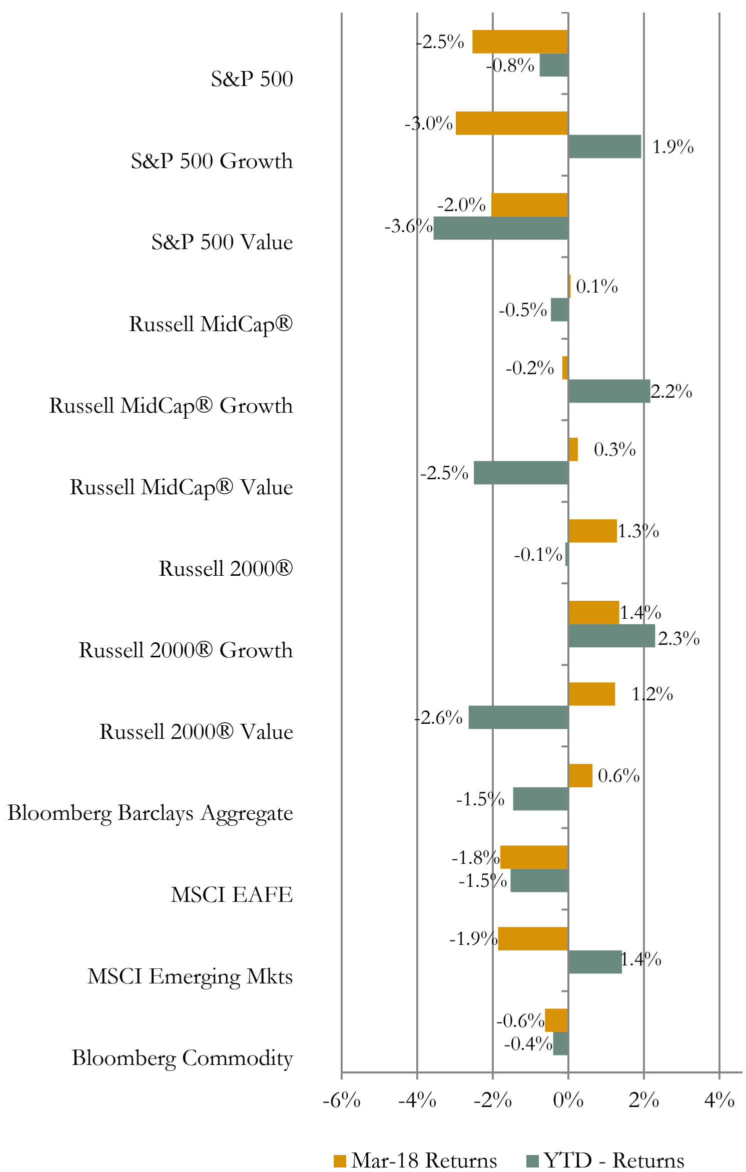
Monthly Market Summary – March 2018

March was an eventful month with major news events breaking on economic, geopolitical, and corporate fronts leading to heightened uncertainty among market participants and choppy global financial markets. Investors faced various cross currents. Positive U.S. economic news was a major tailwind. However, that tailwind was largely offset by headwinds from trade war fears steaming from new tariffs by the U.S. on steel, aluminum, and certain Chinese products along with retaliatory tariffs imposed by China on U.S. goods. The other major headwind battering financial markets was the technology stock rout caused by worries about possible new regulatory scrutiny on popular technology (tech) and social media companies after the user data privacy issue at Facebook came to light and autonomous driving cars were involved in fatal car crashes. Tweets by President Trump questioning the tax treatment and U.S. Postal Service pricing for Amazon also weighed on equity markets.

Market Indices – March 2018



The roller coaster ride in financial markets started right out of the gate on March 1 when global markets sold off after President Trump said he would implement tariffs of 25% on steel imports and 10% on aluminum imports. Trade war fears dominated as market participants awaited details about negotiations for exemptions for U.S. allies or any retaliation actions. Global markets recovered the next week as tariff concerns eased. The Nasdaq index even reached new record closing highs on both March 9 and 12 on huge cash inflows into the largest tech sector exchange traded fund. But things quickly changed as the trade war talk intensified and more news, such as the Facebook user data privacy breach came out. Equity markets reversed again and fell to a low for the month after tariffs on $50 billion of Chinese goods and restrictions on Chinese investment in U.S. tech companies were announced. The equity markets did recover a bit in the last trading days of the month after U.S. fourth quarter gross domestic product was revised higher on stronger consumer spending.

March was the second consecutive month that U.S. large capitalization (cap) stocks had a negative return. Trade war concerns dragged down large export heavy companies, such as Boeing and Caterpillar, and the tech sector sell-off led by Facebook, Apple, Alphabet, and NVidia dragged down the S&P 500 index which finished the month with a return of -2.5%. Smaller sized companies performed better since they are seen as being more domestically focused so less impacted by tariffs. The Russell 2000 index of small-cap stocks was the performance leader with a positive return of 1.3%. The mid-cap index also eked out a small positive return for the month. Due mostly to the tech sector sell-off, growth stocks in the S&P 500 and Russell MidCap indices underperformed value stocks. However, growth stocks continued to outperform value stocks in the Russell 2000 index. Sector returns varied widely. Defensive sectors such as utilities and real estate had among the best returns given the heightened investor uncertainty. The energy sector also had among the highest returns since oil prices rose much of the month. The materials sector was one of the weakest sectors in March across the market cap spectrum in reaction to the new steel and aluminum tariffs. In the S&P 500, the financial sector had the lowest return.

The MSCI EAFE index of developed international stocks and the MSCI Emerging Markets (EM) index each posted a negative return for the month hurt by trade war concerns and some lackluster economic data particularly from Europe. Currency moves had a small positive impact on the EAFE return for U.S. investors but there was essentially no impact on the EM index return. Growth stocks in both the EM and EAFE indices outperformed value stocks, although the difference in returns in the EM index was small. Just as in the U.S. equity market, more defensive sectors, such as utilities and real estate had the best returns while materials and financials were the weakest performing sectors. On a regional basis, Europe outperformed the Far East and the Pacific Region due in part to positive returns for Italy and Portugal as those economies improve and due to the large negative return for Australia as the important mining industry is experiencing declining iron ore shipments to China. Among emerging economies, the Latin American region was one of the best performing with Mexico posting a small positive return. The indices for India, China, and Russia each declined over 3%.

U.S. bond market returns were mostly positive for March resulting in the Bloomberg Barclays U.S. Aggregate Bond index gaining 0.6% for the month. The only major sector of the U.S. fixed income market to post a negative return for the month was the corporate high yield bond sector which declined less than 1%. Despite the Federal Reserve Open Market Committee (Fed) raising its target interest rate by 0.25% in March and its new projections showing a slightly more aggressive pace of rate hikes next year, yields on intermediate and longer-term bonds declined and prices rose. Short-term bond yields ended March about where they ended February. Therefore, returns for longer maturity bonds were higher than for shorter maturity bonds. The 10-year Treasury bond yield ended the month at 2.74% down from 2.87% at the end of February but still up from the year-end 2017 yield of 2.40%.

The Bloomberg Commodity index had a return of -0.6% for March. After posting a large negative return in February, the energy sub-index had a large gain for March as oil prices rose on strong demand and some draw down of inventories. The price of West Texas Intermediate crude oil started the month at $61.53, increased to over $66 during the month before reversing again to end the month at $64.94. The precious metals sub-indices had a very small positive return on higher gold prices, but the price for silver fell throughout the month. The agriculture sub-index declined due to weakness in both livestock and grains. The industrial metals sub-index declined over 4% on tariff/trade war uncertainty.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

The tariffs and trade negotiations have added a new element of uncertainty to the outlook for inflation and earnings and we expect that markets will have various bouts of up and down periods as headlines tell about the latest developments in negotiations. However, at this time fundamentals still appear to be generally positive as far as 1) corporate earnings and forward guidance companies have been providing, 2) strong labor markets and consumer confidence readings that should be supportive to consumer spending and housing markets, and 3) manufacturing and service sector indices that remain firmly in expansion territory. We will be watching for signs that the economic or earnings outlook is changing but are maintaining our tactical asset allocation recommendations for the time being.

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 since yields are likely to move higher (and prices lower) as the Fed continues to hike its policy rate. 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 an overweight to cash reserves that includes adequate cash to support spending needs over the coming 12-24 months.