Peregrine
asset advisers

3rd Quarter 2018 Market Overview
Divergences

US stocks recorded their best quarter since 2013 but these gains were jolted in the opening days of this month.

Eerily reminiscent of last February, the S&P 500 fell 8% in only seven days in October. So far, this plunge hasn't been as pronounced as last February but the damage to the previous trend is concerning and it interrupts the steady climb in the market since April.

The same concern that caused the S&P 500 to fall 13% for in February has returned to haunt the markets again in these early days of October. Federal Reserve Chairman, Jay Powell hinted in his October 3 meeting that the Fed would pursue a course of systematic interest rate increases throughout next year. This was an apparent policy departure from the "data dependent "policy applied by Janet Yellen, his predecessor. This hawkish policy change roiled the markets. Investors fear Chair Powell and the Fed are ignoring ominous signs that would necessitate a more moderate approach to rate hikes.

Our economy is strong but there are divergences so steady rate hikes represent a clear threat. GDP grew at the fastest clip since 2012 and unemployment has dropped to 50 year lows but problems lurk under the surface. If the economy is so strong, why are there so many weak industries?

Housing is a key component to our economy. Clearly, higher mortgage rates have a detrimental effect. Stocks of homebuilders are down 26% year to date as measured by the ETF for this sector. Many housing related stocks like **Sherwin Williams**, **Mohawk**, **Whirlpool**, and **Home Depot** have sagged.

Another area of weakness is worldwide markets which have decisively eroded. Europe and Japan are down 6% for the year.   The Chinese stock market is down 26%. Will soft growth in world economies have a negative impact for our economy?

Technology stocks have also made a decisive downturn. The semiconductor industry reflects of the strength of the economy yet important stocks like **Intel** and **Texas Instruments** are down 15% for 2018.

FANG stocks(**Facebook**, **Alphabet**, **Amazon**, **Apple**, **Netflix**, and **Alphabet**) have been knocked from their mighty perch. Facebook and Netflix had precipitous declines in the third quarter. FANG has consistently been responsible for a great portion of the gain in the S&P 500 but now, this group of stocks is down 20% for the month of October.

The fortunes of banks are considered crucial to the economy. Yet this sector hovers near yearly lows, down 5% for the year. Sub-par loan growth also suggests the economy might not be as strong as believed. In addition, it is worrisome that the stocks of autos, hotels, and airlines continue to languish at yearly lows. These areas of the market should not be doing poorly in a robust economy.

These myriad indicators tell a story of an economy that is not ready for higher interest rates.

It took seven months for the market to recover from the February decline. Hopefully, the recovery from this latest damage will be much swifter. The Fed is expected to raise interest rates again at their December meeting. Between now and then, if investors can be reassured that interest rate increases will moderate, buyers will return and mend the recent market losses. Seasonally, the fourth quarter is the strongest time of the year for the market. We are hopeful client accounts are poised to make progress into the year end.

Peregrine Portfolio

Early in 2018, the top growth stocks for Peregrine managed accounts were **Caterpillar** and **Estee Lauder**. However, the dual threats of earning slowdown and tariffs necessitated that we take profits in these names.

Currently, client accounts hold **Lululemon**, **Etsy**, and **Roku** as growth leaders. These stocks could be vulnerable since recent large institutional investor activity show distribution. We carefully consider these holdings but so far, they are being held due to their outstanding business characteristics.

Healthcare service provider **Veev Systems** was an excellent performer for client accounts in 2018 but we took profits as the market began to appear shaky.

We recently added **Adobe** in advance of their earnings report and a major industry conference. Hopefully, this stock is not dragged down by weakness in technology shares.

The Peregrine Equity and Balanced Composites finished September up 7.02% and 5.88% respectively for the full year of 2018. Both Composites gained over 4% for the third quarter alone. The S&P 500 gained 7.20 for the quarter and is up 8.95% through nine months.

Generally, Peregrine accounts hold a significant percentage of its assets in cash or interest bearing securities like CDs or T-bills. This offers greater stability for Peregrine accounts which is favorable during stock market volatility.

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