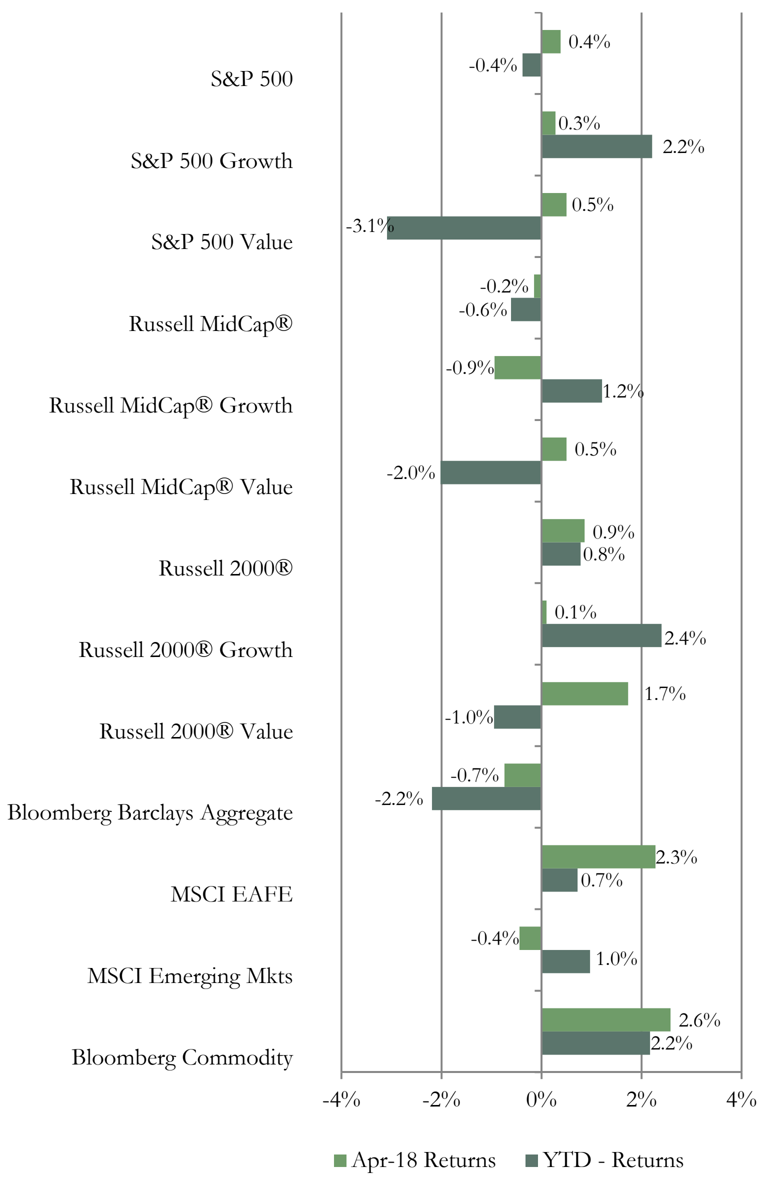
Monthly Market Summary – April 2018

Volatility was the main story in financial markets again in April. Investors faced wide swings in equity markets not only on a day-to-day basis but also on an intraday basis. The swings occurred despite generally strong first quarter earnings reports due to headwinds from increasing interest rates, tariff talk, geopolitical issues, and jitters about building inflationary pressures. Another notable occurrence during the month was that in several instances despite a company reporting robust, and even higher than expected, revenue and earnings growth, the stock price dropped sharply. The declines were often driven by a comment from a company executive on the earnings call about higher costs or capacity constraints which stoked concerns about future earnings.

Market Indices – April 2018



The global economy continues to expand at a solid rate despite some signs of a decelerating rate of growth, particularly in Europe. The first quarter U.S. gross domestic product (GDP) report showed a 2.3% annual growth rate. This is a lower rate than the prior quarter, but is higher than the first quarter 2017 growth and was better than analysts expected. China's economy grew more than expected on a rebound in manufacturing activity and strong consumer spending. Employment reports continue to be strong in the U.S. and Europe. The purchasing managers index (PMI) for manufacturing remains in expansion territory (above 50) in almost all major economies. However, many PMI numbers have turned lower recently coming off multi-year highs even though they remain above 50. Capacity constraint is a major factor in the lower PMI numbers and bad weather in various countries could also be a factor. Certain economic reports from Germany gained attention. German industrial production fell 1.6% due to weak domestic demand and exports dropped due to the strengthening euro.

U.S. equity market returns were mixed for April. For the second consecutive month, the Russell 2000 index of small-cap stocks outperformed the S&P 500 and Russell MidCap indices. One reason for the outperformance is that smaller companies are seen as being more domestically focused so less impacted by tariffs and benefiting more from the tax cuts. Value stocks outperformed growth stocks. Strong gains for the energy sector and solid positive returns for the utilities sector drove the value indices higher while weakness in the information technology sector was a drag on the growth indices. The energy sector was the top performing sector regardless of market capitalization (cap) since energy stocks rallied sharply as oil prices rose to a three-year high. The energy sector return was over 9% in the S&P 500 and Russell MidCap index and was over 13% in the Russell 2000 index. The consumer staples sector had the lowest return for the month in the S&P 500 index with a -4% return as staples companies continue to be hurt by increasing costs in a very competitive market environment that is limiting the ability to pass higher costs on to consumers. The industrials sector had the lowest return in the mid-cap index and was the second weakest sector in the S&P 500 and Russell 2000 indices. The telecommunications services sector had the lowest return in the small-cap index.

Developed international equities outperformed both U.S. and emerging markets equities for the month of April. The MSCI EAFE index of developed international stocks had a return for the period of 2.3% on a U.S. dollar basis. The MSCI Emerging Markets (EM) index had a return of -0.4%. Currency movements had a negative impact for U.S. investors since the U.S. dollar rose. The local currency return was 4.5% for the EAFE index and 1.2% for the EM index. Just as in the U.S., value stocks outperformed growth stocks in the EAFE and EM indices. The energy, materials, and industrials sectors had the best returns in both the developed international and emerging markets while healthcare and information technology stocks had the lowest returns. On a geographic basis, Europe was the best performing region among developed international markets with Italy, France, and the United Kingdom posting the best returns. Japan had one of the lowest returns among developed international countries due to some mixed economic data. Political issues and rising interest rates pressured stock prices in many emerging markets. For example, Russia was one of the worst performing countries with a return of -7% due to the impact of the decision by the U.S. to impose wide-ranging sanctions against specific Russian oligarchs, officials, and companies. At the other end of the spectrum, India was one of the top performing emerging markets countries with a gain of 4%.

U.S. bond market returns were negative in April for all but the shortest maturity bonds and for high yield bonds. The Bloomberg Barclays U.S. Aggregate Bond index had a return of -0.7% for the month. The 10-year Treasury bond yield rose to the psychologically important 3% level during the month as bond prices dropped on signs of increasing inflationary pressures as well as on geopolitical and trade tensions. This was the first time since January 2014 that the 10-year yield has been as high as 3%. Yields rose across all maturities with short and intermediate rates rising more than longer maturity rates, resulting in a flattening of the yield curve. A flatter yield curve means that the difference in the yield between short-term bonds and long-term bonds has gotten smaller so there is less reward for taking on more time to maturity risk. High yield bond prices rose in April due to robust demand, better interest coverage ratios since corporate earnings have been strong, and higher oil prices (a large portion of the high yield bond universe is energy related debt).

The Bloomberg Commodity index had a return of 2.6% for April. The petroleum sector had the best return among the major sectors we track as oil prices rose for the second consecutive month. The price of West Texas Intermediate (WTI) crude rose to $70 per barrel in April as inventories were drawn down even with U.S. production reaching record highs. Geopolitical tensions related to Iran and Syria also contributed to the rise in oil prices. WTI was $68.57 per barrel at month-end. The industrial metals index gained over 3% as prices for metals such as aluminum and nickel rose in reaction to trade tariffs and U.S. sanctions against Russia. The grains index also gained about 3% for the month as bad weather in the middle of the country hurt the outlook for crops such as wheat.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

Global economic growth remains healthy, confidence surveys remain optimistic, corporate fundamentals are generally strong, and corporate earnings growth looks to continue, even though the rate of growth may be lower. However, there are risks to consider, such as the potential for faster than expected interest rate hikes by the Federal Reserve if inflation picks-up and the impact of U.S. trade policies and any retaliatory actions by other countries. Therefore, we expect that financial markets will continue to be volatile as investors react to news on trade agreements and tariffs, monetary policy, or signs of inflationary pressures. However, we continue to be cautiously optimistic and have not changed our tactical asset allocation recommendations.

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 low since yields are likely to move higher (and prices lower) as the Federal Reserve 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, 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.