COUNTRY Trust Bank®
Special Report: Volatility is Back

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Key Points:

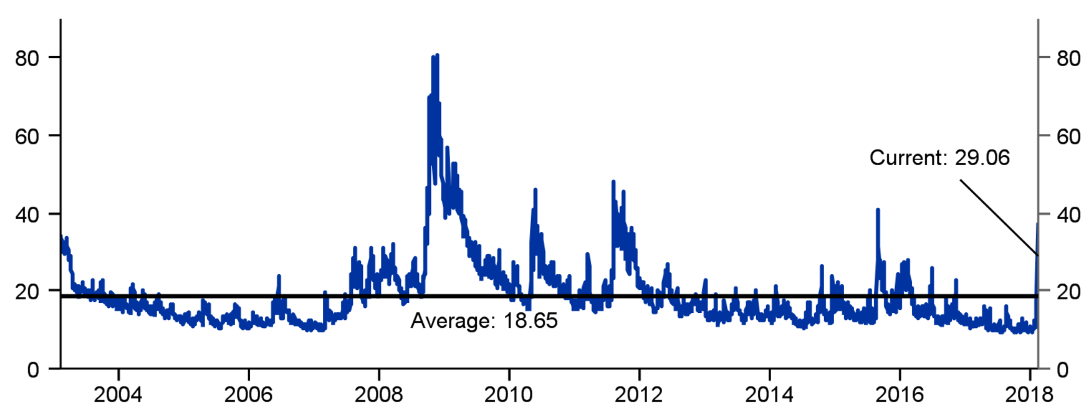
- **The S&P 500® officially entered a correction, declining more than 10% from its previous peak.**
- **We view the return of volatility as really a return to normal market conditions after an abnormally tranquil 2017.**
- **We believe that there are strong underlying fundamentals that should provide support for stock prices.**
- **We continue to believe that investors who have a long-term plan and appropriate investment strategy, and the discipline to stick to it, are well-prepared to weather these occasional storms in the financial markets.**

Volatility is back.

After an abnormally tranquil year for the stock market, the S&P 500® officially entered a correction, having declined more than 10% from its peak on January 26. The Cboe Volatility Index® (VIX), which measures volatility expectations, has spiked from near-record lows to multi-year highs. (Figure 1)

Figure 1

CBOE Volatility Index (VIX)



Source: Thomson Reuters Datastream

Latest data point as of 2/9/2018

So why did the stock market suddenly enter a correction? The answers aren't entirely clear. One possible explanation is that investors suddenly feared higher inflation and interest rates, which prompted a selloff that was exacerbated by the unwinding of certain high-risk products that bet on the continuation of low volatility.

However, according to CME Group's "FedWatch Tool", the odds for higher short-term rates from the Federal Reserve have not changed much. Additionally, the yield on the 10-year Treasury note has been rising for much of 2018, including throughout January when the S&P 500 rose more than 5%, so we fail to see why it is suddenly a problem for the market.

According to the Bureau of Labor Statistics' latest "Employment Situation" report, average hourly earnings did accelerate a bit in January, but 2.9% growth is hardly worrisome. Meanwhile, core inflation measures remain subdued, including the Federal Reserve's preferred metric – core personal consumption expenditures – which last stood at just 1.5%.

Importantly, we have not seen a change in underlying fundamentals, which remain strong. This includes:

- *Better-than-expected fourth quarter financial results:* 74% of S&P 500 companies have delivered positive earnings surprises and 79% have reported positive sales results (both well above their long-term averages).
- *Strong earnings growth:* current 2018 estimates project 18.5% earnings growth for the S&P 500 on 6.5% revenue growth.
- *Positive economic momentum:* both the Institute for Supply Management's Manufacturing and Non-manufacturing indexes remain firmly in "expansion" territory, the labor market remains strong, and consumer confidence remains high.

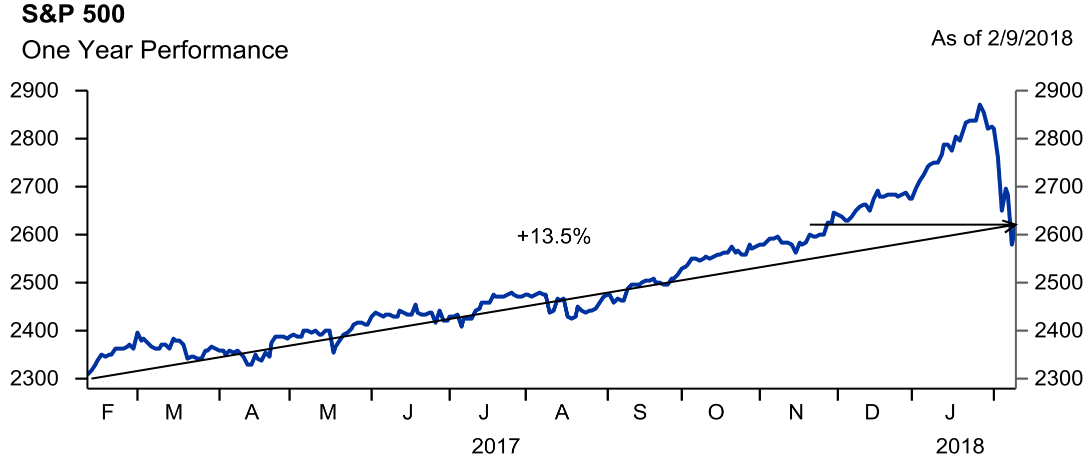
We believe that strong underlying fundamentals should provide support for stock prices. We note that bear markets, or greater than 20% declines in the stock market, rarely occur outside of economic recessions. Given the solid economic backdrop, we view recession risks as low.

It is important to keep this correction in perspective too. The stock market was soaring before the pullback, and the S&P 500 is now back near levels it saw less than three months ago. And over the last 52-weeks, it has still risen a solid 13.5%. (Figure 2)

Figure 2

S&P 500

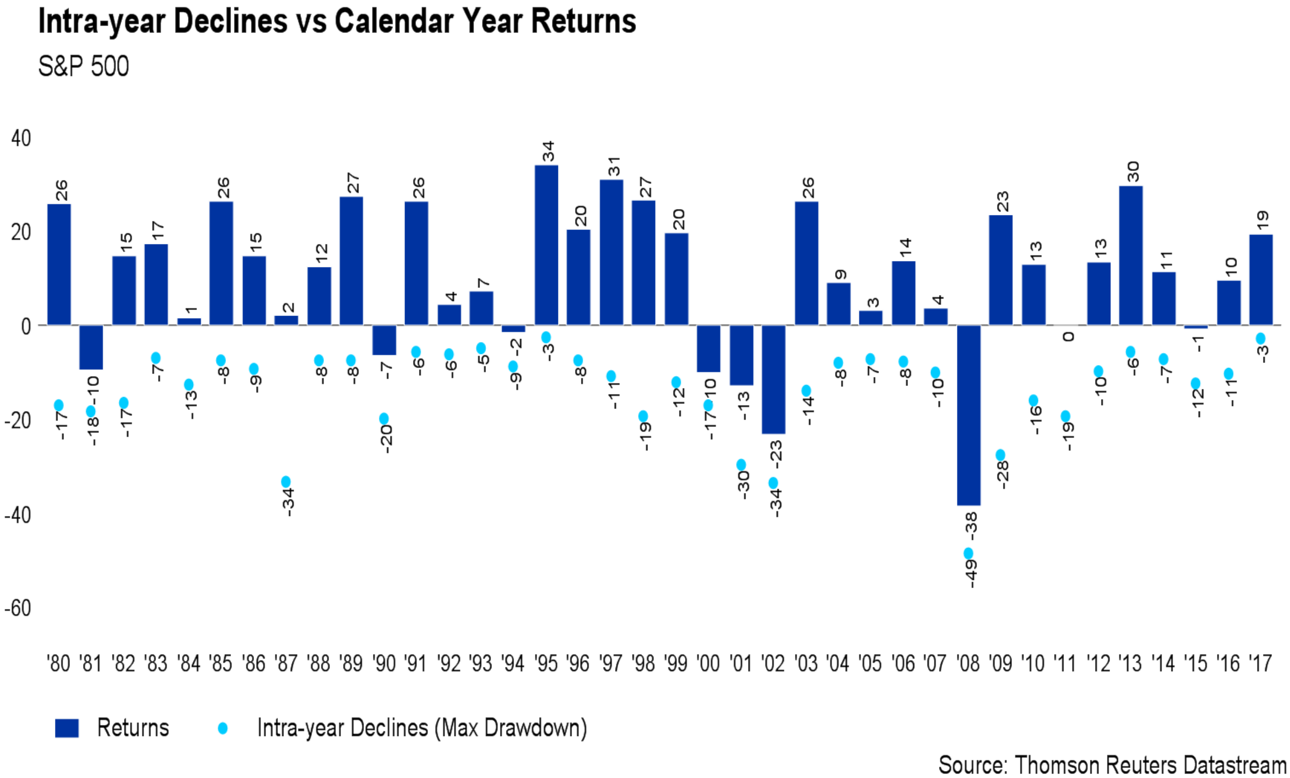
One Year Performance



Source: Thomson Reuters Datastream

We view the recent return of volatility as really a return to normal market conditions. Last year was an anomaly for equities, as a steady, upward climb in the market without periodic setbacks is rare. Since 1980, the average intra-year decline for the S&P 500 has been 13.8%. Despite this, the market has delivered positive annual returns in 29 of the 38 years. (Figure 3)

Figure 3



What Investors Should Do

Volatility is inevitable for equity investors. The ones who are rewarded are the ones who ride it out. As we have written before, avoiding stock market pullbacks is not the key to success for investors, but how they react to those pullbacks often is. We continue to believe that investors who have a long-term plan and appropriate investment strategy, and the discipline to stick to it, are well-prepared to weather these occasional storms in the financial markets.

COUNTRY FINANCIAL®

Definitions

The S&P 500® Index is an unmanaged index that contains securities typically selected by growth managers as being representative of the U.S. stock market.

The Cboe Volatility Index® (VIX Index) is a measure of market expectations of near-term volatility conveyed by S&P 500® index option prices. The VIX Index is widely considered to be the world's premier barometer of investor sentiment and market volatility.

The CME Group's FedWatch Tool uses 30-day Fed Fund futures pricing data to analyze the probability of Federal Open Market Committee (FOMC) rate moves for upcoming meetings. The tool visualizes both current and historical probabilities of various FOMC rate change outcomes for a given meeting date and shows the Fed's "Dot Plot," which reflects FOMC members' expectations for the Fed target rate over time.

The Bureau of Labor Statistics of the U.S. Department of Labor is the primary Federal agency responsible for measuring labor market activity, working conditions, and price changes in the economy. Its monthly "Employment Situation" report provides statistics on the U.S. labor market.

The Institute for Supply Management's non-manufacturing index is based on data compiled from purchasing and supply executives nationwide. Survey responses reflect the change, if any, in the current month compared to the previous month. The NMI® (Non-Manufacturing Index) is a composite index based on the diffusion indexes for four of the indicators with equal weights: Business Activity (seasonally adjusted), New Orders (seasonally adjusted), Employment (seasonally adjusted) and Supplier Deliveries. An NMI® above 48.9 percent, over a period of time, indicates that the overall economy, or gross domestic product (GDP), is generally expanding; below 48.9 percent, it is generally declining. The distance from 50 percent or 48.9 percent is indicative of the strength of the expansion or decline.

The Institute for Supply Management's manufacturing index is based on data compiled from purchasing and supply executives nationwide. Survey responses reflect the change, if any, in the current month compared to the previous month. The PMI® is a composite index based on the diffusion indexes of five of the indexes with equal weights: New Orders (seasonally adjusted), Production (seasonally adjusted), Employment (seasonally adjusted), Supplier Deliveries (seasonally adjusted), and Inventories. A PMI® reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally declining. A PMI® above 43.3 percent, over a period of time, indicates that the overall economy, or gross domestic product (GDP), is generally expanding; below 43.3 percent, it is generally declining. The distance from 50 percent or 43.3 percent is indicative of the strength of the expansion or decline.

Chart data comes from Thomson Reuters Datastream, a powerful platform that integrates top-down macroeconomic research and bottom-up fundamental analysis.

Important Information

Investment management, retirement, trust and planning services provided by COUNTRY Trust Bank®.

All information is as of the report date unless otherwise noted.

Past performance does not guarantee future results. All investing involves risk, including risk of loss.

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Stocks of small-capitalization companies involve substantial risk. These stocks historically have experienced greater price volatility than stocks of larger companies, and they may be expected to do so in the future.

Stocks of mid-capitalization companies may be slightly less volatile than those of small-capitalization companies but still involve substantial risk and they may be subject to more abrupt or erratic movements than large capitalization companies.

International investing involves risks not typically associated with domestic investing, including risks of adverse currency fluctuations, potential political and economic instability, different accounting standards, limited liquidity and volatile prices.

Fixed income securities are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Debt securities typically decrease in value when interest rates rise. The risk is usually greater for longer-term debt securities. Investments in lower-rated and nonrated securities present a greater risk of loss to principal and interest than higher-rated securities.

Diversification, asset allocation and rebalancing do not assure a profit or guarantee against loss.

All indexes are unmanaged and returns do not include fees and expenses associated with investing insecurities. It is not possible to invest directly in an index.