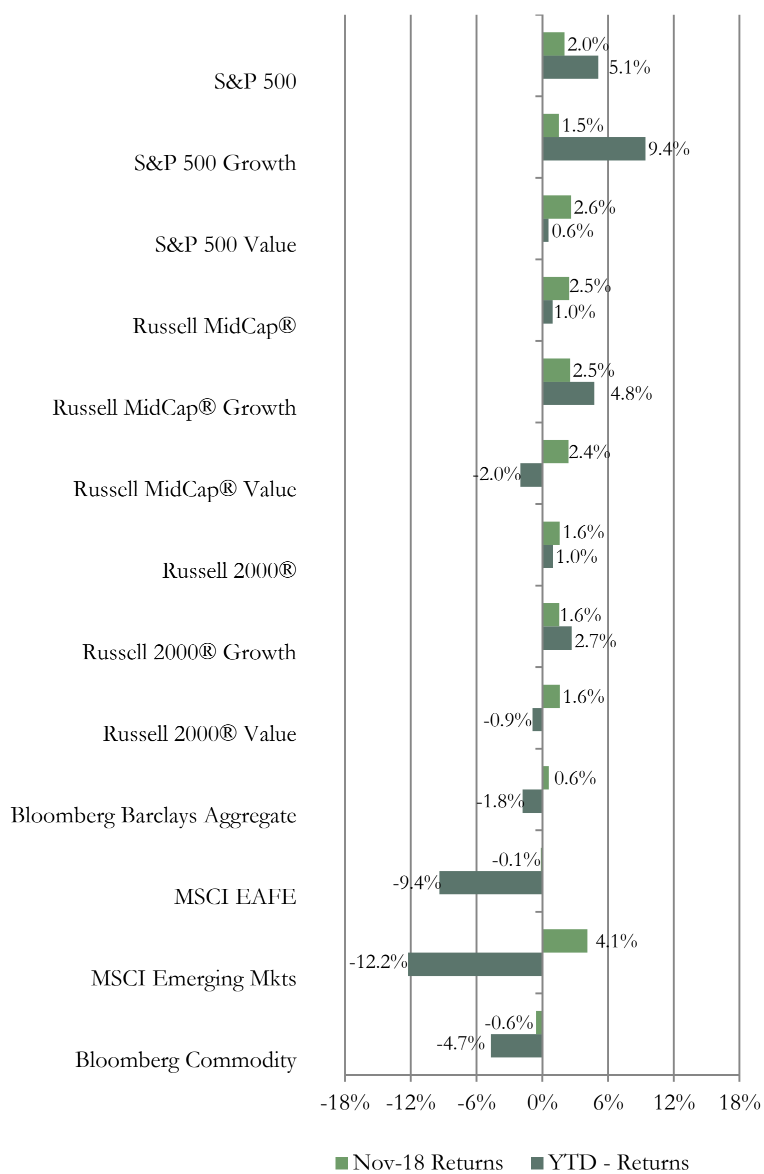
Monthly Market Summary – November 2018

November was a volatile month in financial markets. Despite rallies after the mid-term elections and during the last week, equities declined much of the month. The periods of declining prices were mostly driven by concerns about slowing global growth fueled by reports such as lower home sales in the U.S. and negative growth in third quarter gross domestic product (GDP) in Japan and Germany. Concerns about a slowdown persisted even though economic data continues to be robust in the U.S. For example, wage growth in October was the highest since 2009 with average hourly earnings rising 3.1% over the prior year, and the second estimate of third quarter GDP was strong at 3.5%. In addition, the holiday shopping season started off strongly with record breaking sales. Another source of fuel for stock price declines was the continuing trade tensions particularly between the U.S. and China. The news about iPhone production cuts sparked worries about the future growth potential for technology companies which contributed to a broad sell-off in the technology sector.

Market Indices – November 2018



The S&P 500 index officially reached correction territory, defined as a 10 percent drop from the previous peak, on November 26. This was the second correction for that index this year. However, equity prices moved higher during the last week of the month resulting in the major U.S. equity indices posting gains for the month. The end of month rally was sparked when Federal Reserve (Fed) Chairman Powell signaled a less hawkish view in a speech when he said interest rates were "just below" neutral. The rally was also fueled by the announcement that President Trump and Chinese President Xi were scheduled to discuss trade issues at a dinner meeting during the G20 conference. The emerging markets index rebounded in November and outperformed developed equity markets in large part due to the benefit to various emerging market countries from the plunge in oil prices as well as the easing of trade tensions late in the month. The price of West Texas Intermediate (WTI) crude oil dropped 22% in November due to high supply levels. However, the price of natural gas spiked up by 41% as cold weather settled in leading to a rise in demand.

In the U.S. equity market, higher dividend paying and more defensive stocks outperformed cyclical stocks for much of the month until less hawkish comments by Fed Chair Powell and optimism on some thawing in U.S.-China trade tensions shifted momentum back to cyclicals. In addition, large and mid-capitalization (cap) stocks outperformed small-cap stocks as market participants favored more defensive positioning. Sector performance varied widely by market cap. For example, healthcare was the top performing sector in the S&P 500 index followed by the real estate sector. Whereas, industrials was the top performing sector in the Russell MidCap index and utilities was the top performer in the Russell 2000 index of small-cap stocks. The same divergence was seen at the other end of the performance spectrum. Information technology had the worst return in the S&P 500 index hurt by the repercussions of the Apple production cuts for various suppliers and semi-conductor companies. In the mid and small-cap indices, energy was by far the worst performing sector with the consumer staples and consumer discretionary sectors also weak.

The MSCI EAFE index of developed international stocks had a return for November of -0.1% and the MSCI Emerging Markets (EM) index had a return of 4.1% on a U.S. dollar basis. There was little currency impact on the EAFE index return for U.S. investors, but currency had a sizeable positive impact on the return for the EM index. The local currency return was -0.2% for the EAFE index and 3.0% for the EM index. Growth stocks outperformed value in both the EAFE and EM indices. Energy and materials stocks had the lowest returns in both developed and emerging markets. Real estate was the top performing sector in the EM index while communication services was a top performing sector in developed international markets. On a geographic basis, among emerging market countries Turkey, Indonesia, and India had the best returns with double-digit gains. The sharp decline in oil prices provided a boost to countries, such as India, which are heavy oil importers. Mexico and Brazil, with negative returns, were two of the weakest performing countries in the EM index. Stocks in both countries fell on uncertainty about regulatory policies under incoming Presidents. Brazil was also hurt by the plunge in oil prices. The drop in oil prices hurt the equity markets in Russia as well. In developed markets, Hong Kong, New Zealand, and the Netherlands were among the top performers. The decline in oil prices hurt equities in oil producing developed markets such as Norway. Export heavy economies such as Germany and France also were among the weakest performing developed markets. A newly released report showed that export orders in the euro zone fell for the first time since 2014.

U.S. bond market returns were positive in November for all sectors except for the high yield bond index. Energy company bonds are a large component of the high yield index. Prices for energy related bonds were pressured by the plunge in oil prices. In the Treasury bond market, longer maturity bonds outperformed shorter maturity bonds. The benchmark 10-year Treasury bond yield was little changed for most of the month but finished the month lower with a yield of 3.0% on November 30 compared to the yield of 3.15% on October 31. Treasury bonds outperformed corporate bonds as the spread between the yield on Treasury bonds and corporate bonds widened on increasing concerns about slowing growth in corporate earnings.

The Bloomberg Commodity index had a return of -0.6% for November. The steep decline in the price of oil was the primary reason for the negative return since the petroleum sub-index had a return of -21%. The price of oil fell due to rising U.S. inventories, higher production by Saudi Arabia and Russia, and the U.S. unexpectedly granting waivers related to Iranian oil shipment sanctions to eight countries. The industrial metals sub-index turned positive after trade talks were set between President Trump and President Xi. The precious metals index had a slight gain as the rise in the price of gold offset the decline in the price of silver. The agriculture sub-index also had a small positive return boosted by gains in grains and livestock.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

Our tactical allocation recommendations have not changed although we continue to monitor data closely. While we expect that the rate of economic and profit growth is likely to slow from recent multi-year high levels, economic conditions in the U.S. continue to be strong with employment, wage growth, manufacturing, and service sector indicators still solidly in expansionary territory. The strong dollar, increasing input costs due mostly to capacity constraints, gradually increasing interest rates due to Federal Reserve actions, and the impact of trade tariffs are headwinds. However, fundamentals do not appear to be weakening to the extent that would be consistent with a recession or bear market in the near-term. In addition, valuations have come down significantly. Low valuations are supportive of our emerging markets recommendation as well. In addition, government reforms, newly elected pro-business leaders, and stimulus actions are likely to support economic fundamentals in several emerging market countries.

Our tactical allocation recommendations include 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.