# 2018 Weekly Portfolio Manager Commentary

***September 21, 2018***

Trustmark Investment Advisors, Inc.

## ECONOMIC HIGHLIGHTS

U.S. Homebuilder Confidence remained at a yearly low, however it is still quite expansionary (above 50) at 67 for September. Housing Starts for August were up to 1.282 MM units from 1.174 MM units in July. Permits were down to 1.229 MM from 1.311 MM. The U.S. Index of Leading Economic Indicators was up 0.4% for August, led by a surge in manufacturing orders.

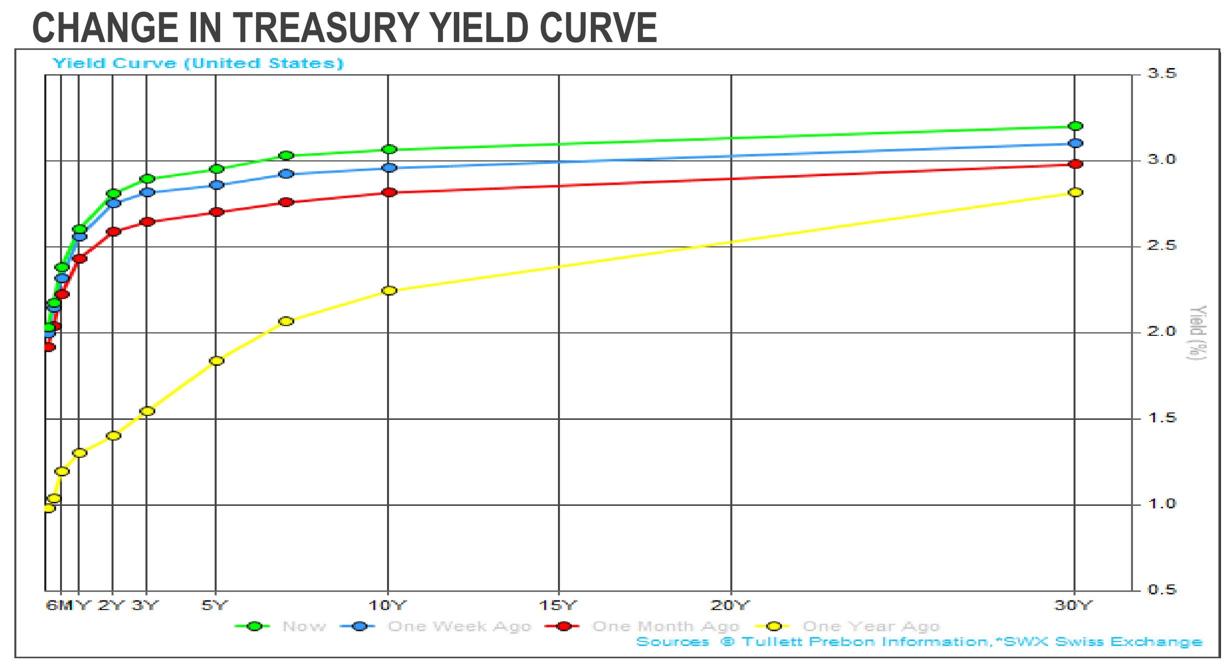
## FIXED INCOME

There seems to be a widening gap between what the Federal Reserve suggest it is likely to do going forward with short-term interest rates and what bond traders believe they will actually do. The Fed's "dot plot," which is a survey of FOMC members' expectations for future policy, suggests that the Fed will likely hike interest rates twice more in 2018, three times in 2019 and two times in 2020. That's seven more rate hikes before the Fed puts an end to the current tightening cycle. Market participants are beginning to have a different school of thought. While forward rates agree with the Fed that an interest rate hike this week is almost a certainty, the likelihood of another increase before the end of the year currently stands at about 67%, according to CME Group's Fed Watch tool. For next year, forward rates are pricing in around two rate increases, instead of the Fed's prediction of three, and for 2020, the market isn't pricing in a rate increase at all. So the market is basically calling for about four more 25 basis point rate hikes through 2020 versus the Fed's dot plot prediction of seven. The main dilemma for the Fed is the challenge in not raising rates too much which could lead to a potential slowdown in the economy or possibly a small recession in the coming years. The current U.S. economic expansion will soon be the longest on record. But old age doesn't necessarily mean the end is near. It takes a domestic policy mistake or a serious external disruption to bring an end to economic expansion. With rising debt loads, a nearly flat yield curve, escalating trade wars and disruptions in emerging market currencies and economies, there is no shortage of factors which might serve as a catalyst for ending the current expansion. There are some on the street who put the odds of a recession in 2020 at about one in three. A best-case scenario domestically may be that the Federal Reserve goes into a holding pattern when it comes to its current tightening phase in the near future. Some arguments for this begin with the rise in both public and private debt to record levels. Rising rates increase the cost of servicing debt and raise the risks of a recession. Also, the yield curve has flattened considerably over the past year. The continued hikes by the Fed could lead to an inverted yield curve which in past history has been a pre-curser to a recession. This doesn't always have to be the case for the economy to take a pause but historically it has been a proven predictor of an economic downturn in the next few years.

**CURRENT GENERIC BONDS YIELDS**

| TREASURIES | | AGENCIES | | CORPORATES | | MUNICIPALS | |
|---|---|---|---|---|---|---|---|
| 3 mo | 2.16% | 3 mo | 2.18% | 3 mo | 2.44% | 3 mo | 1.72% |
| 6 mo | 2.37% | 6 mo | 2.36% | 6 mo | 2.55% | 6 mo | 1.78% |
| 1 yr | 2.56% | 1 yr | 2.51% | 1 yr | 2.68% | 1 yr | 1.84% |
| 2 yr | 2.80% | 2 yr | 2.80% | 2 yr | 3.00% | 2 yr | 1.96% |
| 5 yr | 2.95% | 5 yr | 3.03% | 5 yr | 3.37% | 5 yr | 2.29% |
| 10 yr | 3.06% | 10 yr | 3.35% | 10 yr | 3.78% | 10 yr | 2.81% |
| 30 yr | 3.20% | 30 yr | | 30 yr | 4.18% | 30 yr | 3.78% |

**CHANGE IN TREASURY YIELD CURVE**




## EQUITY

| INDEX RETURNS | LAST WEEK | YTD |
|---|---|---|
| Dow Jones Industrials | 2.25% | 10.01% |
| S&P 500 (Large Cap) | 0.89% | 11.04% |
| S&P 400 (Mid Cap) | -0.26% | 8.53% |
| Russell 2000 (Small Cap) | -0.57% | 12.40% |
| NASDAQ Composite | -0.28% | 16.61% |
| MSCI EAFE (International) | 2.82% | -0.44% |
| iShares Real Estate | -0.41% | 2.93% |

The S&P 500 broke out to a new all-time high on Thursday fueling a new leg higher for this bull market. The rally last week had broad participation with 8 of the 11 major sector groups advancing led by Financials and Materials. Stocks continued to largely shrug off talk of more tariffs as the White House announced plans for a 10% tariff on $200 billion in Chinese goods which will increase to 25% at the beginning of 2019.

Breadth was strong last week confirming the price break to new highs. Bespoke made note of the positive trend in breadth in the latest advance/decline line reading which has been making new highs throughout the year – preceding the new price highs. Investor Sentiment is also in a positive position currently. The latest AAII Bullish Sentiment reading stands at just 32% roughly half of where it was back in January when the index stood just over 60%. Bullish sentiment on the part of investors remains subdued even as the market makes new highs, a positive development.

Bespoke detailed in a report last week the performance of the S&P 500 during various periods through mid-term election years going back to 1946. Their data showed the S&P 500 actually performed well in the two years when the Senate and House flipped to Democrats with a Republican President (1954 and 2006). Overall the study showed a mixed bag in all mid-term election years and likely simply represents an unknown for the market.

Bloomberg reported on Tuesday that Tesla is facing a criminal investigation by the Justice Department over public statements made by CEO Elon Musk over his "funding secured" comments. The article noted the investigation is also running alongside a civil inquiry by the SEC.

Shares of Disney rose Wednesday after the company announced ESPN and ESPN+ streaming service has surpassed 1 million paid subscribers in just over five months since launch.

September has been a bit of a reversal month for U.S. stocks. According to data from Bespoke, the indexes ETFs that are up the most in 2018 are actually struggling this month, while there has been a rally in area that had been underperforming on the year. Normally when the index rotates out of winners and into losers as the broad market rallies is viewed as a bullish sign.

The corporate calendar news flow picks up steam in the week ahead. Notable earnings include – Nike, CarMax, Bed, Bed, and Beyond, and KB Home. On the economic calendar the focus will be on the mid-week FOMC rate decision and Q2 final GDP. Later in the week personal income and spending reports are set to be released.

The S&P 500 broke out of the trading range we have been noting in these comments for the past several weeks. Support and resistance levels have changed somewhat as a result. Support for the index stands at 2915, 2872, and 2800. The S&P 500 experienced an intraday reversal, so we will keep an eye on the intraday highs at 2940. The S&P closed Friday at 2929.

## 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.