2018 Weekly Portfolio Manager Commentary

November 16, 2018

Trustmark
Investment Advisors, Inc.

ECONOMIC HIGHLIGHTS

The U.S. Consumer Price Index came in at +0.3% month-over-month and +2.5% year-over-year. Core CPI was up 2.1% year-over-year. Retail sales were up 0.8% for October, and Business Inventories were up 0.3%. Finally, Industrial Production came in at +0.1% for October with a Capacity Utilization Rate of 78.4%.

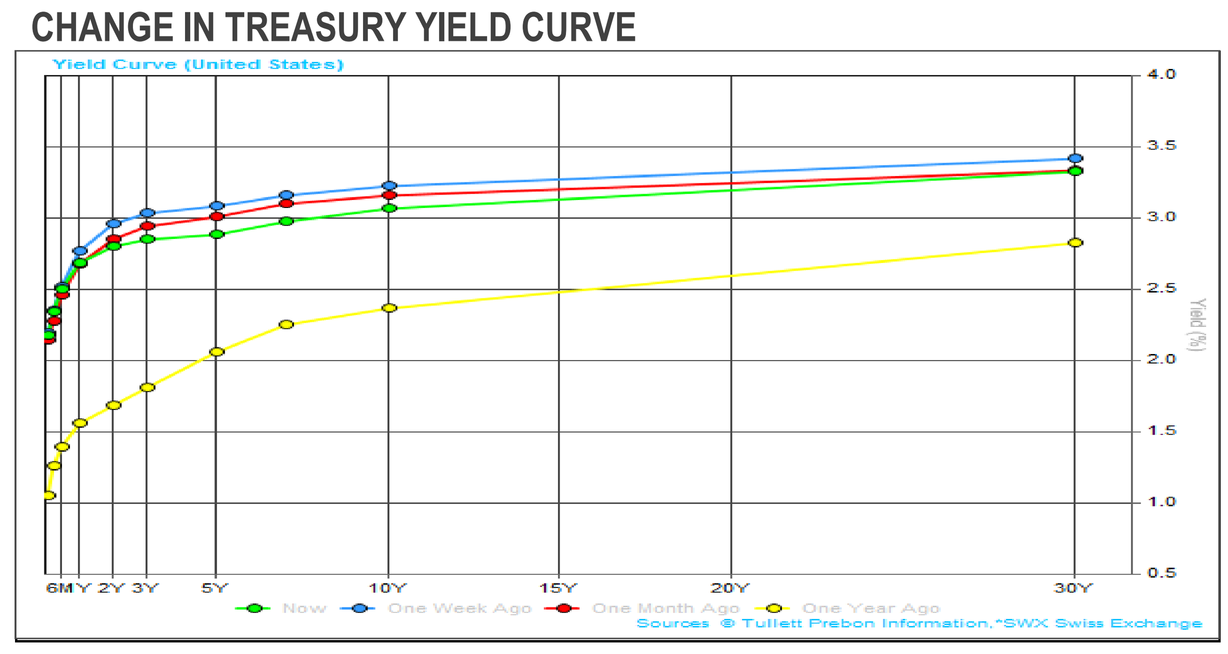
FIXED INCOME

For Federal Reserve Chairman Jerome Powell, the day of straightforward policy meetings are numbered. An interest-rate increase at the December 18-19 gathering of the U.S. central bank is priced at around 70% odds and the case for a move, backed up by comments from Powell and his colleagues last week, is supported by strong economic growth and ultra-low unemployment. But a hike next month would also lift the top Fed's benchmark target rate to 2.5% -- the bottom of officials' range of estimates for a neutral policy setting that neither spurs nor slows growth. Going forward, officials will have to decide how much higher to go. Investors are reading their recent remarks as backing off from a policy on autopilot to a strategy that could see them pause in 2019 and wait for feedback from the economy. "There is a narrative that the Fed is going to keep hiking until something breaks," said Neil Dutta, an economist at Renaissance Macro Research. "I don't buy that. Global growth weakness has caught their attention." Fed officials in September estimated a range of 2.5% to 3.5% for a neutral policy rate. The Fed's benchmark policy rate is currently 2% to 2.25%. Subsequent moves, as Powell's remarks about maneuvering in the dark made clear, are highly dependent on what they bump into and what the shape of things they encounter tell them about the outlook. Officials including Fed Vice Chairman Richard Clarida and Chicago Fed President Charles Evans are not comfortable maintaining a simulative rate at a time when the labor market is beyond their estimate of full employment and inflation is at their 2% target. "Being at neutral would make sense," Clarida told CNBC on Friday. Evans, speaking later in the day, used almost identical language at an event in Chicago. "It makes a lot of sense to at least get back to neutral," he said. Despite their desire to keep moving, there are plenty of signs that their rate increases are starting to have an impact. Housing markets have slowed, financial market volatility has increased, and credit spreads have widened as investors reassess the outlook for growth and profits. What's more, estimates for global growth are slowing. "The global economy is something" the Fed has to pay attention to, Clarida said, adding that there "is some evidence that it's slowing."

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.34%	3 mo	2.41%	3 mo	2.66%	3 mo	1.94%
6 mo	2.50%	6 mo	2.54%	6 mo	2.80%	6 mo	1.99%
1 yr	2.66%	1 yr	2.69%	1 yr	2.88%	1 yr	2.05%
2 yr	2.80%	2 yr	2.79%	2 yr	3.16%	2 yr	2.17%
5 yr	2.88%	5 yr	2.97%	5 yr	3.49%	5 yr	2.39%
10 yr	3.06%	10 yr	3.38%	10 yr	3.91%	10 yr	2.88%
30 yr	3.32%	30 yr		30 yr	4.38%	30 yr	3.66%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	-2.15%	4.87%
S&P 500 (Large Cap)	-1.55%	4.10%
S&P 400 (Mid Cap)	-0.86%	-0.53%
Russell 2000 (Small Cap)	-1.38%	0.54%
NASDAQ Composite	-2.09%	6.01%
MSCI EAFE (International)	-0.71%	-8.66%
iShares Real Estate	0.37%	2.36%

U.S. stock fell last week, albeit off the weekly lows following rallies on Thursday and Friday. Materials and Real Estate were the only two of the eleven major sector groups to post gains – Consumer Discretionary, Telecommunications, and Technology were the worst three performing sectors.

Shares of Nvidia tumbled -19% on Friday following the company's Q3 earnings update and guidance for Q4 which came in about 21% below consensus estimates. Management has indicated it may take 1-2 quarters to work through the inventory headwind.

JPMorgan and Oracle rose on Thursday after the latest 13-F filing from Warren Buffett's Berkshire Hathaway showed the famed investor had taken a new position in both companies. Berkshire disclosed a 41.1 million share stake in Oracle and a position in JPMorgan worth $4 billion.

Ned Davis released a report last week noting that seasonality for Thanksgiving week is typically bullish. Since 1952 the Wednesday and Friday of Thanksgiving week have been positive 75% of the time with average gains of about 0.3%. However, the study noted the market usually struggles on the Monday after Thanksgiving with positive returns only 42% of the time with an average loss of -0.3%.

Crude oil fell last week continuing its recent drawdown from its recent highs reached in early October. Bespoke issued a note on crude last week pointing out that from its closing high on October 3, WTI has dropped over -20% and is now in a bear market. Crude had a 20% decline in June 2017 and a 22% decline in July/August 2016. While the current drawdown is not unprecedented in recent history, the consistency of declines is. This past week, WTI broke a stretch of 10 straight lower closes which is a record pace going back all the way to 1983.

According to data from FactSet, with 92% of the companies in the S&P 500 reporting actual results for the quarter, 78% of companies have reported a positive EPS surprise and 61% have reported a positive sales surprise. For Q3 2018, the blended earnings growth rate for the S&P 500 is 25.7%. If 25.7% is the actual growth rate for the quarter, it will mark the highest earnings growth since Q3 2010.

Bespoke issued a report last week on the technical profile of the S&P 500. The firm noted that Monday's decline last week was the first time the S&P 500 fell and closed below its downward sloping 200-day moving average in more than 2 ½ years. Prior periods where the S&P 500 has dropped and closed below a downward sloping moving average have typically been followed by lower than average returns over the following one, three, six, and twelve months.

For the holiday shortened week ahead, we will see most corporate action taking place early in the week with the markets closed on Thursday and a shortened trading day on Friday. Some of the notable reporters include Best Buy, Kohl's, Foot Locker, and John Deere. On the economic front we will see NAHB housing numbers on Monday and Housing Starts and completions on Tuesday. Wednesday will have durable goods orders and PMI on Friday.

Despite losses last week, the technical picture for the S&P 500 did not materially change. We continue to watch support for the index at 2700 and then the 2580-2595 range. Resistance for the S&P remains at 2815 and then at 2870 – the index closed last week at 2736.

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	Unfavorable
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Neutral
Real Estate	Neutral
Commodities	Unfavorable

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

Cash - Neutral weighting now that Fed Funds rate is above 2%. Any exposure is for defensive positioning or liquidity needs.
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 floating rate securities.
Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.
High Yield Bonds - Spreads have tightened considerably and do not warrant exposure to unnecessary credit risk when compared to Treasuries.
International Bonds - Foreign bonds offer good diversification qualities and higher yield opportunities, however, risks have been elevated recently and investment should be made cautiously.
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 continues to be a more favorable style and should be overweighed versus Value.
Mid Cap Stocks - Mid cap exposure remains an attractive market capitalization. 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. However, trade uncertainty and dollar strength provides a headwind for EM in the near term.
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. Volatility will be higher and commodities will be susceptible to short-term price shocks, however, if used in conjunction with other asset classes, risk can be reduced substantially within a diversified portfolio. Used alone though 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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