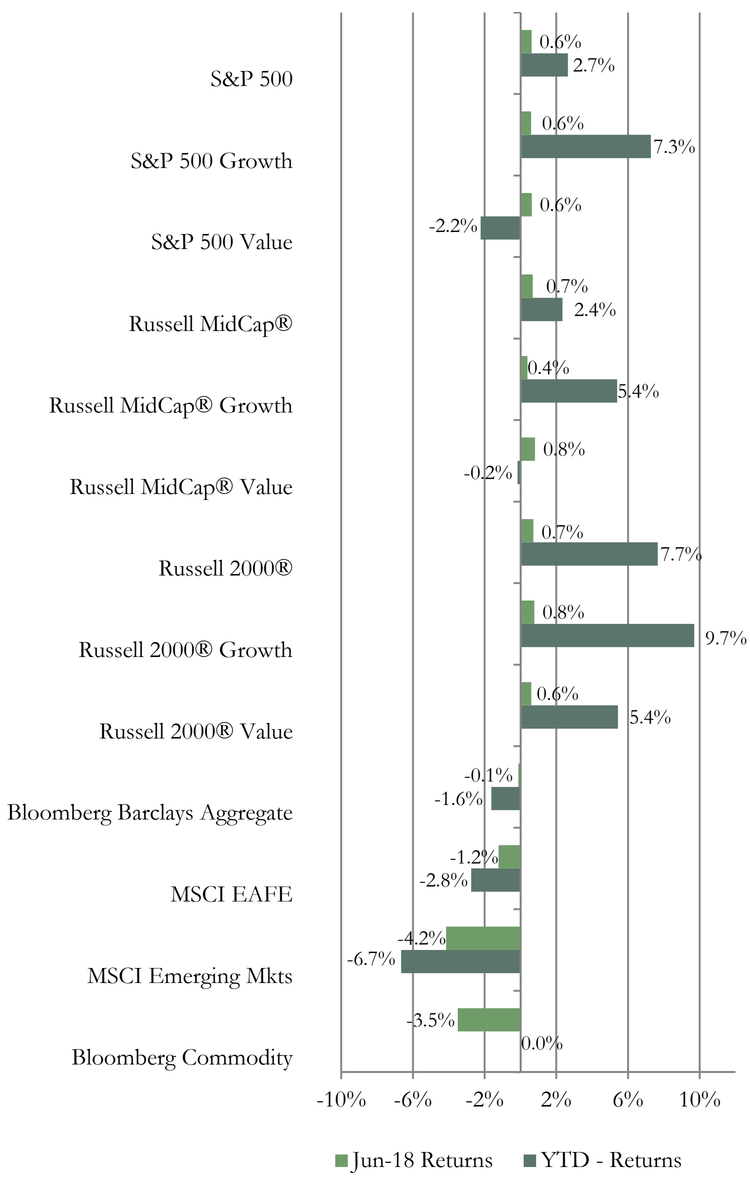
Monthly Market Summary – June 2018

June was a rocky period for global financial markets. Political issues dominated investor focus. Front and center were the increasingly complex tit-for-tat tariff actions and threats of possible actions by the U.S., the European Union, Canada, Mexico, and other countries. These actions weighed not only on equity prices, but also on commodity, bond, and currency prices. Central bank actions were another focus in June. The U.S. Federal Reserve (Fed) raised its policy rate by 0.25% and pointed to two more rate increases this year. The European Central Bank said it would wind down its asset purchase program by year-end, but said it does not expect to raise interest rates until mid-2019. The Bank of Japan, the Bank of England, and Australia's central bank left interest rates unchanged continuing accommodative monetary policy. The People's Bank of China cut the reserve requirement ratio for large banks to offset signs of slower growth and the impact of U.S. trade restrictions. The strengthening U.S. dollar also played a key role in financial markets, especially in emerging markets, in June. The dollar advanced on data that showed steady growth in the U.S. and on indications from the Fed that interest rates will continue to move higher which contrasted with some weaker economic data outside the U.S.

Market Indices – June 2018



Returns for the major U.S. equity indices we track were modestly positive for June. Again this month, the Russell 2000 index of small-capitalization (cap) stocks hit several new record highs boosted by investor's expectations that small-cap stocks are hurt less than large multi-national companies by the rising dollar and benefited more from the tax cuts. June was the fourth consecutive month that the Russell 2000 index outperformed the S&P 500 and Russell MidCap indices, but the margin of outperformance was much narrower than in previous months. There was little difference between the returns for the growth and value stock indices in June even though there was a wide range of returns among sectors. The consumer staples sector was the top performing sector across the market cap spectrum with returns of over 4% as investors favored more defensive stocks. The consumer discretionary sector was also a top performer boosted by merger and acquisition news as well as a jump in retail sales. The industrials sector was the worst performing with a negative return in the large and mid-cap indices dragged down by trade policy concerns. The materials sector was the worst performing sector in the small-cap index. After outperforming for most of the year, the information technology sector had a small negative return in the large, mid, and small-cap indices. Profit taking coupled with uncertainty about the impact of threatened tariffs and foreign investment restrictions weighed on the sector.

Developed international and emerging market equities underperformed U.S. equities for the month of June. The MSCI EAFE index of developed international stocks had a return for the period of -1.2% on a U.S. dollar basis. The MSCI Emerging Markets (EM) index had a return of -4.2%. Just as in the prior month, currency movements had a negative impact for U.S. investors since the U.S. dollar rose. However, the local currency returns for the EAFE and EM indices underperformed major U.S. equity indices also. The local currency return was -0.3% for the EAFE index and -2.5% for the EM index. Trade tensions hurt stock prices in export heavy economies such as Germany, Korea, and China. The strengthening U.S. dollar continues to pressure financial markets in countries with large amounts of dollar denominated debt. Country specific issues hurt stock prices in other countries, such as Brazil that is dealing with labor unrest and high inflation. The outlier in June was Mexico which had a sizeable gain on positive news on the domestic economy. There was little difference between the growth and value stock performance in the EAFE index, whereas, growth outperformed value in the EM index. The more defensive sectors, such as consumer staples and telecommunications, were the better performing sectors while sectors more exposed to the trade uncertainties, such as industrials and information technology, were among the weakest performers for the month.

U.S. bond market returns were mixed in June with some sectors essentially flat, some up slightly, and some down modestly. The Bloomberg Barclays U.S. Aggregate Bond index had a return of -0.1%. Short-term bond yields rose the most while longer-term bond yields were little changed. For example, the 2-year Treasury bond yield was 2.52% at the end of June compared to 2.40% at the end May while the 10-year Treasury bond yield was 2.85% at the end of June compared to 2.83% at the end of May. The U.S. Inflation Protected Securities index and the U.S. Corporate High Yield index had the best returns for the month, but the returns were less than 0.5%. The U.S. Credit index was the worst performing sector for the month with a return of -0.5%.

The Bloomberg Commodity index had a return of -3.5% for June driven by steep declines in the grains and industrial metals sectors due to the trade tensions and tariff actions. The price for soybeans, for example, fell 16% in June. China announced during the month that an additional 25% tariff on a range of American farm goods, including soybeans, corn, and wheat, will go into effect July 6. The precious metals sector also had a large decline as both gold and silver moved lower. The price of West Texas Intermediate crude oil (WTI) fell in early June after it reached a multi-year high at the end of May. However, the price rose again late in the month after the Organization of Petroleum Exporting Countries (OPEC) and other countries including Russia agreed to increase production, but at a lower than expected amount. WTI ended the month at $74.12 per barrel, which was higher than the price at the end of May.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

We continue to be cautiously optimistic for the second half of the year. Economic growth remains healthy in many regions, corporate fundamentals are generally strong, and corporate earnings growth looks to continue, even though the rate of growth may be lower. Trade tensions and the tit-for-tat tariff actions are increasing the risk of a slowdown in global growth due to the negative impact on business confidence, supply chain disruptions, and higher costs. The uncertainty created by the trade situation is likely to continue since at this time there is no clear sign of what will resolve the current tensions. Therefore, we expect that financial markets will continue to be volatile as investors react to news on trade talks and tariff actions in addition to the upcoming second quarter earnings reports and the regularly scheduled economic data releases.

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 are maintaining the overweight since at this time, the growth potential and improved fundamentals in various emerging market countries along with more attractive relative valuations appear to offset the risks from further strengthening of the U.S. dollar. 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.