ECONOMIC HIGHLIGHTS

The U.S. Consumer Price Index was up 0.5% for January 2018, and up 2.1% year-over-year. Final Demand Producer Prices were up 0.4% for January and 2.7% year-over-year. Retail Sales for January were surprisingly negative, coming in at -0.3% for the month. Industrial Production was flat for January, as was Capacity Utilization, at 77.5%. Housing Starts were quite strong at 1.326mm units versus 1.232mm units expected. Multi-unit homes showed much of the strength.

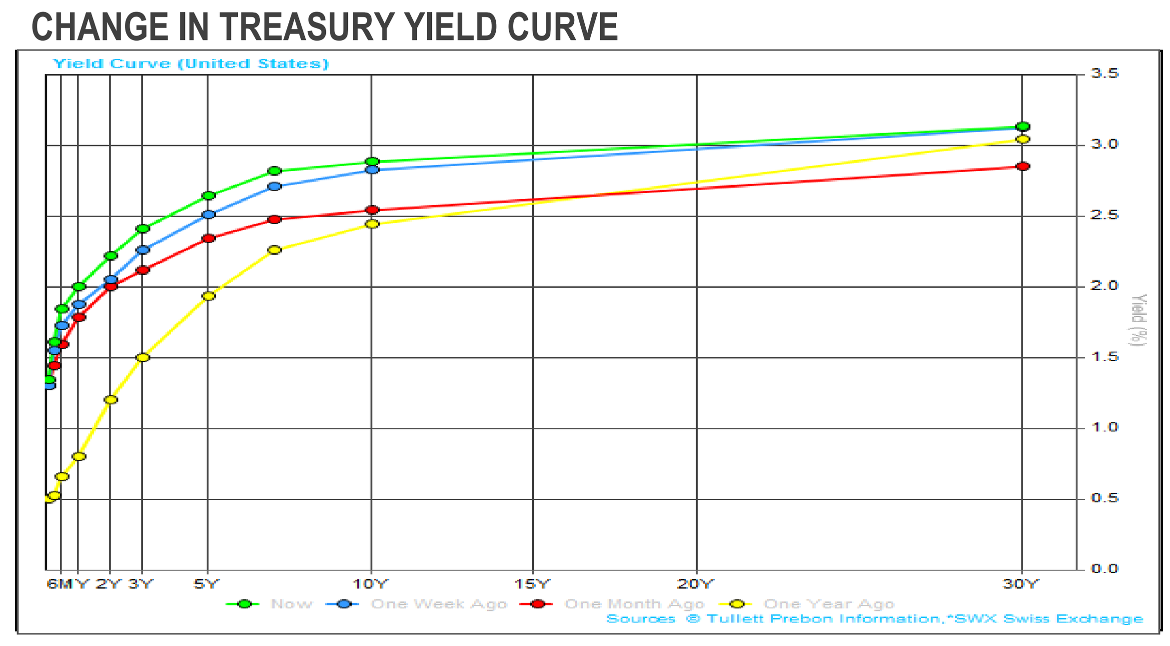
FIXED INCOME

The latest debt-ceiling drama is over, and the floodgates are open for the U.S. Treasury to step up issuance. It'll be up to bond traders this week to signal how much that extra supply will cost American taxpayers. In a week shortened by the Presidents' Day holiday this past Monday, the Treasury will pack in auctions totaling $258 billion. It begins with $151 billion of short-term bills, followed by a slate of two-, five- and seven-year maturities that's $4 billion larger than last month. It's a lot for bond traders to chew on, especially after a bond-market rout pushed yields to multiyear highs last week. With little in the way of significant economic data ahead, the sales will provide the clearest gauge of just how steeply borrowing costs will need to rise as the U.S. debt burden swells. "We're going to have this theme for a while -- there's a lot of issuance that has to come," Jeff Rosenberg, chief fixed-income strategist at BlockRock Inc., said in a Bloomberg TV interview. "It's not so much the demand -- it's the demand at what price?" The three- and six-month bill auctions this week will be the largest on record, at $51 billion and $45 billion, respectively. Investors are already demanding higher rates from borrowers across money markets, and that's before the nation's ballooning budget deficit causes even more short-term issuance later. Auctions are also rising as the Federal Reserve is moving to let bonds roll off its balance sheet. The two-year Treasury yield touched 2.209% last week, the highest since 2008. The five-year Treasury yield, at 2.6849%, touched the highest since 2010. The seven-year Treasury yield hit 2.874%, the highest since 2011. Solely from that perspective, these auctions may present an opportunity to step up and buy, and there are some big investors saying yields may not go much higher. But that's not the consensus. According to a Bloomberg survey, the two-year yield will rise above 2.5% by year-end. That's in part because a growing chorus expects the Fed to step up the pace of rate hikes in 2018 as government spending heats up the economy.

CURRENT GENERIC BONDS YIELDS

TREAURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.59%	3 mo	1.60%	3 mo	2.01%	3 mo	1.18%
6 mo	1.82%	6 mo	1.74%	6 mo	2.12%	6 mo	1.26%
1 yr	1.97%	1 yr	1.97%	1 yr	2.22%	1 yr	1.33%
2 yr	2.19%	2 yr	2.17%	2 yr	2.50%	2 yr	1.53%
5 yr	2.63%	5 yr	2.50%	5 yr	3.04%	5 yr	2.04%
10 yr	2.88%	10 yr	3.22%	10 yr	3.63%	10 yr	2.69%
30 yr	3.13%	30 yr		30 yr	4.04%	30 yr	3.70%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	4.36%	2.37%
S&P 500 (Large Cap)	4.37%	2.45%
S&P 400 (Mid Cap)	4.47%	0.19%
Russell 2000 (Small Cap)	4.48%	0.64%
NASDAQ Composite	5.36%	5.03%
MSCI EAFE (International)	4.13%	1.58%
iShares Real Estate	2.43%	-7.34%

Stocks continued their sharp rebound after the first -10% decline for the S&P 500 in two years – the index rose every day last week. All 11 of the major sectors rose with Technology, Financials, and Industrials leading gainers.

The recent decline was not unusual by historical standards – 10% declines on average happen at least once a year. However, the speed at which the decline occurred was fairly unusual with the decline happening in only 9 days. As a result, several Overbought/Oversold indicators had historic moves. For example, Bespoke graphs the S&P 500's price relative to its 50-day moving average. In less than two weeks of trading, the S&P 500 went from Overbought on the reading – which means price was more than 2 standard deviations above its 50-day moving average to Oversold – which means price was more than 2 standard deviations below its 50-day moving average. It was the first time this condition was met since July 2007 and only the 21st occurrence going back to 1928.

This quarter's earnings season has pretty much wrapped up and has been strong. FactSet noted that for the fourth quarter 2017 – 75% of the companies that have reported thus far have reported positive earnings surprises and 78% have reported positive sales surprises. If 78% is the final number for the quarter, it will mark the highest percentage since FactSet began tracking this metric in Q3 2008.

The other fact that made last week's decline unusual was the fact that stocks and bonds both fell in value at the same time. Pension Partners wrote that of the 20 worst weekly S&P 500 declines since July 2002, last week was only the second time long duration Treasuries also finished lower. Going further back, they made mention of the fact that since 1928, the S&P 500 and the 10-Year Treasury bond fell in the same calendar year only 3 times, last occurring in 1969.

For the holiday-shortened week ahead – earnings are expected from Wal-Mart, Home Depot, Domino's Pizza, and Hewlett-Packard. On the economic front, there will not be much in the way of market moving data. The latest Federal Reserve meeting minutes will be released on Wednesday and Thursday.

The volatility of the past few days has moved some of the near-term support and resistance levels we are watching. Support for the S&P 500 stands at 2730, 2600, and 2555, while any further rallies will encounter resistance at 2775 and all-time highs of 2872. The S&P 500 ended last week at 2732.

ASSET ALLOCATION

CURRENT SENTIMENT	
Cash	Neutral
Short Fixed Income	Neutral
Intermediate Fixed Income	Neutral
Inflation-Adjusted Fixed Income	Unfavorable
High Yield Fixed Income	Neutral
International Fixed Income	Neutral
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Favorable
Real Estate	Favorable
Commodities	Unfavorable

Below is a summery of our current stance on most asset classes:

Cash - Holding as little as possible given the miniscule yields in money market instruments. Any exposure is for defensive positioning.
Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the outlook for higher interest rates.
Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in spread products.
Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.
High Yield Bonds - Spreads have tightened; however, still remain attractive versus Treasuries.
International Bonds - Emerging market bonds offer good diversification qualities while providing higher yield opportunities relative to domestic fixed income.
Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.
Large Cap Stocks - A favorable weighting is recommended. Growth has reemerged as a more favorable style and should be overweighed versus Value.
Mid Cap Stocks - Mid cap exposure along with a value tilt is preferred. Mid cap stocks continue to provide the "sweet spot" of market capitalization - large enough to provide stability, but small enough to be more nimble.
Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. However, a recent divergence of relative strength between small caps and large caps warrants a neutral exposure.
International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight to neutral weight is recommended.
Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. Recent relative performance versus developed markets support the stronger fundamental backdrop and positions have been added.
Real Estate - Pricing has stabilized and long-term valuations appear attractive. Real Estate has performed well of late and should continue to be a strong alternative to other asset classes.
Commodities - Global demand should support higher prices if the global recovery remains on track. Although, volatility will be higher and commodities will be susceptible to short-term price shocks, if used in conjunction with other asset classes, risk can be reduced substantially to a diversified portfolio. However, used alone is not recommended as the short-term outlook is not favorable.

Sources of statistical information are Bloomberg and Ned Davis Research.