After The Close

A profit warning from Apple inflames slowing global growth fears

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Stocks stumble out of the gate

U.S. equities fell sharply on Thursday, due to a quarterly profit warning from Apple, Inc. and slower-than-expected growth in U.S. manufacturing. Utilities and Real Estate benefited from a flight to quality, as Information Technology sank over 5.0% on the day. The 10-year U.S. Treasury yield finished at 2.56%, and gold edged higher. The S&P 500 Index is now off 16.8% from its 52-week high and lower by 2.4% at the start of 2019 – and we are just two trading days in.

Major Domestic Equity Indices - Today

Benchmark	Index Level	Net Change	% Change
S&P 500 Index	2,448	-62.1	-2.5%
Dow Jones Industrial Average	22,686	-660.0	-2.8%
Russell 2000 Index	1,331	-25.0	-1.8%
NASDAQ Composite	6,464	-202.4	-3.0%

All data via FactSet as of approximately 4 PM ET

Growth fears continue to dominate the market narrative

After the market closed on Wednesday, Apple cut the midpoint of its December quarter revenue guidance by 8.0%, representing the first negative preannouncement in over a decade. The profit warning sent shockwaves across the market today. The iPhone maker cited weaker demand in China as the primary reason for the lower revenue guidance as well as a slower overall uptake of its new iPhones. In our view, Apple's specific issues could be indicative of a broader problem facing more American companies, as slowing economic growth in China may negatively affect large multinational profits in 2019. In particular, we believe companies that rely on supply chains across China and generate a meaningful amount of their revenue from the country's burgeoning consumer class are most exposed to potential profit disappointment this year. Several economic indicators show that growth in China is slowing or outright contracting, which could make for a difficult macro environment for multinationals at least through the first half of 2019. In our view, the negative tone in the market on Thursday was a reaction to this macro, and reflects the ongoing tension of slowing global growth, due to trade frictions, on U.S. corporate profits.

On a related note, analysts cut their 2019 earnings per share (EPS) estimates for more than half the companies in the S&P 500 during December, according to *FactSet*. This marks the largest number of EPS cuts in two years. Interestingly, annual growth estimates for S&P 500 earnings generally come in lower at the end of the year compared to initial estimates in January. We believe investors are now pricing in a rather flat earnings growth environment for this year, which is adding to the pressure on equity prices.

Importantly, data on the world's two largest economies show that growth meaningfully slowed in December, raising recession fears. On Wednesday, an important measure of private sector manufacturing activity in China marked its first contraction since May 2017, while Beijing's official manufacturing PMI reading contracted in December for the first time since July 2016. Today, December data showed that U.S. manufacturing activity experienced its most dramatic deceleration since 2008, as domestic demand trends declined in the face of slower growth and increasing tariffs. Outside of more meaningful progress on U.S./China trade talks, which are expected to ramp up over the next week or so, investors appear more comfortable reducing risk in the current environment. On a related note, U.S. Trade Representative Robert Lighthizer is still very skeptical of Beijing's intentions and has warned President Trump that he may have to exert more pressure through additional tariffs to see lasting concessions from China. Currently, the U.S. and China remain far apart on solving their trade issues. In our view, weaker-than-expected manufacturing activity and declining asset prices are a reflection of the growing friction. Slowing global growth, as well as a decelerating U.S. corporate profit picture, has investors on edge at the start of the year.

Committee View

The challenges that tripped up markets in 2018 remain large stumbling blocks in 2019. Decelerating growth trends, potentially higher interest rates, and tariffs all pose headwinds for asset prices. A partial U.S. government shutdown, Brexit, and a more volatile environment only add to the stew of current worries. With that said, the S&P 500 fell 4.4% in 2018 on a total return basis, its worst performance since the financial crisis and first down year since 2015. In our view, market conditions are oversold at the moment, and negativity among investors is high. Consequently, we believe this is the time to have a solid game plan in place, summon a little fortitude, and stay focused on the longer-term. The new year is starting like the last ended – volatile and unpredictable from day-to-day. We suggest centering on longer-term goals and trends in the market as well as maintaining a diversified portfolio. Please refer to tomorrow's *Before The Bell* for additional insight on these topics.

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