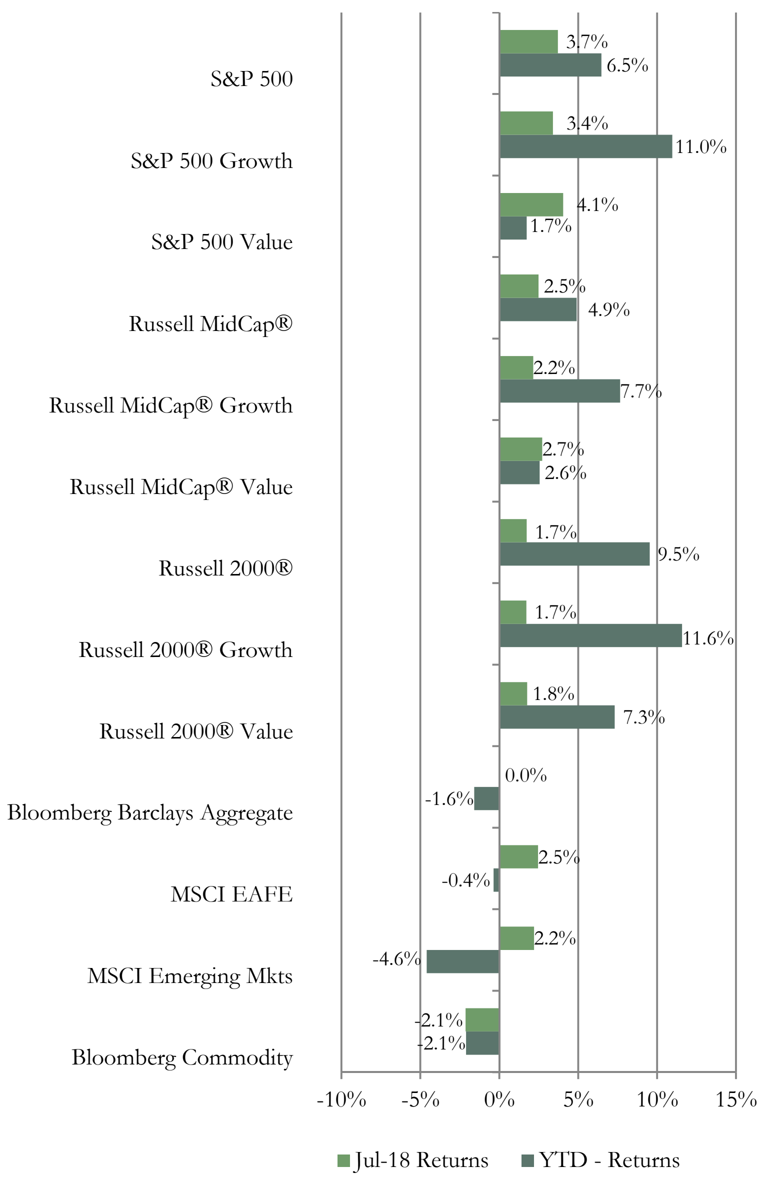
Monthly Market Summary – July 2018

Global equity markets advanced in July driven by solid corporate earnings and some easing in trade tensions. Government bond yields edged higher and commodities were mostly lower.

Trade issues continued to dominate headlines. More tariffs between the U.S. and China were implemented on July 6. Plans for tariffs on an additional $200 billion in Chinese imports were announced by the U.S. with pledges of retaliatory actions quickly made by China. On a positive note, the U.S. and the European Union agreed to refrain from implementing new tariffs and agreed to further negotiations and progress appears to have been made in the North American Free Trade Agreement negotiations since the recent Mexican election.

Market Indices – July 2018



One of the important economic news items of the month was that China shifted its policy focus from deleveraging to fiscal and monetary stimulus. This shift was made in reaction to the recent sharp declines in China's stock market and currency amid signs of economic slowing and increasing trade tensions with the U.S. Gross domestic product (GDP) in China grew at an annual rate of 6.7%, which was the slowest pace since 2016. Economic growth slowed in the eurozone as well. Second quarter GDP declined to 2.1% on a year-over-year basis, which was down from 2.5% in the first quarter. However, in a sign of potential stabilization in the eurozone economy, the manufacturing purchasing managers' index increased for the first time in 2018. In contrast, economic data in the U.S. continues to be strong. Second quarter GDP grew 4.1% over the previous quarter. This was the highest growth rate since the third quarter of 2014. In corporate earnings news, the current reporting season has seen strong sales and earnings growth. According to S&P Global, for the two-thirds of the companies in the S&P 500 index that have reported, sales growth is 10% year-over year and 80% of companies reported better than expected earnings.

Returns for the major U.S. equity indices we track were positive for July as generally strong corporate earnings and some encouraging news on trade tensions with Mexico and the

European Union boosted investors' risk appetite. However, disappointing earnings reports from Facebook and Netflix rattled investor confidence and led to a rotation from growth to value stocks late in the month. Therefore, in a shift from prior months, for July, value stocks outperformed growth stocks across the market capitalization (cap) spectrum. In another shift, after outperforming for four months, small-cap stocks underperformed large and mid-cap stocks in July. The industrials sector was the top performing sector in the large and mid-cap indices and the second best performing sector in the small-cap index. The materials sector had the best return in the small-cap index. The weakest sectors varied by market cap, with real estate, consumer staples, and telecommunications having the lowest returns in the large, mid, and small-cap indices respectively.

Developed international and emerging market equities advanced during July. The MSCI EAFE index of developed international stocks had a return for the period of 2.5% and the MSCI Emerging Markets (EM) index had a return of 2.2% on a U.S. dollar basis. Currency movements did not have as much of an impact on returns for U.S. investors in July as in prior periods since the U.S. dollar was relatively stable. The local currency return was 2.6% for the EAFE index and 1.7% for the EM index. Just as in the U.S., value stocks outperformed growth stocks in developed international and emerging markets. Healthcare was the top performing sector in the EAFE index while cyclical sectors such as industrials, financials, and energy also had solid gains. Consumer and technology stocks were the laggards in the developed international equity markets. Energy and materials stocks led in the EM index while consumer and healthcare stocks declined. On a geographic basis, among the developed international economies, Europe outperformed the Far East and the Pacific-ex Japan regions. European stock markets moved higher in reaction to generally good corporate earnings reports and some easing of trade tensions with the U.S. after European Union representatives met with President Trump. Japan and the United Kingdom had among the weakest returns in developed markets. Mixed economic data in Japan and Brexit negotiation setbacks in the United Kingdom weighted on market sentiment in those countries. Among emerging markets, Latin America was the performance leader boosted by a double-digit gain for the Brazil index on a rebound in the currency. Mexico also had a strong gain. Chinese stocks lagged pressured by trade tensions with the U.S. and weakening in some economic data.

U.S. bond market returns were mixed in July leading the Bloomberg Barclays U.S. Aggregate Bond index to post a flat return for the month. All but the shortest maturity Treasury bond sectors had a negative return for the period as yields rose. The benchmark 10-year Treasury bond yield rose to 2.96% from 2.85% at the end of June. Corporate bonds had small positive returns as yields declined on strong corporate earnings news. The corporate high yield sector had the best return in the fixed income market for the month. Municipal bond returns were also positive.

The Bloomberg Commodity index had a return of -2.1% for July driven by declines in the industrial metals, energy, and precious metals sectors. Grains was the only sub-index we track that had a gain for the month. Drought conditions have pushed up grain prices especially for wheat. Industrial metals continue to trade lower due to trade tariff impacts and a slowdown in manufacturing in China. The price of West Texas Intermediate crude oil (WTI) declined to end July at $68.76 per barrel due to increased production. In the precious metals sector, both gold and silver moved lower.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

We continue to be cautiously optimistic. 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 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.