ECONOMIC HIGHLIGHTS

Final Demand Producer Prices in the U.S. were flat for July and up 3.3% year-over-year. Consumer Prices were up 0.2% for July and up 2.9% year-over-year. Otherwise, it was a slow week for economic releases.

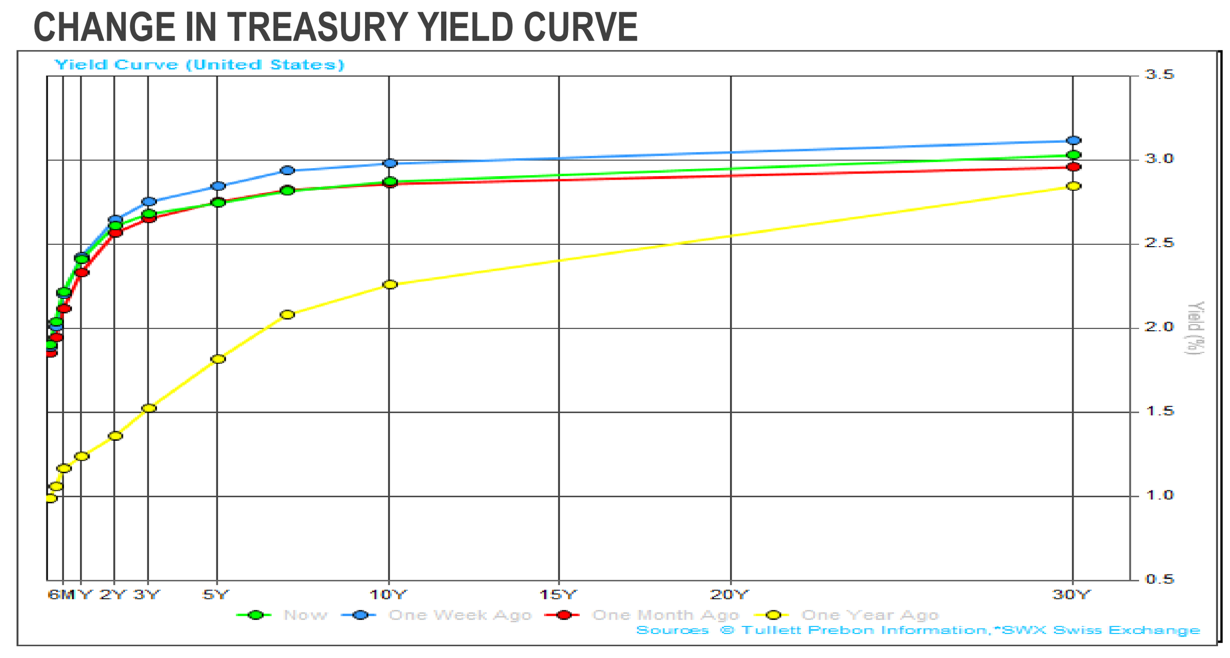
FIXED INCOME

Over the past few months, Treasuries have been mired in the tightest monthly range this year, and this week brings little hope for a breakout. Aside from retail sales figures, the week offers a thin gruel of mostly second-tier economic data and T-bill auctions. Barring fresh geopolitical convulsions, traders may find themselves looking to the risks that looms once summer vacations wind down. While Treasury just increased issuance across the curve, it's probably going to continue boosting supply to finance the ballooning budget deficit and offset the Fed's shrinking of its bond portfolio. At the August refunding, Treasury said that "by September" the amount of bills outstanding will likely approach levels last seen in March, when a wave of short-term U.S. issuance reverberated across global financing markets. Although an influx of tax revenue in September may lead to a brief paydown of bills, auctions will ramp back up starting in October. And for traders inclined to look ahead to November's refunding, there's a chance that the Treasury decides to lean more heavily on longer maturities. In its August report, the Treasury Borrowing Advisory Committee said there may be more room to increase issuance in five-year notes and further out the curve. So far, the Fed's unwind of its portfolio is seen as having gone pretty smoothly, but it's about to accelerate. Beginning in October, the central bank's reinvestment cap for Treasuries will rise to its maximum monthly level, $30 billion, from $24 billion currently. For mortgage-backed securities, the limit will rise to $20 billion from $16 billion. That raises the likelihood of "super-sized" weekly unwinds that put debt markets under pressure, according to some analysts on Wall Street. Since the unwind started in October 2017, there's only been one week where reductions exceeded $20 billion, but looking ahead there are more than 11 occurrences that could exceed that amount. The Federal Reserve, the biggest holder of the nation's debt, has shrunk its balance sheet by about $200 billion since October, leading bank reserves at the Fed to drop by the same amount. That pushes more banks into the market for overnight financing, raising their borrowing costs. So as the central bank's unwind picks up speed, traders will be monitoring whether the effective fed funds rate rises relative to the interest on excess reserves rate, a proxy for the upper bound of the Fed's target range. Should the spread between the two shrink, the Fed may need to repeat its June tweak to its policy-setting tools. Also there is the specter of the risk that lawmakers fail to pass a budget before the close of the federal fiscal year at the end of September. For now, the scenarios for the fixed-income world may not be as ominous as last year, because the debt ceiling has been suspended through March 1, but it could still spur some haven buying of Treasuries.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.04%	3 mo	1.99%	3 mo	2.32%	3 mo	1.33%
6 mo	2.22%	6 mo	2.20%	6 mo	2.44%	6 mo	1.39%
1 yr	2.39%	1 yr	2.38%	1 yr	2.54%	1 yr	1.47%
2 yr	2.60%	2 yr	2.59%	2 yr	2.83%	2 yr	1.63%
5 yr	2.75%	5 yr	2.81%	5 yr	3.20%	5 yr	2.06%
10 yr	2.87%	10 yr	3.18%	10 yr	3.63%	10 yr	2.64%
30 yr	3.03%	30 yr		30 yr	4.08%	30 yr	3.63%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	-0.44%	3.82%
S&P 500 (Large Cap)	-0.18%	7.21%
S&P 400 (Mid Cap)	-0.16%	5.97%
Russell 2000 (Small Cap)	0.82%	10.63%
NASDAQ Composite	0.40%	14.29%
MSCI EAFE (International)	-2.01%	-3.16%
iShares Real Estate	-1.74%	1.52%

After five straight weeks of gains, the S&P 500 fell marginally last week. Eight of the eleven major sector groups declined with Real Estate, Consumer Staples, and Industrials falling over -1% each. Telecommunications led the three advancing sectors, booking a gain of 2%. A sharp decline in Turkey's currency, the lira, was in focus amid growing concerns the country is facing an economic crisis.

According to FactSet's latest Earnings Insight report, the blended earnings growth for Q2 S&P 500 EPS currently stands at 24.6%. Of the 91% of companies that have now reported Q2, 79% have beaten consensus EPS expectations, better than the one-year average of 75% and five-year average of 70%.

In the commodity space, 2018 has been a mixed bag. Precious metals are down across the board, while oil is up 13%. The big winner so far this year is Orange Juice which is up 24% in 2018 while coffee is down -14%. Gold prices are down around -7% this year and have been stuck in a downtrend since rolling over in April – a move that coincides almost exactly to the sharp rally in the U.S. dollar which began at the same time as gold's decline.

Bespoke issued a fascinating report last week taking a look back at the S&P 500 since the last real sell-off of this bull market, a 19% decline which ended in August 2011. Since that bottom, the S&P 500 is up 138%, while the average stock in the index has returned over 200%. A total of 37 stocks are up over 500%, while two-thirds of the stocks have at least doubled. Put another way, if you picked any random stock back in August 2011, you would have been more likely to pick a five-bagger (500% gain) than a stock that went down.

One consequence to the recent spate of tariffs that is not being reported is the effect they are having on front-loaded growth. Bespoke wrote in a note last week they estimate that Q2 growth got a 1.12% tailwind from exports. That surge was partly caused by companies rushing product to market ahead of any tariffs going into effect. The firm noted the surge in soybean exports to the second-highest nominal value ever in Q2. Nominal export growth was 18% versus 12% ex-soybeans in Q2. Expect exports to grow much less in Q3 given the new tariffs on soybeans.

Tesla shares were in the headlines on Tuesday after CEO Elon Musk tweeted he is considering taking the company private at $420 per share. He added that funding is secured. The tweet came on the heels of an FT report that Saudi Arabia's Public Investment Fund has built a 3%-5% stake in the company. Not to be outdone, the SEC subsequently announced it was looking into Musk's tweet.

For the week ahead the earnings calendar quiets down a good bit. Notable reporters include Sysco, Macy's, Home Depot, Wal-Mart, and Cisco. The economic calendar is equally light as we will see CPI, PPI and NAHB Index.

Moving forward, the support and resistance levels we are watching for the S&P 500 have not changed. Support for the index resides at 2800, 2785, and 2715, while any rallies will encounter resistance at prior all-time highs at 2872. The index closed last week at 2833.

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.