility Index, or **VIX**, hitting a 23-year low, U.S. stocks turned in their worst day in 10 months this week as the VIX surged to its highest level in over a month.

Most of the apprehension stemmed from Washington, D.C., as the Trump administration weathers storms on multiple fronts and doubts grow as to whether the president's agenda will make it through Congress. The admission by the president that he had shared confidential intelligence details with Russian diplomats did little to move the markets on Tuesday. However, the market turned sharply lower Wednesday on news of a memo that alleges that the president asked then-FBI director James Comey to end his investigation into former national security adviser Michael Flynn's ties to Russia. The White House denied the version of events outlined in the memo, saying the president never asked Comey to end any investigation.

As a result, on Wednesday, the "Trump Bump" that had been powering the market since November turned into the "Trump Dump," at least for a day. The S&P 500 fell 1.8% that day, its biggest one-day drop since September of last year. In addition, the Dow Jones industrial average shed 1.8% and the NASDAQ Composite fell 2.6% after posting a new all-time high close the day before. In addition, the VIX spiked 46% on Wednesday. In turn, investors flocked to safe-haven assets such as Treasuries and gold. Bank stocks were hit hardest, as financials in the S&P 500 were down 3% on Wednesday as hopes for bank deregulation and tax reform faded.

As U.S. stocks turned pessimistic this week, so too did retail investors. The weekly **AAII Investor Sentiment Survey** showed that bullish sentiment among members fell to its lowest level since the week before the November election. Bullish sentiment also saw its biggest one-week decline since July 2015.

Wednesday's selloff was followed by a rebound on Thursday and Friday, although it was not enough to wipe away the mid-week losses.

While there is growing uncertainty about the president's ability to push through major campaign promises such as tax reform and infrastructure improvement, it's important not to lose track of the fact that the U.S. economy, for the most part, seems healthy. The U.S. job market is robust, and a healthy corporate earnings season is drawing to a close.

This week's events highlight the impact that political risk has on the stock market. However, while it may generate short-term volatility, as this week shows, it is unlikely that it will have a long-term effect on stocks. In addition, this week saw sectors that have been underperforming lately come to the forefront. Real estate posted a strong week despite declines in the major U.S. indexes. The Real Estate Select Sector ETF (**XLRE**) added 1.3% for the week. In addition, Consumer Staples (**XLP**) posted a 0.7% gain this week.

This week supported some of the key tenets of the SSR methodology. First, over the long term, stocks will rise. There may be short-term and even intermediate downturns in the market, but in the long run, stocks generate positive returns. In addition, not all stocks move in the same direction all the time. This is why it is important to have a well-diversified portfolio, so when some sectors in the market are retreating, others may be advancing. With the SSR portfolio, you have a portfolio that is diversified not only across selection methodology, with each of the four groups using unique stock selection criteria, but it is also diversified across market-cap segments and industry and sector groups.

Earnings Season Update

Three more companies in the SSR tracking portfolio reported their results for the second calendar quarter of 2017 this week. Only one of the three exceeded their consensus estimate: Cisco Systems (Group 2: **CSCO**). Meanwhile, Group 3 holdings Foot Locker (**FL**) and Photronics (**PLAB**) reported quarterly earnings that fell 1.4% and 40.0% short of their respective consensus estimates. The news section below has more detailed information on the results from these companies.

Through the end of this week, 32 of the 36 stocks in the SSR portfolio have reported their quarterly results for the current earnings season. Twenty-six, or roughly 81%, of those firms have reported positive earnings surprises, while six companies reported earnings that fell short of estimates. So far for this earnings season, the median earnings surprise for the SSR companies is 4.0%, as is the average surprise.

Next week, the last four SSR companies will report their second calendar quarter results. Toll Brothers (Group 3: **TOL**) will report before the market open on Tuesday, May 23. Copart (Group 4: **CPRT**) will announce after the market close on Wednesday, May 24. Group 1 holdings Burlington Stores (**BURL**) and Ulta Beauty (**ULTA**) will announce before the market open and after the market close, respectively, on Thursday, May 25.

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