

Market Environment

Second Quarter 2018



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Global Economy

The U.S. economy remained on strong footing in the second quarter. The unemployment rate dropped to 3.8% in May, the lowest since 2000, and wages inched up. Consumer spending was robust and consumer and business confidence remained elevated. While real U.S. GDP growth in the first quarter was a mere 2.0% (annualized), expectations for second quarter growth are sharply higher. Overseas, signs of deceleration emerged, especially in Europe, Japan, and China.

- U.S. unemployment rate dropped to 3.8% in May
 - Lowest since 2000
 - Wages increased 2.7% (y/y) in May
- Inflation rising
 - Headline CPI was 2.8% in May (y/y); Core CPI was 2.2% (y/y)
 - PPI jumped 0.5% (3.1% y/y) in May
 - Core PCE Index the Fed's target of 2% (y/y) in May for the first time since 2012
- Housing starts climbed to an eleven-year high
 - Home prices also continued to rise
- University of Michigan Consumer Sentiment Survey remained elevated
 - Survey measures attitudes of future economic prospects across 500 consumers
 - Retail sales beat forecasts, up 0.8% in May (6% y/y)
- The Fed raised rates
 - As expected, a 25 bp hike in June brought Fed Funds target to 1.75%–2.0%
 - The Fed expects two more rate hikes this year and three more in 2019
- U.S. dollar appreciated
 - Relatively high interest rates and the strength of the U.S. economy bolstered the currency
 - Gained 5% versus a basket of developed market currencies
- Threat of escalating trade wars ongoing as quarter closed
 - Tariffs being imposed on goods imported from China, Europe and Canada (and vice versa)
 - Outcome unclear as to impact on U.S. economic growth and inflation
- Overseas
 - Euro zone bankers trimmed their outlook for growth in 2018 to 2.1%, down from 2.4%, given weaker economic data
 - Politics in Italy worried investors, causing yields on Italian bond to surge
 - Brexit negotiations stalled, raising the prospect of a “hard” Brexit
 - Japan's GDP contracted for the 1st time in two years in the 1st quarter
 - China also showed signs of slowing



Fixed Income

U.S. rates rose in the second quarter and the yield curve continued its flattening trend. The yield on the 10-year U.S. Treasury note hit an intra-quarter high of 3.11% in May but closed the quarter at 2.85%. Concerns over mounting trade tensions and slower global growth pushed yields lower going into quarter-end. Overseas, changes in interest rates were modest (with the exception of Italy, where yields spiked on political news) and U.S. dollar strength drove returns for unhedged bonds.

- U.S. rates rose modestly and the yield curve continued to flatten
 - 10-year U.S. Treasury yield up 11 bps to 2.85%
 - 2-year U.S. Treasury yield up 25 bps to 2.52%
 - Spread between the 2-year and 10-year (33 bps) lowest in more than 10 years
- Investment grade bonds roughly flat for the quarter
 - Bloomberg Barclays Aggregate -0.2%; -1.6% y-t-d
 - Investment grade corporates underperformed Treasuries as heavy supply weighed on the market; Corporate Index -1.0%; -3.3% y-t-d
- High yield corporates outperformed investment grade
 - Bloomberg Barclays High Yield: +1.0%; +0.2% y-t-d
- Municipals performed relatively well on reduced supply and strong demand
 - The Bloomberg Barclays Municipal Bond Index: +0.9%; -0.2% y-t-d
- TIPS outperformed nominal Treasuries
 - 10-year breakeven rose to 2.11% from 2.05%
 - Bloomberg Barclays TIPS +0.8%; +0.0% y-t-d
- Foreign bonds (unhedged) hurt by U.S. dollar strength
 - Bloomberg Barclays Global Agg ex-U.S. (hedged): +0.5%; +1.4% y-t-d
 - Bloomberg Barclays Global Agg ex-U.S. (unhedged): -4.8%; -1.3% y-t-d
 - Emerging markets sank
 - Higher interest rates in the U.S. and trade concerns weighed on markets
 - The JPM EMBI Global Diversified Index: -3.5%; -5.2% y-t-d
 - EM currencies hit especially hard; local currency-denominated JPM GBI-EM Global Diversified Index: -10.4%; -6.4% y-t-d



Global Equity

The U.S. equity market posted solid returns in the second quarter on the back of strong first quarter earnings as well as record share buybacks fueled by the Trump Administration's \$1.5 trillion tax cut. Small growth stocks continued to dominate in the U.S., which outperformed developed markets largely due to relative strength in the U.S. dollar. Emerging market equities underperformed developed markets.

U.S. Equity

- Small caps outperformed large caps
 - R1000: +3.6%; +2.9% y-t-d
 - R2000: +7.8%; +7.7% y-t-d
 - Small caps more immune to global trade spats
- Growth outperformed value
 - R1000 Growth: +5.8%; R1000Value: +1.2% (+7.3% vs. -1.7% y-t-d)
- Energy sector fueled by rising oil prices
 - S&P 500 +3.4%; +2.6% y-t-d
 - Energy sector +13.5%
 - Consumer Discretionary (+8.2%) and Technology stocks (+7.1%) also top performers
 - Financials and Industrials lagged (both -3.2%)
 - Amazon alone accounted for ~50% of y-t-d total return of S&P
 - “FAAMG” plus Netflix: accounted for 57% of Q2 return of S&P

	Q2	YTD
Facebook Inc A	21.6%	10.1%
Apple Inc	10.8%	10.2%
Amazon.com Inc.	17.4%	45.3%
Microsoft Corp	8.5%	16.3%
Google (Alphabet A&C)	8.2%	13.8%
Netflix Inc.	32.5%	103.9%

International Equity

- The U.S. dollar appreciated vs most currencies
 - Up 5% versus a basket of developed market currencies
 - Benefitted from higher interest rates and relatively strong U.S. economy
- Developed markets
 - MSCI EAFE (in \$US): -1.2%; -2.7% y-t-d



- MSCI EAFE (local): +3.5%; -1.0% y-t-d
- ACWI ex-US -2.6%; -3.8% y-t-d
- Energy +7.3% on rising oil prices
- Financials, 22% of the ACWI ex-US, sank 7.3%
- Italy down sharply on political woes (-7.3%)
- UK (+2.9%) and Australia (+5.2%) were bright spots, both benefitting from energy companies
- As in the U.S., growth outperformed value
- Emerging Markets
 - MSCI EM (in \$US): -8.0%; -6.7% y-t-d
 - Brazil (-26.4%); Russia (-6.0%); India (-0.6%); China (-3.5%)



Liquid Real Assets

Real assets performed relatively well in the second quarter. Geopolitical tensions influenced a number of hard commodities. Most notable performers included Oil, which in turn boosted returns for MLPs, while equity REITs and infrastructure also posted solid results despite a continued rise in nominal rates.

- Brent crude oil prices closed the quarter at \$74/barrel, up 14% for the quarter
 - Strong demand combined with supply disruptions and limits on OPEC's willingness to increase production fueled price gains
 - Exacerbated by President Trump's threat to sanction countries that import from Iran
 - S&P 1200 Energy: +11.8%; +6.9% y-t-d
 - Commodities mixed
 - Bloomberg Commodity TR Index: +0.4%; 0.0% y-t-d
 - S&P Gold Spot Price Index: -5.5%; -4.2% y-t-d
 - Lean hogs: +45% as cost of feed spiked
 - Soybeans: (-18%) hurt by threats of a trade war with China; US is largest exporter and China is largest buyer of soybeans
- Master Limited Partnerships rebounded strongly
 - Alerian MLP Index: +11.8%; -0.6% y-t-d
- Listed Infrastructure and Real Estate posted positive returns
 - DJ-Brookfield Global Infrastructure Index: +4.2%; -1.3% y-t-d
 - FTSE NAREIT: +10.0%; +1.0% y-t-d
- TIPS outperformed nominal US Treasuries
 - Bloomberg Barclays U.S. TIPS Index: +0.8%; 0.0% y-t-d
 - 10-yr Breakeven Inflation Rate at 2.11%, up from 2.05% as of 3/31



Index Returns

		April	May	June	Last Quarter	Year to Date	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 15 Years
EQUITY	1 Russell:3000 Index	0.38	2.82	0.65	3.89	3.22	14.78	11.58	13.29	10.23	9.61
	2 Russell:1000 Index	0.34	2.55	0.65	3.57	2.85	14.54	11.64	13.37	10.20	9.54
	3 Russell:1000 Growth	0.35	4.38	0.96	5.76	7.25	22.51	14.98	16.36	11.83	10.30
	4 Russell:1000 Value	0.33	0.59	0.25	1.18	(1.69)	6.77	8.26	10.34	8.49	8.63
	5 Russell:Midcap Index	(0.15)	2.27	0.69	2.82	2.35	12.33	9.58	12.22	10.23	11.17
	6 Russell:Midcap Growth	(0.94)	3.74	0.39	3.16	5.40	18.52	10.73	13.37	10.45	11.07
	7 Russell:Midcap Value	0.50	1.09	0.81	2.41	(0.16)	7.60	8.80	11.27	10.06	11.04
	8 Russell:2500 Index	0.24	4.70	0.72	5.71	5.46	16.24	10.30	12.29	10.74	10.99
	9 Russell:2500 Growth	(0.64)	5.32	0.84	5.53	8.04	21.53	10.86	13.87	11.38	11.46
	10 Russell:2500 Value	1.09	4.11	0.53	5.80	3.00	11.49	9.76	10.78	10.10	10.37
	11 Russell:2000 Index	0.86	6.07	0.72	7.75	7.66	17.57	10.96	12.46	10.60	10.50
	12 Russell:2000 Growth	0.10	6.30	0.78	7.23	9.70	21.86	10.60	13.65	11.24	10.95
	13 Russell:2000 Value	1.73	5.82	0.61	8.30	5.44	13.10	11.22	11.18	9.88	9.93
	14 S&P:500	0.38	2.41	0.62	3.43	2.65	14.37	11.93	13.42	10.17	9.30
	15 S&P:400 Mid Cap	(0.26)	4.13	0.42	4.29	3.49	13.50	10.89	12.69	10.78	11.39
	16 S&P:600 Small Cap	1.03	6.46	1.13	8.77	9.39	20.50	13.84	14.60	12.25	12.03
	17 MSCI:ACWI ex US	1.60	(2.31)	(1.88)	(2.61)	(3.77)	7.28	5.07	5.99	2.54	7.74
	18 MSCI:EAFE	2.28	(2.25)	(1.22)	(1.24)	(2.75)	6.84	4.90	6.44	2.84	7.26
	19 MSCI:EM	(0.44)	(3.54)	(4.15)	(7.96)	(6.66)	8.20	5.60	5.01	2.26	10.70
	20 MSCI:ACWI	0.95	0.12	(0.54)	0.53	(0.43)	10.73	8.19	9.41	5.80	8.19
FIXED INCOME	21 Blmbg:Aggregate	(0.74)	0.71	(0.12)	(0.16)	(1.62)	(0.40)	1.72	2.27	3.72	3.77
	22 Blmbg:Gov/Credit	(0.85)	0.72	(0.19)	(0.33)	(1.90)	(0.63)	1.83	2.29	3.78	3.71
	23 Blmbg:Credit	(0.91)	0.50	(0.47)	(0.88)	(2.99)	(0.65)	2.86	3.37	5.15	4.52
	24 Blmbg:Corporate High Yld	0.65	(0.03)	0.40	1.03	0.16	2.62	5.53	5.51	8.19	7.77
	25 Blmbg:Municipal Bond	(0.36)	1.15	0.09	0.87	(0.25)	1.56	2.85	3.53	4.43	4.13
	26 Blmbg:US TIPS	(0.06)	0.43	0.40	0.77	(0.02)	2.11	1.93	1.68	3.03	4.01
	27 Blmbg:Glob Agg ex USD	(2.27)	(1.87)	(0.70)	(4.76)	(1.31)	2.78	3.23	0.88	1.76	3.58
	28 S&P:LSTA Levg Loan	0.41	0.17	0.12	0.70	2.16	4.37	4.21	4.01	5.18	4.91
	29 ML:US Treasuries 1-3 Yrs	(0.16)	0.36	0.02	0.22	0.09	0.08	0.42	0.58	1.24	1.92
	30 LIBOR - 3 Month	0.19	0.20	0.19	0.58	1.04	1.75	1.07	0.74	0.73	1.69
	31 3 Month T-Bill	0.13	0.15	0.17	0.45	0.81	1.36	0.68	0.42	0.35	1.29
REAL ASSETS	32 Blmbg:Commodity TR Idx	2.58	1.42	(3.50)	0.40	0.00	7.35	(4.54)	(6.40)	(9.04)	(0.63)
	33 GS Commodity Index	5.04	1.45	1.36	8.00	10.36	30.04	(4.37)	(9.41)	(12.36)	(2.33)
	34 MSCI:US REIT Index	1.44	3.94	4.42	10.10	1.19	3.57	8.06	8.26	7.95	9.96
	35 Alerian:MLP Index	8.09	5.05	(1.54)	11.80	(0.63)	(4.58)	(5.93)	(4.09)	6.46	9.07
	36 DJB:Gibl Infrastructure	1.48	(0.02)	2.72	4.22	(1.26)	2.51	4.55	7.15	7.63	11.35
	37 US DOL:CPI All Urban Cons	0.40	0.42	--	--	--	--	--	--	--	--



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