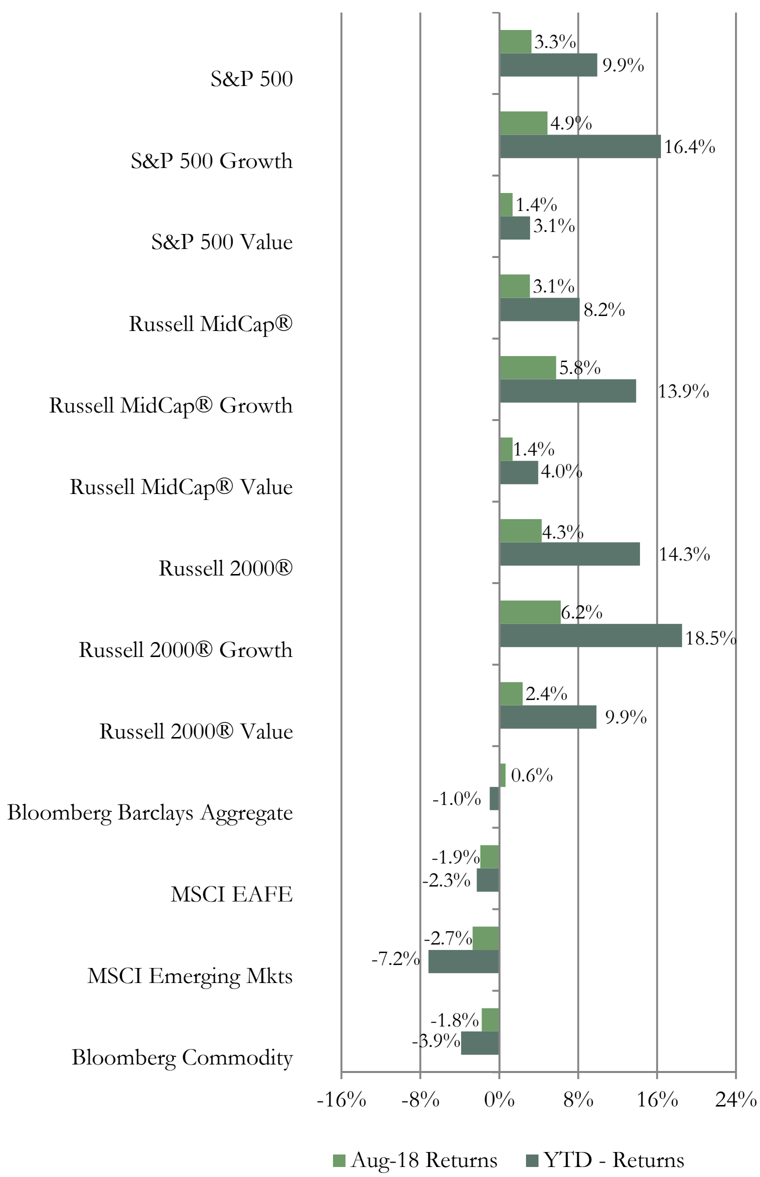
Monthly Market Summary – August 2018

August was a record setting month for U.S. equity markets. Early in the month, Apple, Inc. reported better than expected earnings which drove the stock price up about 20% resulting in Apple becoming the first public company to have a market value above $1 trillion. More strong corporate earnings reports, including from various major retail companies, along with bullish comments by Federal Reserve chairman Jerome Powell on the strength of the U.S. economy and progress on trade talks with Mexico drove equity prices higher and into record territory. On August 24, the S&P 500 index reached a new record high for the first time since January. The index set three more record highs before the month was over. The Russell 2000 index of small company stocks and the technology heavy NASDAQ composite index set new highs during the month as well. Also getting attention in August was that according to S&P Global, at 3,462 days the current bull market become the longest on record for the S&P 500.

Market Indices – August 2018



Trade issues continued to dominate headlines. On the positive side, Mexico and the U.S. agreed to a preliminary trade deal. That agreement brought Canada back to the North American Free Trade Agreement (NAFTA) negotiating table, but no deal was reached before month-end. On the China front, the U.S. and China implemented 25% tariffs on $16 billion of each other's goods. In addition, President Trump indicated he may impose $200 billion more in tariffs on Chinese goods in early September and China pledged to retaliate. The U.S. increased sanctions on Turkey, which led to a sharp drop in the value of the Turkish lira that fueled worries about U.S. dollar financing of debt in certain emerging market countries and pushed emerging markets equities prices lower.

U.S. equity markets rallied in August with each of the equity indices we track posting a positive return for the month. In a reversal from July, small-capitalization (cap) stocks outperformed large-cap stocks and growth stocks outperformed value stocks. Information technology was the top performing sector in each market cap index. Healthcare and consumer discretionary were other top performers. Energy and materials were the weakest performing sectors in each market cap index with negative returns. The significant outperformance of growth stocks over value stocks in August widened the spread between the year-to-date returns of growth and value stocks. For example, the year-to-date return for the Russell 2000 growth index is 18.5% compared to the return for the Russell 2000 value index of 9.9%. The difference in sector returns is also noteworthy. For example, the best performing sector year-to-date in the Russell 2000 index is healthcare with a 30.1% return. In contrast, the poorest performing sector in that index is materials with a year-to-date return of 1.1%. In the S&P 500 index, the best performing sector on a year-to-date basis is information technology with a return of 21.0%. The poorest performing sector in the S&P 500 index is consumer staples with a return of -4.3%.

Non-U.S. equity markets declined in August. The MSCI EAFE index of developed international stocks had a return for the period of -1.9% and the MSCI Emerging Markets (EM) index had a return of -2.7% on a U.S. dollar basis. Local currency returns were negative as well. The local currency return was -1.7% for the EAFE index and -0.6% for the EM index. Growth stocks outperformed value stocks in the EAFE index, but value outperformed in the EM index. On a geographic basis, among the developed international economies, the Far East index was the best performing region with a small negative return. The eurozone was the weakest performing region dragged down by the steep drop in equity markets in Italy and Spain on concerns about the stability of Italian debt in the current political climate in that country. Among emerging market economies, Latin American equity returns were among the lowest on a U.S. dollar basis. For example, Brazil had a return of -11% as the Brazilian currency hit the lowest level on record against the U.S. dollar due in part to polls showing only limited support for the market friendly candidate in the upcoming presidential election. Chinese equities continue to be weak performers as the economy slows in that country and trade issues continue to pressure various industries. India, which has minimal exposure to the trade and tariff uncertainty, was one of the best performing EM countries with a small positive return.

U.S. bond market returns were positive in August leading the Bloomberg Barclays U.S. Aggregate Bond index to post a return of 0.6%. All sectors had a positive return for the month as yields declined slightly. Longer maturity bonds had the best returns. The benchmark 10-year Treasury bond yield declined to 2.85% at the end of August compared to 2.96% at the end of July. Safe haven trading in reaction to emerging market currency weakness and budget negotiations in Italy's new government pushed U.S. government bond yields lower and prices higher.

The Bloomberg Commodity index had a return of -1.8% for August. Only the energy and petroleum sub-indices posted a gain for the period. The price of natural gas rose - boosted by strong demand due to the hot weather in most of the country - and the price of oil moved higher on inventory data. Industrial metals and silver prices continue to decline in reaction to trade tensions and the slowdown in China. The price of gold fell to the lowest level in a year. The agriculture indices declined due to high supply reports.

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.