LORD ABBETT

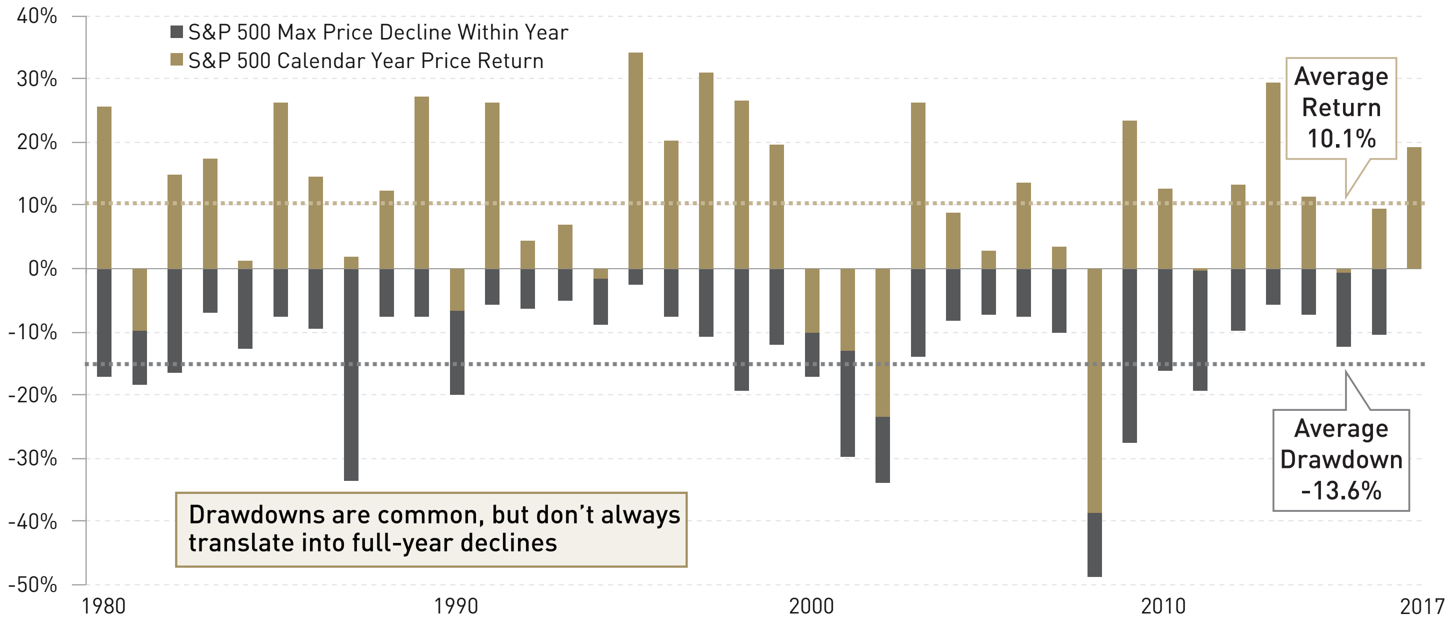
MARKET VIEW

VOLATILITY, THE MIDTERMS, AND THE MARKETS: AN UPDATE

Addressing political uncertainty and renewed market volatility.

CHART 1. DRAWDOWNS HAVE BEEN COMMON, BUT THEY HAVEN'T ALWAYS TRANSLATED INTO FULL-YEAR DECLINES

S&P 500 ANNUAL PRICE RETURNS VERSUS MAXIMUM PRICE DECLINE, AS OF DECEMBER 31, 2017



Source: Morningstar.

Note: The historical data are for illustrative purposes only, do not represent the performance of any specific portfolio managed by Lord Abbett or any particular investment, and are not intended to predict or depict future results. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. **Past performance is not a reliable indicator or guarantee of future results.**

IN BRIEF

- Amid uncertainty surrounding the U.S. midterm elections, and a renewed bout of market volatility, we thought it would be a good idea to provide a fresh update on the investment backdrop by addressing five key questions.
- For this article, we asked our investment experts to provide updates on the current equity market; trends in U.S. corporate earnings; broader economic fundamentals; a sensible approach to market volatility; and the potential investment impact of the U.S. midterm elections.
- Based on our experts' responses, we would once again emphasize that investors focus on the current fundamental strength of the U.S. economy, and maintain a patient, long-term approach to their investment portfolios amid the current volatility.

FEATURED INVESTMENT LEADERS

Giulio Martini
Partner and Director of Global Asset Allocation

Daniel Solender
Partner and Director of Municipal Bonds

Leah Traub
Partner and Portfolio Manager

In recent weeks, *Market View* has focused on two major threads that investors in U.S. assets have been following closely. On October 1, we featured Lord Abbett experts' views on how the U.S. midterm elections might influence the economy and markets. Two weeks later, we surveyed the resurgence in market volatility. Since then, there have been a number of additional developments to weigh: U.S. interest rates have whipsawed; geopolitical hot buttons (Brexit, Italy's fiscal woes, U.S. trade friction with China, controversy surrounding Saudi Arabia's alleged role in the death of a journalist) have gotten hotter; and third-quarter U.S. earnings season has moved into high gear. Meanwhile, President Trump has roundly criticized U.S. Federal Reserve (Fed) rate hikes, and floated a middle-class tax cut plan that took the U.S. Congress, and pretty much everyone else, by surprise.

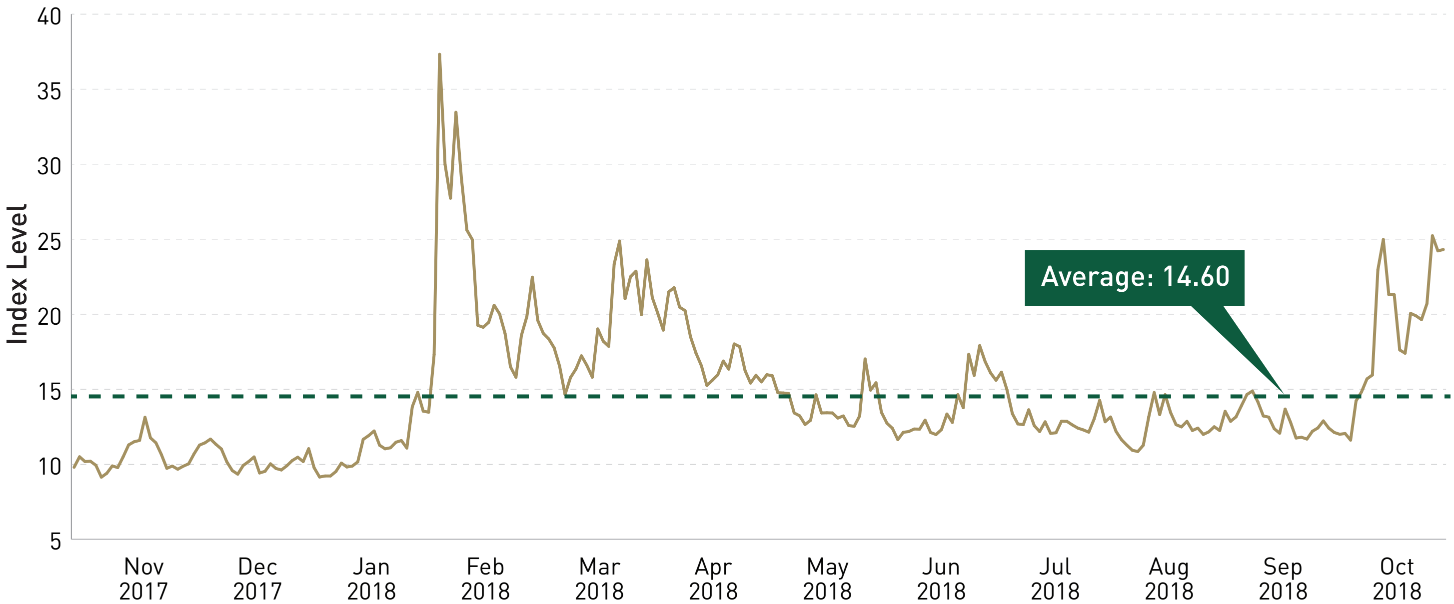
In this fluid environment, we thought it would be a good idea to provide a fresh update on the investment backdrop. Here we answer five key questions that may be top of mind for investors at the current moment.

1. What's been going on in the U.S. equity market?

The week of October 22 was rather tough on U.S. equity markets. On Wednesday, October 24, both the S&P 500® Index and the Dow Jones Industrial Average fell to negative territory for the year. Major indexes staged a partial recovery on Thursday, October 25, only to decline again the following day. The potential contributors to the volatility included concerns about a slowdown in U.S. corporate earnings growth; escalating trade tensions between the United States and China; higher interest rates; a stronger U.S. dollar; and the prospect of global economic weakness. The barrage of corporate profit reports during the week included disappointing earnings and revenue numbers from heavyweights such as AT&T, Amazon, and United Parcel Service. A Lord Abbett strategy brief issued on October 26 noted that "with the absence of a tax-cut boost and the likelihood of higher interest rates, which can raise the borrowing costs of businesses, there are concerns that companies' earnings growth will slow."

CHART 2. ONCE AGAIN, OCTOBER HAS BEEN A VOLATILE MONTH FOR U.S. STOCKS

VIX INDEX, OCTOBER 27, 2017-OCTOBER 26, 2018



Source: Bloomberg.

The information shown is for illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that markets will perform in a similar manner under similar conditions in the future. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. **Past performance is not a reliable indicator or a guarantee of future results.**

The VIX Index, which is sometimes referred to as the market's "fear gauge," spiked due to the recent sell-off in equities, and reached a level above 25 for the first time since February. (See Chart 2.) The October 26 strategy brief noted that "it is likely that there will be additional volatility as companies continue to report quarterly earnings." It is worth pointing out that October historically has been a month with above-average volatility for U.S. stocks.

2. Speaking of U.S. corporate earnings, how have they been holding up?

According to data from FactSet, through October 26, 48% of the companies in the S&P 500 had reported third-quarter results.[1] Of those companies, 77% had reported a positive earnings per share (EPS) surprise and 59% had posted a positive sales surprise. The blended earnings growth rate for the S&P 500, at 22.5%, represented the third highest growth pace since the third quarter of 2010. But the news was not all good: For the fourth quarter of 2018, 26 S&P 500 companies had issued negative EPS guidance, compared to 15 providing positive guidance.

A research brief from Credit Suisse issued on October 29 noted the "problematic" narrative around corporate guidance.[2] But a Credit Suisse analyst said that third-quarter data indicates that "profits look intact for much of the market," with negative revisions limited to groups with high economic sensitivity (autos, materials, and capital goods) or those lacking pricing power (consumer staples and telecom).

What about next year? In a note issued October 25, Lord Abbett Partner and Director of Strategic Asset Allocation Giulio Martini observed that earnings forecasts for 2019, after the tax law has been fully factored in, "have always reflected the expectation of a sharp slowdown." With the U.S. economy receiving substantial fiscal stimulus over the next few quarters—around 1% of GDP from the release of spending caps on federal defense and non-defense spending—and consumer spending fueled by strong employment and income growth, Martini said "U.S. companies should be able to perform better than non-U.S. companies that are more exposed to the slowdown in global trade."

3. What about broader fundamentals?

Despite the gloom in financial markets, U.S. economic news has continued to be positive. Gross domestic product (GDP) expanded by a 3.5% annual rate in the third quarter of 2018, according to a preliminary estimate issued by the U.S. Bureau of Economic Analysis (BEA) on October 26, ahead of economists' estimates of a 3.4% increase tracked by Dow Jones. The BEA report showed that the PCE price index, a key measure of inflation, increased by 1.6% during the quarter, well below the 2.2% increase expected by economists.

Martini recently told *Market View* that "the United States is really accelerating in part because of the stimulative effect of the fiscal policy package that was passed and of the tax reform that was put into effect late last year." Thus, the United States is getting a domestic stimulus that contrasts with the negative effect of the downturn in global trade in the rest of the world. "And so we're really seeing the U.S. economy pick up just as the rest of the world turns down," Martini added. Indeed, Martini noted that surveys of purchasing manager sentiment for October showed that the United States and Japan were well outperforming the euro area, where sentiment is now back down to levels that predate the global growth acceleration in 2016. Meanwhile, "China is implementing fiscal stimulus and other measures designed to mitigate the effects" of tightening domestic credit, which "should be felt more broadly in the fourth quarter and first half of 2019."

4. What should equity investors be thinking about amid the current volatility?

This question comes up frequently in our investment conversations. As long-term investors, we have always counseled a patient approach during times of market turmoil. We believe this philosophy is validated by a chart we have used over the years to illustrate just how common big market downturns are—and that they don't necessarily lead to full-year losses.

5. What are your latest views on the potential implications of the U.S. midterms?

As noted earlier, we published a detailed summary of our investment experts' views on the U.S. midterm elections on October 1. But we've continued to receive questions on the upcoming contest. So we asked Leah Traub, partner and portfolio manager, for her thoughts.

If Republicans keep the House and Senate, Traub expects that Trump will push for another tax cut that may provide a sentiment boost for the markets and also offer another temporary lift to U.S. GDP after it is enacted. She thinks U.S. Treasury yields, however, likely will rise as the Fed will be more likely to remain on course for further rate hikes. "This will prevent other developed market currencies from rising too much against the dollar as the interest rate differential widens out even further in favor of the United States," she says.

Traub believes the most likely scenario is that the Democrats gain control of the House while the Republicans keep the Senate. In that case, she thinks further tax cuts are unlikely. "The economy is still doing well, so nothing is really needed on the policy front," she says. Attention may turn more toward the probe of Russian interference in the 2016 U.S. presidential election, and Traub thinks further sanctions against Russia would be likely. Ultimately, "markets will trade more on the U.S. and global economic outlooks rather than anything to do with what's happening—or not happening—in D.C." Under the least likely scenario of a Democratic sweep of both houses of Congress, Traub thinks the markets may sell off on is the possibility of an attempt to reverse the 2017 U.S. tax cuts or other measures. "While that is not likely to be successful, the markets will have to price in some probability it will be."

As for the municipal bond market, Lord Abbett Partner and Director of Municipal Bonds Dan Solender offered an updated view based on recent developments. Trump's idea for a second round of U.S. tax cuts focused on the middle class "is no longer just a hypothetical, because if Republicans keep control of both the House and the Senate this is clearly on the agenda," Solender says.

Solender also noted the release of figures showing a growing U.S. deficit as the decreased revenues from tax cuts have, at least in the short term, created an unbalanced budget. He said that Trump recently requested 5% budget cuts from U.S. government agencies. "It is unclear where these cuts will come from, but we will need to watch to determine whether it will have an impact on state and local budgets," and how—and where— the cuts may be need to be implemented.

Summing Up

In addressing the torrent of headlines surrounding the U.S. midterm elections, the global economy, and the gyrations of the U.S. stock market, we believe investors' response should be twofold. First, they should focus on the fundamental strength of the U.S. economy, especially as it relates to the rest of the world. In light of that broad-based strength, we think the second point is clear: A market sell-off in a fundamentally strong economic environment should not by itself be seen as a reason to abandon sound long-term strategies that offer investment opportunity. ■

[1]FactSet, "Earnings Insight," October 26, 2018.
[2]Credit Suisse, "U.S. Equity Strategy: Revisions –You Can't Handle the Truth," October 29, 2018.

IMPORTANT INFORMATION

A Note about Risk: The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy.

Statements concerning financial market trends are based on current market conditions, which will fluctuate. All investments involve risks, including the loss of principal invested.

This material is provided for general and educational purposes only. The examples provided are for illustrative purposes only, and are not indicative of any particular investor situation.

This ***Market View*** may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

The S&P 500® Index is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

The Volatility Index, or **VIX**, is a real-time market index created by the Chicago Board Options Exchange that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments

Indexes are unmanaged and are not available for direct investment.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product or service may be appropriate for your circumstances.

*The opinions in **Market View** are as of the date of publication, are subject to change based on subsequent developments, and may not reflect the views of the firm as a whole. The material is not intended to be relied upon as a forecast, research, or investment advice, is not a recommendation or offer to buy or sell any securities or to adopt any investment strategy, and is not intended to predict or depict the performance of any investment. Readers should not assume that investments in companies, securities, sectors, and/or markets described were or will be profitable. Investing involves risk, including possible loss of principal. This document is prepared based on the information Lord Abbett deems reliable; however, Lord Abbett does not warrant the accuracy and completeness of the information. Investors should consult with a financial advisor prior to making an investment decision. Investors should consult with a financial advisor prior to making an investment decision.*

Lord, Abbett & Co. LLC | 90 Hudson Street | Jersey City, NJ 07302-3973 | T 1.888.522.2388 | lordabbett.com

Investors should carefully consider the investment objectives, risks, charges, and expenses of the Lord Abbett funds. This and other important information is contained in each fund's summary prospectus and/or prospectus. To obtain a prospectus or summary prospectus on any Lord Abbett mutual fund, contact your investment professional or Lord Abbett Distributor LLC at 888-522-2388, or visit us at lordabbett.com. Read the prospectus carefully before you invest.