2017 Weekly Portfolio Manager Commentary

July 28 , 2017

Trustmark Investment Advisors, Inc.

ECONOMIC HIGHLIGHTS

The FOMC left interest rates unchanged this week, with no surprise announcements. June Durable Goods orders were quite strong, at +6.5% versus +3.5% expectations. Most of the strength was due to aircraft orders. Second quarter U.S. Real GDP growth was +2.6%, as expected. Finally, the Employment Cost Index was up 0.5% for the second quarter, and up 2.4% on an annual basis.

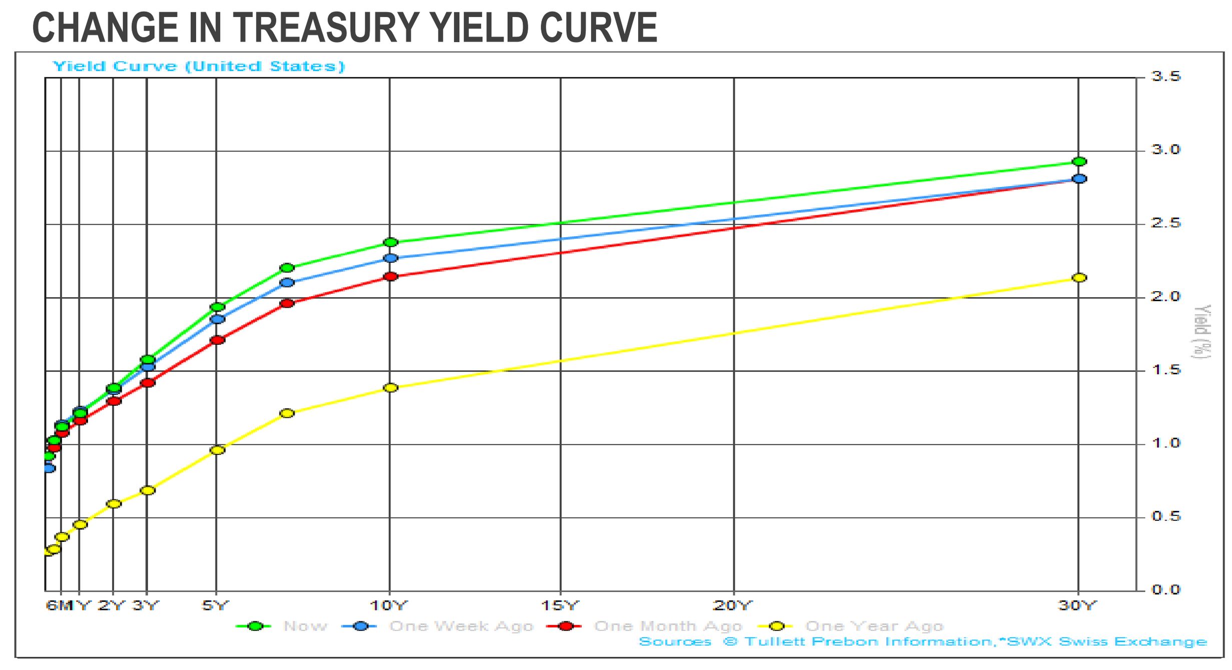
FIXED INCOME

The Federal Reserve is trying to have its cake and eat it too when it comes to its controversial balance sheet policies, and it's bound to end in indigestion. Policymakers have touted their use of large-scale bond purchases during the Great Recession and the anemic recovery that followed, also known as quantitative easing or QE, as having helped to prevent a second Great Depression. Yet now that they have decided the time has come to begin reducing the $4.5 trillion portfolio, composed primarily of mortgage and Treasury bonds, officials would like to pretend that the balance sheet is a passive tool whose decline will simply be on auto-pilot as the central bank uses interest rate hikes to tighten monetary policy on a broader scale. The Fed said after its July meeting last week that it "expects to begin implementing its balance sheet normalization program relatively soon, provided that the economy evolves broadly as anticipated." Investors take this to mean the Fed's September meeting, which includes one of Fed Chair Janet Yellen's quarterly press conferences. There are a few problems with this scenario. First, it's theoretically inconsistent: if quantitative easing provided massive support to growth and jobs during the downturn, surely its withdrawal will create some drag on the economy's performance. Second, the time and pace of the reduction, which as of yet is uncertain, will surely matter for underlying monetary and financial conditions, with implication for credit markets for business and consumer lending. Despite the Fed's desire to implement its balance sheet reduction in a gradual, almost automatic fashion, the economic data will surely affect its thinking on the pace of such actions.

CURRENT GENERIC BONDS YIELDS

TREAURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.07%	3 mo	1.07%	3 mo	1.26%	3 mo	0.73%
6 mo	1.11%	6 mo	1.13%	6 mo	1.36%	6 mo	0.80%
1 yr	1.21%	1 yr	1.15%	1 yr	1.42%	1 yr	0.85%
2 yr	1.35%	2 yr	1.43%	2 yr	1.65%	2 yr	0.98%
5 yr	1.83%	5 yr	1.74%	5 yr	2.26%	5 yr	1.26%
10 yr	2.29%	10 yr	2.69%	10 yr	3.04%	10 yr	1.90%
30 yr	2.90%	30 yr		30 yr	3.90%	30 yr	3.33%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	1.17%	11.96%
S&P 500 (Large Cap)	0.00%	11.67%
S&P 400 (Mid Cap)	-0.63%	7.02%
Russell 2000 (Small Cap)	-0.45%	6.07%
NASDAQ Composite	-0.19%	19.19%
MSCI EAFE (International)	0.36%	17.58%
iShares Real Estate	0.27%	6.80%

The S&P 500 ended last week at essentially the same price it started, and spent the entire week in a narrow 6 point range from high to low – amounting to about one quarter of one percent, or 0.25%. The Dow Jones Industrials fared better, making a new all-time high on Friday. Developed International and Emerging Market equities marked their third straight weekly gains – adding to their recent outperformance of domestic equities.

For the week five sectors rose, while six posted losses. Leading advancers were Energy, Financials, and Real Estate – while Health Care finished the week down the most, falling -1.2%.

Several notable tech companies reported earnings last week. On Thursday, shares of Facebook rose after the company reported results ahead of estimates, revenue for the company rose 49% year-over-year. Twitter shares dropped -14% on Thursday after the company reported a decline in ad revenue and announced expectations for next quarter that fell short of estimates. On Friday, Amazon stock fell -2.50% after its reported revenue beat expectations, but earnings per share fell short.

Earnings season continues this week in full swing with reports expected from among others: Pfizer, Apple, AIG, Humana, Tesla, Papa John's Pizza, Clorox, Yum Brands, Viacom, and Cigna.

Pension Partners noted last week that this current streak of numbers of trading days without a 5% correction is now the fourth longest stretch for the S&P 500. Dating back to June 2016, the S&P 500 has now booked 274 trading days and counting without a -5% drawdown – rising over 23% during the streak. Ned Davis Research shows that on average one should expect the S&P 500 to have three 5% corrections every year.

The narrow range that contained the S&P 500 last week did nothing to change the key support levels we continue to watch. Those levels remain 2450 in the short-term, with 2400, 2365, 2325, and 2310 acting as intermediate and longer-term support levels. The S&P 500 closed last week at 2472.

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.