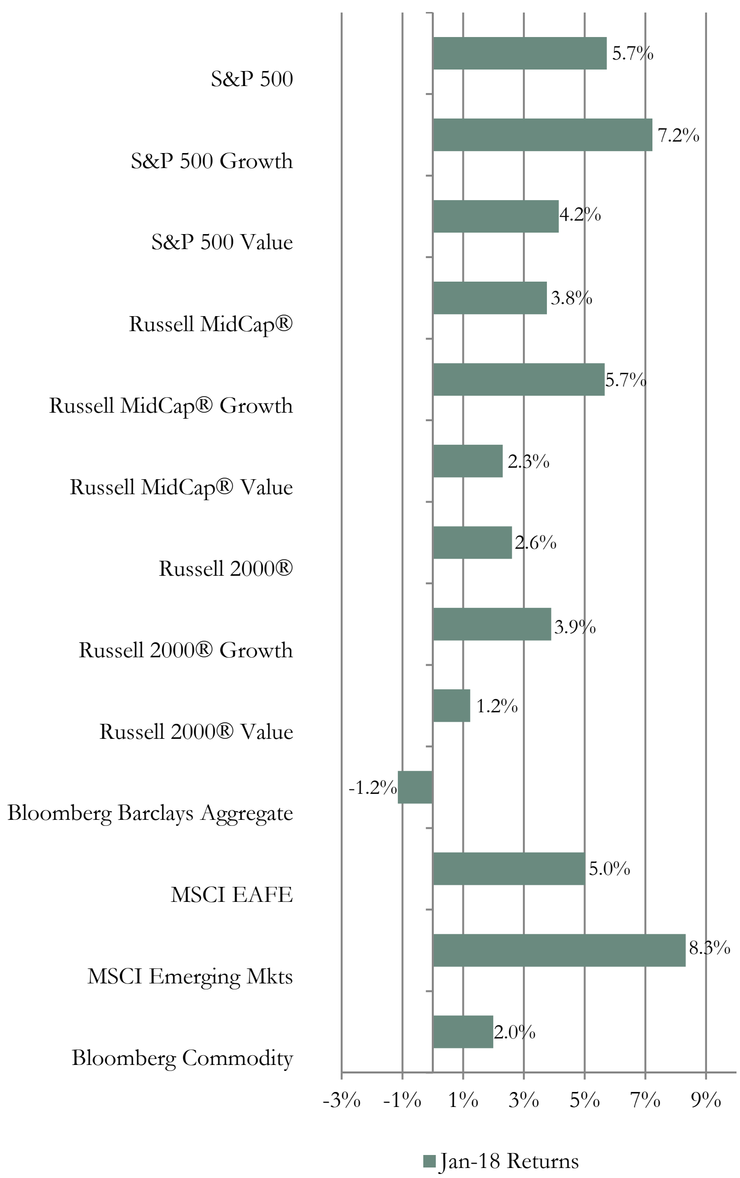
Monthly Market Summary – January 2018

The global equity rally of 2017 continued into 2018. Several equity indices set new record closing highs in January including the S&P 500 and Nasdaq Composite in the U.S., the DAX 30 in Germany, the FTSE 100 in the United Kingdom (U.K.), the Hang Seng in Hong Kong, and the IBOV in Brazil. The S&P 500 hit 14 new highs during the month. Robust economic fundamentals, strong earnings reports, up beat corporate outlooks, and positive sentiment related to the U.S. tax cuts were the primary catalysts to move equity markets higher. Many U.S. economic reports indicated that economic fundamentals continue to improve. The Institute for Supply Management's manufacturing index rose more than expected to 59.7 due to a surge in new orders. Durable goods orders were up 2.9% from the prior month. Industrial production increased 6.2% from the prior quarter. Retail sales were up 5.4% over the prior year boosted by auto sales that were higher than expected at an annualized rate of 17.9 million. Economic data showed strength outside the U.S. as well. For example, the Eurozone composite purchasing managers' index rose to 58.6, which was the highest level since June 2006. Fourth quarter gross domestic product (GDP) growth in the U.K. was better than expected at 0.5%. GDP growth in China increased to 6.8% on a year-over-year basis. This was the first increase in China's GDP in seven years.

Market Indices – January 2018



The strong economic data and a pick-up in the core inflation rate in the U.S. solidified investors' expectations of at least three, and maybe four, interest rate increases by the Federal Reserve (Fed) this year. These expectations for rate hikes drove bond prices down and yields higher. The two-year Treasury bond yield rose from 1.89% at the end of 2017 to 2.14% at the end of January. The two-year Treasury yield has not been over 2% since 2008. The 10-year Treasury bond yield rose from 2.41% at the end of 2017 to 2.72% at the end of January. The month-end yield for the 10-year Treasury was the highest since 2014. Foreign bond yields rose as well in January as the European Central Bank began to implement its plan to cut the monthly amount of asset purchases in half.

The concerns about increasing inflation and the resulting higher yields took a toll on equity markets late in the month. For example, the

S&P 500 fell 0.6% on January 29 and 1.1% on January 30. The surprise announcement that Amazon, JP Morgan, and Berkshire Hathaway plan to form a healthcare partnership to tackle the high cost of providing healthcare for their employees also contributed to the drop in equity markets late in the month. The late month sell-off trimmed equity market returns, but January was still an unusually strong start to the year with the S&P 500 posting a return of 5.7%, the best start to the year for that index since 1997. The MSCI EAFE index of developed international equities was up 5.0% and the MSCI Emerging Markets (EM) index was up 8.3%. Equities outperformed bonds by a wide margin as yields rose. The Bloomberg Barclays U.S. Aggregate Bond index had a return of -1.2%. The strong global manufacturing activity drove a broad-based rally in commodity prices and the Bloomberg Commodities index was up 2.0%.

In the U.S. equity markets large-capitalization (cap) stocks outperformed mid-cap stocks and both outperformed small-cap stocks. The outperformance of growth stocks over value stocks across the market cap spectrum continued from 2017 into the first month of 2018. The equity market rally was broad-based except for interest rate sensitive sectors. The consumer discretionary, information technology (tech), and healthcare sectors had the highest returns. Consumer discretionary stocks advanced on expectations that higher disposable income due to the tax cuts will fuel consumer spending. Tech stocks were up on robust earnings reports. The healthcare sector had a boost from several biotechnology company mergers. More defensive sector stocks, such as consumer staples, lagged the higher growth sectors with market participants in a pro-risk mood. Higher income bond-proxy stocks, such as in the utilities and real estate sectors, were the weakest performers for the month with negative returns in reaction to higher bond yields.

Emerging markets equities outperformed both U.S. and developed international equities on a U.S. dollar basis for January. The MSCI EM index had a return for the period of 8.3% compared to the return of 5.0% for the MSCI EAFE index of developed international stocks. The impact of the declining U.S. dollar, which reached a three-year low against the euro, provided a sizeable boost to the EM and EAFE returns for U.S. investors. The local currency return was 6.8% for the EM index and 1.2% for the EAFE index. Unlike in the U.S., value stocks in both the EM and EAFE indices outperformed growth stocks. In developed markets, the euro area index had the highest return boosted by some of the strongest economic data for the region in years. In EM, the Latin America index had the highest return boosted by the almost 17% return for Brazil. Brazil's equity market rallied on news related to the upcoming presidential election that is seen as business friendly. China and Russia also had double-digit gains due to strong economic data and in Russia's case, higher oil prices. Sector returns in both the EAFE and EM indices were similar to the U.S. in that the more economically sensitive sectors had the better returns and the more defensive and higher dividend yield sectors had weaker returns.

The phrase "reflation trade" was used frequently to describe fixed income market activity in January as bond yields rose to multi-year highs. The upward move in yields and downward move in bond prices was driven by expectations that tax reform will strengthen already strong economic growth and push up labor and commodity prices which will in turn lead to higher inflation which will keep the Fed in the rate hiking mode and maybe even accelerate the pace of rate hikes. U.S. bond market returns were mostly negative for January leading the Bloomberg Barclays U.S. Aggregate Bond index to post a return for the month of -1.2%. As mentioned above, short maturity through intermediate-term maturity bond yields rose sharply with the two-year Treasury bond yield rising above 2% for the first time since before the financial crisis and the 10-year Treasury bond yield reaching a four-year high. The corporate high yield sector was the best performing sector of the fixed income market with a small positive return reflecting the improving economic environment which is supportive to credit quality. As usual in a rising yield period, longer maturity bonds had larger price declines than shorter maturity bonds.

The Bloomberg Commodity index had a return of 2.0% for January. Commodity prices rose due to strong global manufacturing activity driving broad-based demand for raw materials. Prices for industrial metals such as zinc rose to multi-year highs on supply concerns. Oil also received a boost from limited supply as a result of the prior production limit agreement by the Organization of Petroleum Exporting Countries (OPEC) and certain non-OPEC countries. The price of West Texas Intermediate (WTI) crude oil rose to over $66 per barrel during the month. This was the first time WTI traded above $66 since 2014. The price pulled back slightly late in the month and closed at $64.85 on January 31 with a gain of 8% for the month.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

Our tactical recommendations have not changed. We continue to be positive on the outlook for U.S. and developed international stocks as we see support for corporate earnings growth due to positive global economic growth momentum since most economic data continues to be solidly in expansionary territory. However, after the improvements that have been seen in various economic data in the U.S., Europe, and Japan, we expect the rate of future improvement may be lower. In contrast, various emerging markets regions appear to still be earlier in the economic cycle and we expect a higher rate of economic and profitability growth in emerging markets than in developed markets in the coming months. In addition, given the unusually strong equity returns in January after the high returns of 2017 without a significant pullback, there is a rising risk that market volatility is likely to increase if any earnings reports, economic data, or political news disappoint investors.

We continue to recommend an equal weight to U.S. large-cap, mid-cap, and small-cap stocks and to developed international equities. We recommend an overweight to emerging markets equities. We continue to favor equities over bonds and retain our underweight recommendation for fixed income investments. Our underweight recommendation is because the return expectation for bonds is modest due to the prospects for yields to move higher (and prices lower) if inflation picks-up and the Fed continues to hike its policy rate as it has suggested or if the Fed accelerates the pace of rate hikes. Within fixed income we continue to recommend a focus on short to intermediate term bonds. We also continue to favor non-Treasury bonds for the yield advantage they provide. We continue to favor hedge fund strategies over fixed income for the lower expected volatility portion of portfolios but also recommend an underweight allocation to hedge funds. Since our expectation is for a moderate rate of inflation to continue, we recommend an equal weight to real assets. We continue to recommend using periods of market strength to raise any cash needed to support spending needs over the coming 12-24 months.