# 2018 Weekly Portfolio Manager Commentary

**August 3, 2018**

Trustmark Investment Advisors, Inc.

## ECONOMIC HIGHLIGHTS

Personal Income was up 0.4% for June, with the PCE Price Index up 0.1%. The U.S. Employment Cost Index was up 2.8% for the second quarter of 2018 on an annualized basis, consistent with the prior quarter. The Chicago Purchasing Managers' Index came in at a strong 65.5 for July. Factory orders accelerated for June, up 0.7% vs. +0.4% for May. The PMI and ISM Services Indexes came in at around 56 for July. Finally, the U.S. unemployment rate was 3.9% for July.

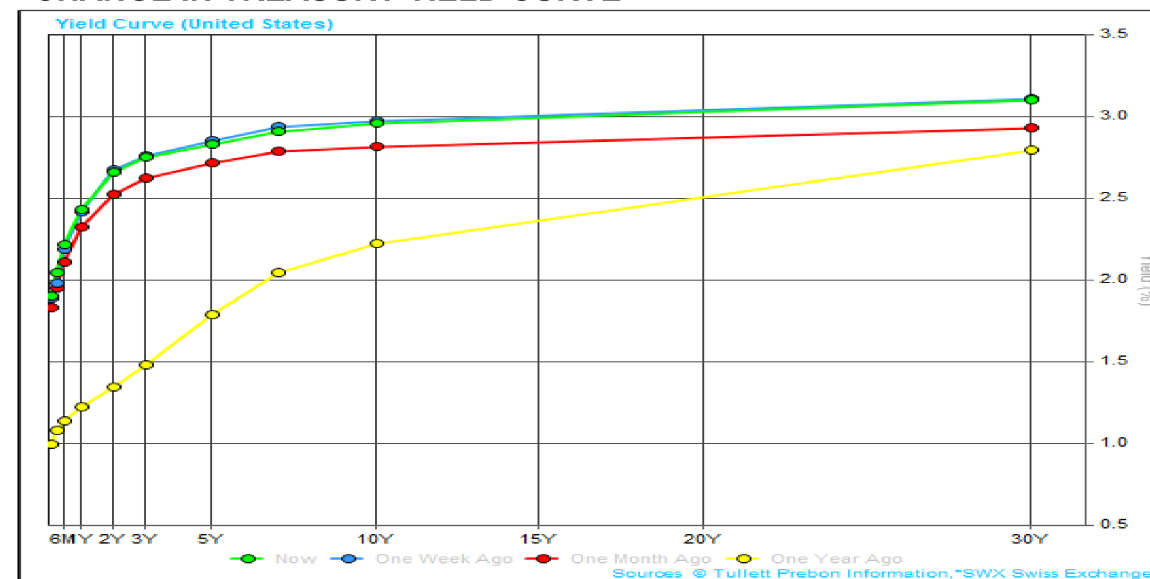
## FIXED INCOME

The payroll increase in July fell significantly below the consensus forecast, but this should not be viewed as a weak jobs report. Substantial upward revisions to the prior two months pushed the cumulative gain well above consensus expectations. May and June hiring was revised up by an impressive 59,000, which, combined with the 157,000 July increase, adds up to a cumulative net gain of 216,000, much higher than the consensus projection. Softness in July payrolls was concentrated in the private-service sector and government, so analysts looking at the profile over the past few months would be off-base to consider this collateral damage from a trade war. Manufacturing payrolls continue to build momentum, posting the largest monthly increase of the year and the fastest 12-month change since 1995. These results should provide confidence to President Trump that the trade-tariff escalation is not materially damping economic activity; in fact, the accelerating pace of factory job gains will be used as evidence to the contrary. This may give the Trump administration greater assurance to continue fomenting trade tensions, given there is not a visible impact. The Fed will view the July jobs report as more of the same. The pace of hiring, even at 157,000 per month, is above trend and consistent with growth exceeding 2% and the unemployment rate continuing to decline. The July jobs data should have virtually no impact on the Fed's planned September rate increase, nor will it meaningfully influence expectations for December. Markets were unfazed by the July labor data. Yields on both two-year and ten-year Treasuries edged lower after the report. The Fed Funds Futures market is pricing in around a 90% chance of a rate hike in September, basically unchanged from before the report's release. The Fed's first reaction to the latest jobs report will come this Wednesday from Richmond Fed President Tom Barkin. He is scheduled to speak to members of the financial community in Roanoke, Virginia. Barkin recently cited a strong labor market as one of many reasons why he supports further removal of policy accommodation. A more complete response from the central bank will likely come later in the month at the Fed's annual Jackson Hole meeting. The Fed's assessment of economic conditions, based on the messaging of the August FOMC statement, shouldn't be materially changed by the July employment report. If anything, muted wage pressures will bolster policymakers' confidence that gradual normalization of interest rates remains appropriate, while manufacturing hiring will allay fears about the trade war materially impacting the growth outlook in the near term.

### CURRENT GENERIC BONDS YIELDS

| TREASURIES | | AGENCIES | | CORPORATES | | MUNICIPALS | |
|---|---|---|---|---|---|---|---|
| 3 mo | 1.97% | 3 mo | 2.04% | 3 mo | 2.34% | 3 mo | 1.31% |
| 6 mo | 2.15% | 6 mo | 2.18% | 6 mo | 2.47% | 6 mo | 1.37% |
| 1 yr | 2.41% | 1 yr | 2.33% | 1 yr | 2.56% | 1 yr | 1.45% |
| 2 yr | 2.64% | 2 yr | 2.62% | 2 yr | 2.86% | 2 yr | 1.62% |
| 5 yr | 2.81% | 5 yr | 2.89% | 5 yr | 3.24% | 5 yr | 2.05% |
| 10 yr | 2.95% | 10 yr | 3.25% | 10 yr | 3.67% | 10 yr | 2.67% |
| 30 yr | 3.09% | 30 yr | | 30 yr | 4.10% | 30 yr | 3.68% |

### CHANGE IN TREASURY YIELD CURVE




## EQUITY

| INDEX RETURNS | LAST WEEK | YTD |
|---|---|---|
| Dow Jones Industrials | 0.05% | 4.28% |
| S&P 500 (Large Cap) | 0.80% | 7.40% |
| S&P 400 (Mid Cap) | 1.29% | 6.15% |
| Russell 2000 (Small Cap) | 0.63% | 9.73% |
| NASDAQ Composite | 0.98% | 13.83% |
| MSCI EAFE (International) | -0.99% | -1.17% |
| iShares Real Estate | 3.06% | 3.32% |

All four major U.S. equity indices finished higher last week. The S&P 500 was up for a fifth straight week. Trade headlines remained fairly volatile and tensions between the U.S. and China continued to ratchet higher. The Fed meeting was largely a non-event, while comments from the Bank of Japan garnered some headlines.

The Technology sector bounced last week following the prior week's sell-off. Some of the reprieve came from the better results and guidance from Apple. In addition, the press remained focus on the favorable fundamental backdrop for the biggest names in the space.

Defensive sectors led last week with Health Care, Real Estate, and Consumer Staples leading the seven advancing sector groups. Market moving headlines included July's nonfarm payrolls report coming in below consensus on Friday. Also of note were reports that China announced it had prepared plans for retaliatory tariffs if the U.S. proceeds with the 25% levy on $200 billion in Chinese goods the White House discussed earlier in the week.

According to data from FactSet, 80% of the S&P 500 companies have reported a positive EPS surprise and 74% have reported a positive sales surprise. If 80% is the final number, it will mark the highest percentage since FactSet began tracking this metric in Q3 2008.

FactSet also released a report exploring how significantly the recent tariffs have impacted corporate earnings thus far. FactSet searched for the term "tariff" in the conference call transcripts of the 159 S&P 500 companies that had conducted second quarter earnings call through July 25. Of these companies, 70 or 44% cited the term "tariff" during the call. Overall, 43 of the 70 companies saw little to no impact on their earnings, while 19 discussed at least a "modest" negative impact on their businesses.

Bespoke wrote in a report that it has now been 126 trading days since the S&P 500 last closed at an all-time high, making the current streak the third longest drought without a new high since the bull market began in March 2009. If the current streak continues through August 10, this period will move into second place. What makes this streak even more interesting is the index's proximity to that all-time high – at the end of last week the S&P 500 stood less than 1.5% from the prior high.

Apple made history on Thursday becoming the first company to ever reach a $1 trillion market capitalization. The move followed an earnings report highlighting strong results and guidance.

For the week ahead the corporate calendar moves into the second half of earnings season with announcements expected from Tyson Foods, Disney, Papa John's, Twenty-First Century Fox, CVS, and Viacom among others. The U.S. economic calendar is relatively light but we will see latest readings of Consumer Price Index, Producer Price Index, and trade balance.

From a technical perspective, the S&P 500 has maintained the 2800 level which is now acting as important support. The index closed last week at 2840 which puts the prior all-time high of 2872 as next resistance level. Support stands at 2800, 2770, and 2705.

## 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.*

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