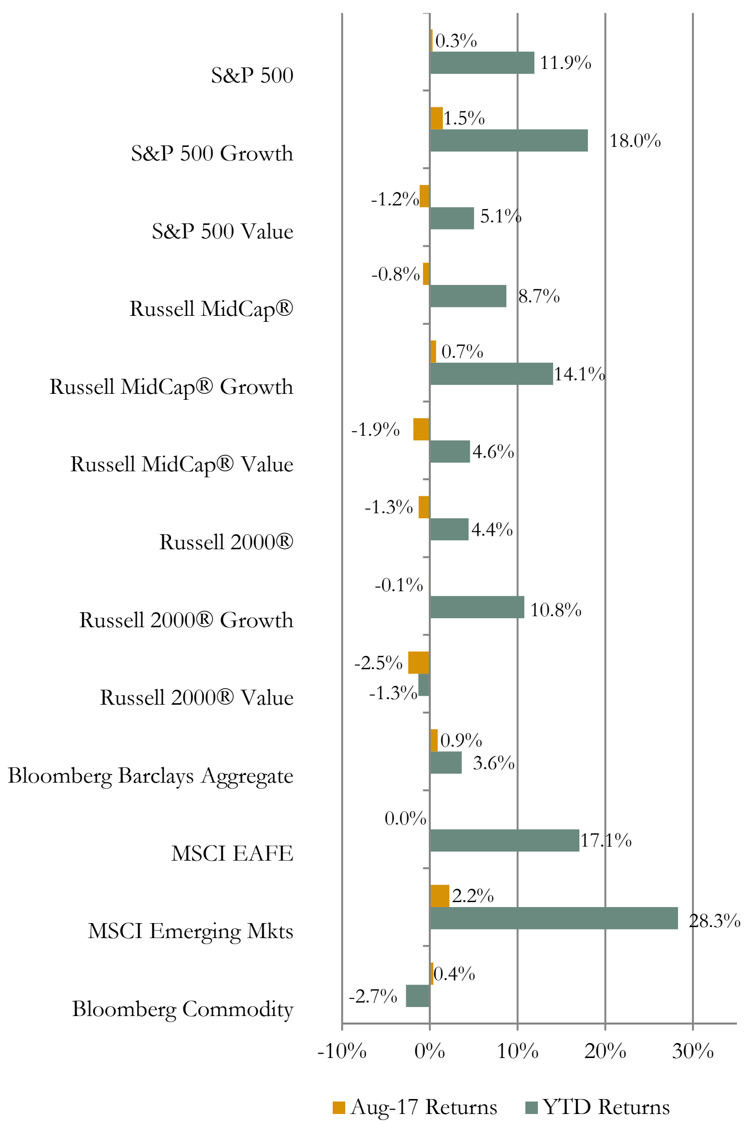
Monthly Market Summary – August 2017

Volatility returned to global equity markets during August. Equity markets started August with a continuation of the uptrend experienced during July. The Dow Jones Industrial Average and the S&P 500 indices even advanced enough to set more new record closing highs. Then stocks declined for about a two-week period on some weaker than expected economic data in the U.S. and as various geopolitical events dominated the headlines. Investor sentiment was shaken by North Korean sabre rattling and President Trump's hard line rhetoric in response, a terror attack in Spain, and controversy surrounding reactions to a violent protest in Charlottesville, VA. Stock markets reversed course again late in the month as unease about North Korea subsided and investors focused on some better than expected earnings announcements and positive economic data reports in the U.S. and other countries.

Market Indices – August 2017



After the ups and downs during the month, the emerging markets stock index had once again outperformed U.S. and developed international stock indices propelled by stronger growth and improving fundamentals. Global bond markets also had periods of advances and declines in reaction to the geopolitical events and speculation about potential adjustments to monetary policy, but yields for most types of bonds ended the month lower, and prices higher. As a result, the Bloomberg Barclays U.S Aggregate Bond index outperformed the S&P 500 for the month. The commodities index had a positive return for the month and also outperformed the S&P 500 despite the continued weakness in the crude oil prices since improving global economic activity has been increasing demand for industrial metals and driving prices higher. Also, there was a spike in demand for safe haven assets such as gold in reaction to heightened geopolitical tensions.

Economic news was mixed during August. The news from Japan was strongly positive. Japan's most recent gross domestic product (GDP) growth report came in above expectations at 4% boosted by an increase in domestic consumption and business investment. Also, the ratio of job openings to applicants rose to 1.5, which was a multi-decade high. The European Union reported that second quarter GDP grew 2.3% over the prior year. This was the fourth consecutive quarter of year-over-year GDP growth. In the U.S., second quarter GDP growth was revised higher to 3% from 2.6%, the number of job openings increased to a new record high, and retail sales grew 0.6% over the prior month. However, both new and existing home sales declined, housing starts fell, auto sales weakened, and industrial production slowed. Industrial production also declined in the euro zone due to a contraction in both capital and consumer goods production. In China, both the manufacturing and the nonmanufacturing purchasing managers' indices softened, but remained in expansionary territory. Investors' also focused on the fact that inflation reports in various regions including the U.S., the European Union, and China remain low and under central bank targets, which may delay central bank decisions to reduce monetary stimulus programs.

In U.S. equity markets, large-capitalization (cap) stocks outperformed mid-cap stocks and both outperformed small-cap stocks. Growth stocks again outperformed value stocks and widened the significant year-to-date performance gap. Industry sector returns were mixed. The energy sector with large negative returns was the poorest performing sector among large, mid, and small-cap stocks. The energy sector slump worsened even before Hurricane Harvey hurt the Gulf Coast oil industry. U.S. oil inventories have actually declined for several weeks, but production continues to rise. The consumer discretionary and consumer staples sectors also had a negative return in each market cap index. Information technology with modest positive returns was the best performing sector in the S&P 500 and the Russell MidCap indices on positive outlooks for various companies in the sector. Healthcare had the top return in the Russell 2000 index of small sized companies driven in part by the rally in biotechnology stocks. The utilities sector had the second highest returns in the large, mid, and small-cap indices boosted by investors' preference for more defensive stocks when volatility picked up mid-month.

Emerging markets equities continue to outperform both U.S. and developed international equity indices. The MSCI Emerging Markets (EM) index posted a return of 2.2%. The MSCI EAFE index had a return of 0.0%. Currency movements had a minimal impact on returns for U.S. based investors. On a local currency basis, returns for the EM and EAFE indices were 2.1% and 0.0% respectively. The only negative sector in the EM index for the month was consumer discretionary which had a -0.5% return. The highest sector return was the 5.3% return for the materials sector. On a geographic basis, Brazil was one of the top performing emerging markets stock indices with a return of over 6% for the month. Stocks in Brazil rallied after the government announced sweeping privatization plans for assets including electricity generation, oil fields, and airports. In contrast, India was one of the weakest countries with a small negative return. Healthcare stocks declined in India hurt by a government proposal to make healthcare more affordable that was seen as a negative for companies in the sector. In developed international country equity markets, many European stocks were pressured by the increasing value of the euro. The higher euro is raising concerns about the competitiveness of European exports. The euro rallied on expectations that the European Central Bank will begin to taper its monthly bond buying program since the amount of bonds available for purchase is dwindling. Stocks in the United Kingdom, and the pound, were hurt during the month by lack of progress in Brexit negotiations. For the second month in a row, Israel had the worst return among developed international countries. The Israel index was down over 14% hurt by a steep decline in the price of the stock of Teva Pharmaceutical.

The Bloomberg Barclays U.S. Aggregate Bond index had a positive return of 0.9% for August. The only sector of the bond market to post even a small negative return was high yield corporate bonds, with prices pressured by a surge in new bond issuance. Longer maturity bonds outperformed shorter maturity bonds. The yield on the benchmark 10-year Treasury bond declined slightly during the month to 2.1% from 2.3% at the end of July.

For the second consecutive month, the Bloomberg Commodity index had a positive return. The index was up 0.4%. The grains sub-index had the largest negative return of -8% on news of bountiful harvests. In contrast, the industrials metals sub-index was up over 9% on improving demand. The precious metals sub-index was up 4% on safe haven demand as geopolitical issues flared. The price of oil declined during the month from about $50 per barrel to about $47. Natural gas prices were slightly higher.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

Since there were no significant changes to economic data or government policies our outlook has not changed. Most economic data continues to point to stable to improving global economic conditions, which is likely to be generally supportive for corporate earnings. However, with the strong equity markets over recent months, valuations are not cheap. Therefore, we continue to have a neutral view on global equities. Our tactical allocation recommendation remains as an equal weight to the long-term target allocation for U.S., international developed, and emerging markets stocks as well as to U.S. large-cap, mid-cap, and small-cap stocks. We continue to favor equity over bonds so retain our underweight recommendation for fixed income investments. Our underweight recommendation is because the return expectation for bonds is modest due to the low level of yields and 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. 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 would not be surprised if financial markets experience bouts of volatility as more details emerge about any fiscal, monetary, or political policy changes or if there are delays in implementing these actions. Therefore, we continue to recommend using periods of market strength to raise any cash needed to support spending needs over the coming 12-24 months.