



Quarterly Economic Update

Second Quarter 2018

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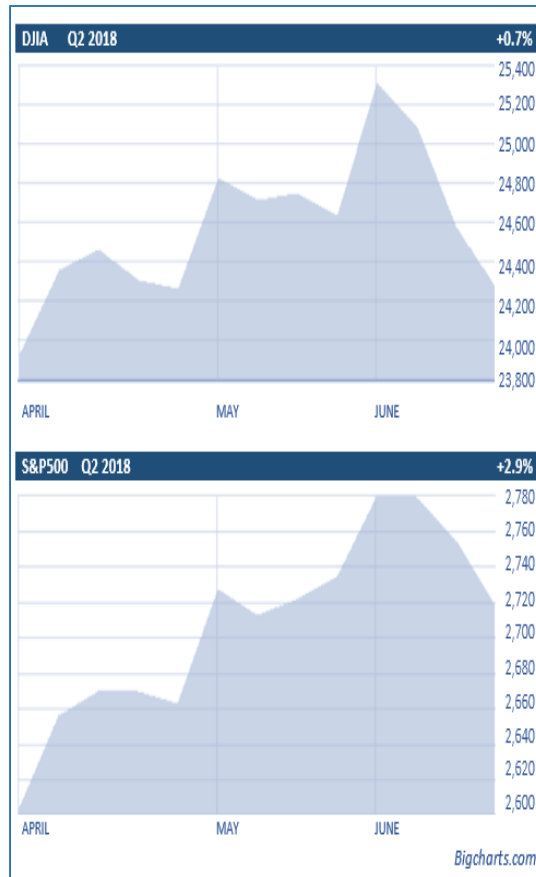


The second quarter of 2018 contained ups, downs and tariffs. Equity prices were very volatile as investors seemed to back off of many industrial heavyweights, while favoring large technology companies. Although the tensions of trade wars, tariffs, political uncertainty in the Eurozone and slowing momentum in the global economy surfaced, many indexes seemed to finish the quarter slightly higher.

While still below January 2018 highs, the S & P 500 and Dow Jones Industrial Average both rose for the quarter. The Dow ended the quarter on a sour note, losing over 300 points in the last week of trading to bring its quarterly gain to less than 1%. The S & P 500 also fell in the quarter's last week of trading, but it ended the quarter with a gain of 2.9%.

Some risk-oriented investors were rewarded, when companies like Netflix, despite its price earnings multiple of over 200 (which by definition makes it risky) rose over 30%. Jim Paulson, Chief Market Strategist at Leuthold Group warned that, "A lot of the investing public is invested in the same things." Although high flying technology companies did reward some investors, he is concerned about the risk factors and their possible price decline for investors.

Categorically, large-cap equities did not do as well as small-cap equities in the second quarter and so conservative



investors with more defensive positions might have experienced lower returns.

Barron's reported that some fund managers headed into the quarter-end feeling optimistic. "The tariffs are still dwarfed by the tax cuts, whose full positive effects have not made their way to the market", argues David Waddle, Chief Investment Strategist at Waddle and Reed. He also adds, "I do not feel that many people have really done the math on the tax cuts". (Source: Barron's 7/2/2018)

Gina Sanchez, CEO of Chantico Global, explained to CNBC that for the remainder of 2018 she's expecting beaten-down value names to fall back into favor. "Now that caution has steadily crept back into the market this year amid rising global trade tensions, political uncertainty abroad and an increasingly aggressive Federal Reserve, investors may steadily return to these names that traditionally offer 'safe' return." (Source: CNBC 7/2/2018)

For the quarter, Evercore ISI research found that the economy grew at a 4% annual rate as employment statistics looked healthy. They felt that the quarter's economic results are ones which "restrain inflation and help profit margins." (Source: Barron's 7/9/2018)

MONEY RATES		
(as posted in Barron's 7/1/2018)		
	LATEST WEEK	YR AGO
Fed Funds Rate (Avg. weekly auction -c)	1.91%	1.16%
Bank Money Market -z	0.20%	0.12%
12-month Cert -z	0.65%	0.35%

c- Annualized yields, adjusted for constant maturity, reported by the Fed Reserve on a weekly average basis. z - Bankrate.com (Source: Barron's; bankrate.com)

From a big picture standpoint, the bull market that began in 2009 is now over 3,400 calendar days and is the second longest ever (the 4,494 days starting in 1987 is the longest

ever). Although the S & P 500 has risen slightly over 300% since March of 2009, during the 1987-2000 bull market, the S & P 500 rose over 582%. While investors have already seen a correction, market strategists remind us that, “bull markets don’t die of old age.” Even the savviest of investors need to have a watchful eye on risk. Short term interest rates have risen and cash equivalent yields are still historically low. As financial professionals, we try to make our best forecasts and look for a probability of success understanding we face an uncertain future. Our main goal is to continually understand our client’s goals and to match those goals with the best possible solutions. (Source: *Barron’s* 7/2/2018)

Interest Rates Are Still Center Stage

As expected, in June, the Federal Reserve headed by Jerome Powell, increased its target short-term rate to a range between 1.75% and 2.00%. This seventh increase since the financial crisis was widely expected, as policymakers continue the process of normalizing interest rates. The central bank hinted at gradual hikes for this year with two more increases but turned hawkish for 2019 and 2020.

Interest rates and bond prices have an inverse relationship. When interest rates rise, bond prices usually decrease. As interest rates rise, the decline in bond prices is most severe for longer-term bonds, compared to shorter-term and floating-rate bonds. During periods of rising interest rates, stock prices could come under some pressure. Low interest rates in the bond market made investing in stocks a relatively more attractive option, however, as interest rates rise, and bonds offer investors higher yields, long-term investors sometimes sell their stocks and invest in bonds. While we can’t predict what the future will bring, it’s important that investors take appropriate steps to look for adjustments, if necessary, to prepare for any interest rate move. Interest rates continue to be a key area that investors need to watch closely in 2018.

Inflation Concerns

The inflation rate in the US increased to a six year high of 2.8% in May of 2018 from 2.5% in April, beating market forecasts of 2.7%. It is the highest inflation rate since February of 2012, mainly due to rising prices for gasoline and housing. (Source: *TradingEconomics.com* 5/2018)

KEY POINTS

1. **2018 equity markets made slight advances in Quarter 2**
2. **The bull market is now over 3,400 calendar days old.**
3. **The Fed raised U.S. Fed Fund rates again to 1.75 – 2.00% in June and is projected to raise rates two more times in 2018.**
4. **Inflation, trade wars and tariff talks are causing some uncertainty.**
5. **Market volatility is back and investors need to continue to be cautious and watchful.**
6. **Focus on your personal goals and call us with any concerns.**

When connecting inflation to the Fed’s long term plan, Seeking Alpha reports that, “Fed Chair Jerome Powell has recently reiterated this fact. At the news conference after the last rate increase, Mr. Powell insisted that the Fed would “cool things off ‘if inflation were to persistently run above’ 2 percent.” With unemployment decreasing a strong dollar and inflation rising, investors now need to monitor inflation rates again.

Tariffs

The Trump administration recently placed tariffs on Mexico, Canada, EU countries, and China. A recent economic report from Nationwide stated that, “Tariffs generally stifle economic growth, but even if the proposed tariffs are fully implemented, the potential drag on the U.S. economy would be much less than the expected jolt from tax reform and higher government spending.” The report also noted that, “Investors focusing on possible negative impacts from tariffs should bear in mind that trade negotiations are in flux and the outcome is still uncertain; however, the tax reform and government spending packages are in place and already positively affecting the U.S. economy.” Their key takeaway was that the global economic cycle is progressing as expected. Tariff and trade threats from President Trump could continue to bring uncertainty for investors, but many

economists still feel that momentum of the business cycle may do more to keep economic growth going than vague threats of trade protectionism. Tariffs and their impact on equity investors are now a serious potential concern that we need to pay careful attention to moving forward. (Source: *Nationwide* 6/2018)

General Electric leaves the DOW

It's hard not to see GE leaving the Dow as the end of an era. Until late June, General Electric (GE), Thomas Edison's old company, was the only original Dow component left of the 30 stocks that comprise the Dow Jones Industrial Average. It was the sole survivor from a time when the Dow consisted of mostly "old school" industrial companies.

Although Thomas Edison might not have approved, after 122 years, GE has been replaced by Walgreens Boots Alliance in the Dow Jones Industrial Average. This current Dow move not only reflects GE's recent struggles, but also the



changes in today's American economy. At one time, GE could have been viewed as a potential "buy and hold" investment. Buy and hold is a passive investment strategy in which an investor buys stocks and holds them for a long period regardless of fluctuations in the market. As the old saying goes, "buy and hold works....until it doesn't". This is a great example of why the days of hold forever, might need to be revisited. For many investors, it could be helpful for a qualified professional to constantly monitor your holdings and make adjustments when it is in your best interest. When keeping holdings, managing risk is something we attempt to evaluate as we review holdings for our clients.

What Should an Investor Do?

Market volatility is expected in the investment world. Experienced investors understand that volatility is a part of investing. They also understand that more important than volatility is an investor's response to it. Sometimes volatility is a sign of heightened risk, but at other times volatility is just a normal part of investing.

Stock market volatility can unnerve even the best of investors. This is not a new concept. In 1990, Robert Shiller, a Yale professor penned one of the times most extensive studies of how market volatility affects investor behavior. Empirical studies many times show that investors who react to market volatility in the wrong manner can harm their overall investment performance. Remember, a stock market correction is a 10% decline in stocks from a recent high. A correction is less severe than a bear market. A bear market is defined as when stocks decline 20% from their recent highs. Simply put, market volatility is a statistical measure of when the equity markets rise or fall sharper than usual within a short period of time.

Proceed with CAUTION is still the principal notion for investors.

Market volatility is different from corrections and bear markets. Low volatility means small fluctuations and high volatility means large fluctuations. Market volatility is possibly one of the most misunderstood concepts in investing, so we thought it would be helpful to share some things to think about during volatile times.

Things to Consider in Times of Market Volatility

✓ Revisit your financial goals and objectives.

Panic is not a strategy. It's important to keep perspective when markets get choppy. A sudden drop in the market can have dramatically different implications for someone just starting their career compared to someone nearing retirement. What's important is you understand your situation and your financial plan.

✓ Consider avoiding or ignoring nightly financial news.

Short-term downward market movements can trigger anxiety, but letting emotions drive your investment decisions may prove costly. Looking at the forest and not the trees can be helpful. For long term investors, a day to day focus can be very distracting. Forbes reminds us that, "the typical daily "noise" from news outlets should not cause steadfast investors to abandon ship." One key to living with market volatility is avoiding or ignoring daily financial returns and

staying focused on long-term results rather than the daily bumps along the way.

✓ **Revisit your risk tolerance.**

Being comfortable with your plan and your portfolio are important, but so is knowing your tolerance for risk. According to Forbes, successful investors know that volatility is part of the process on Wall Street. Instead of fearing volatility, they have learned to plan for it and actually embrace it. Volatile markets or a correction can provide a good reminder for long-term investors to reassess their holdings. (Source: Forbes 6/5/2018)

✓ **Review important paperwork**

Making sure you have a will, health care proxy, and power of attorney is sometimes an uncomfortable topic, but the alternative could be messy and costly. Do you want someone else making important financial and health decisions on your behalf without any input from you? If you are missing some of these key documents, let us know at your next review. Reviewing housekeeping items, like checking beneficiaries, is not complicated, but it can potentially cause serious consequences if neglected. Trying to protect our clients is something that we always try to do.

✓ **Connect with us to discuss your investing time frame, goals and strategy to make sure you're still on track.**

While CDs and money market funds offer the highest level of safety, they can also bring the lowest return, especially in the current climate of historically low interest rates. Full market risk is not appropriate for most investors even though today's traditional fixed rates might not help many investors to achieve their desired goals. Most investors attempt to build a plan that includes risk awareness. Many times, this can lead to safer but lower returns. ***If you are concerned with your current investments or your goals or risk tolerance levels have changed, call us.***

Let's focus on YOUR personal goals and Strategy.

Our advice is not one-size-fits-all. We will always consider your feelings about risk and the markets and review your unique financial situation when making recommendations.

We pride ourselves in offering:

- ✓ consistent and strong communication,
- ✓ a schedule of regular client meetings, and
- ✓ continuing education for every member of our team on the issues that affect our clients.

A skilled financial advisor can help make your journey easier. Our goal is to understand our clients' needs and then try to create a plan to address those needs. Should you need to discuss your investments, please call us.



Please share this report with others!

This year, our goal is to offer services to several other clients just like you. To share this report with a friend or colleague, please call **Peter at Kerntke Otto McGlone Wealth Management Group at (920) 733-3874!**

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