

FINANCIAL MARKETS COMMENTARY

JUNE 2018



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SECOND QUARTER HIGHLIGHTS

Global growth continued and remains on track to exceed 4.0% this year despite longer term headwinds including poor demographics, the advent of selective Quantitative Tightening and potential trade wars.

U.S. growth might hit 4.0% in the second quarter as stimulus attributable to increased government spending and tax cuts fosters continued growth.

International stock and bond markets generally rose during the quarter in local currency terms, but the rising dollar versus other currencies created largely negative foreign returns to U.S. investors. Emerging markets were the only exception; submerging on the implications of trade rhetoric.

U.S. stocks performed well with small caps continuing to outperform large and growth strategies continuing to trounce value. U.S. credit was mostly positive as rates pulled back somewhat. Alternatives and real assets were broadly mixed globally.

INDEX RETURNS AS OF 6/30/2018

BASIC INDEX RETURNS

	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
BALANCED INDEX (50% ACWI, 35% US Gov. Cr 1-5, 5% HFRX, 5% commodity, 5% bill)	-0.46%	0.38%	-0.26%	13.55%	27.14%	41.49%
HFRX GLOBAL HEDGE FUND INDEX	-0.19%	0.17%	-0.85%	2.50%	6.76%	-3.89%
CPI - SEASONALLY ADJUSTED	0.10%	0.43%	1.06%	5.36%	7.55%	15.20%
S&P 500 COMPOSITE	0.62%	3.43%	2.65%	40.23%	87.70%	163.39%
LIPPER LARGE - CAP CORE	0.52%	3.05%	1.81%	36.18%	76.55%	136.64%
WISDOM TREE LARGE CAP DIVIDEND	0.46%	2.09%	-1.18%	35.38%	73.30%	158.65%
MSCI ALL COUNTRY WORLD INDEX NET	-0.54%	0.53%	-0.43%	26.62%	56.79%	75.68%
MSCI EAFE NET	-1.22%	-1.24%	-2.75%	15.43%	36.62%	32.36%
BLOOMBERG BARCLAYS MUNICIPAL BOND 5Y (4 - 6)	0.27%	0.87%	0.30%	4.93%	10.79%	40.46%
BLOOMBERG BARCLAYS US AGGREGATE	-0.12%	-0.16%	-1.62%	5.25%	11.89%	44.09%
BANK OF AMERICA / MERRILL LYNCH US T - BILL 3MONTH	0.17%	0.46%	0.81%	2.05%	2.12%	3.59%

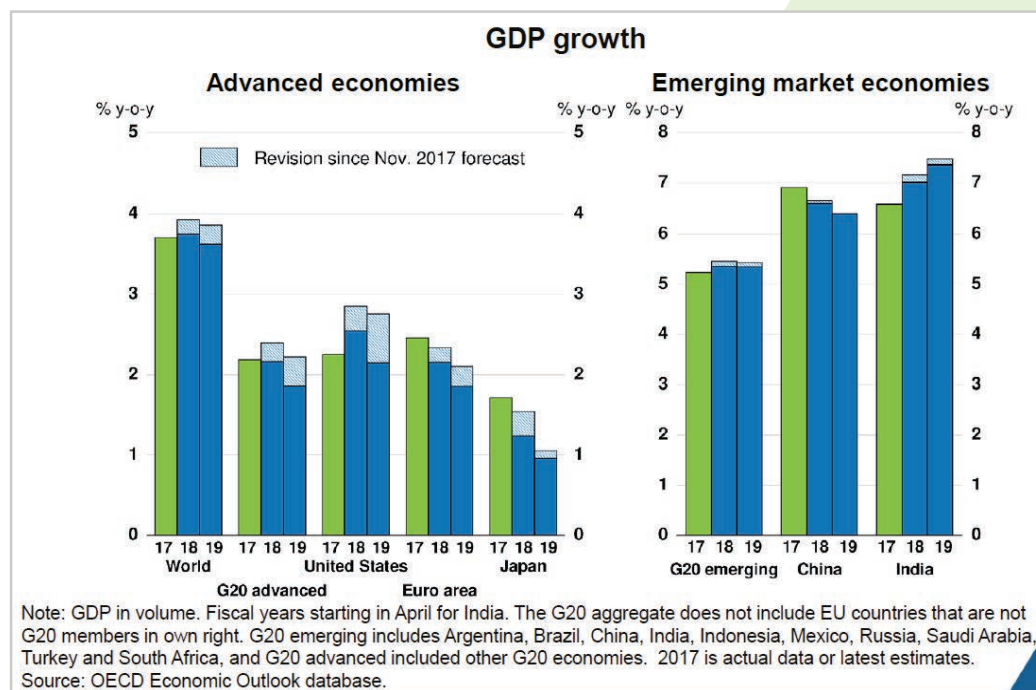
EXTENDED INDEX RETURNS

	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
RUSSELL 1000 GROWTH	0.96%	5.76%	7.25%	51.98%	113.26%	205.77%
RUSSELL 1000 VALUE	0.25%	1.17%	-1.69%	26.88%	63.57%	125.91%
RUSSELL MIDCAP GROWTH	0.39%	3.16%	5.40%	35.75%	87.27%	170.24%
RUSSELL MIDCAP VALUE	0.81%	2.41%	-0.16%	28.79%	70.57%	160.88%
RUSSELL SMALL CAP COMP GROWTH	1.07%	6.09%	9.08%	38.46%	98.57%	198.46%
RUSSELL SMALL CAP COMP VALUE	0.58%	5.71%	3.12%	31.57%	66.24%	152.04%
MSCI EM (EMERGING MARKETS) NET	-4.15%	-7.96%	-6.66%	17.75%	27.71%	25.00%
BLOOMBERG BARCLAYS US TREASURY BILL 6 MONTH	0.18%	0.50%	0.84%	2.66%	3.00%	6.65%
BLOOMBERG BARCLAYS US AGENCY	-0.04%	0.00%	-0.53%	3.36%	7.82%	29.52%
JP MORGAN EMERGING MARKET BOND INDEX(EMBI) + COMPOSITE	-1.03%	-4.14%	-6.09%	12.40%	21.88%	82.26%
CITI GROUP WORLD GOVERNMENT BOND	-0.28%	-3.35%	-0.94%	8.68%	5.65%	22.70%
BLOOMBERG COMMODITY	-3.50%	0.40%	0.00%	-13.00%	-28.17%	-61.25%
ALERIAN ENERGY MLP	-1.54%	11.80%	-0.63%	-16.76%	-18.86%	87.01%
PHILADELPHIA STOCK EXCHANGE GOLD / SILVER	-2.08%	0.58%	-4.32%	29.22%	-9.50%	-58.21%
LIPPER GLOBL NAT RES	-0.91%	5.16%	0.28%	12.39%	6.83%	-33.35%
LIPPER PRECIOUS METAL FUND	-0.73%	0.87%	-6.52%	21.16%	1.41%	-41.68%
MSCI WORLD REAL ESTATE	1.43%	3.17%	-0.76%	19.98%	35.96%	60.46%
LIPPER REAL ESTATE FUND	3.28%	7.10%	0.16%	23.22%	42.80%	72.05%

Note: The data is cumulative not annualized. All data in U.S. dollars.

THE GLOBAL ECONOMY – SYNCHRONIZED EXPANSION CONTINUES BUT RANGE OF OUTCOMES WIDENS

Global growth should continue to expand through at least 2019 despite myriad concerns. This position is supported by the Organization for Economic Cooperation and Development [OECD] and International Monetary Fund [IMF]. Both have revised their world growth projections upward this year. The IMF expects global growth of approximately 3.9% this year and next while the OECD is a bit more optimistic, forecasting 4.0% global growth in 2018 and 4.1% in 2019. To be sure, this growth rate is substandard in an historical context, but a welcome development in the world post-2008. The upswing is attributable to the larger than expected surge of growth witnessed in the back half of 2017 and continuing across the developed world even now. The United States is the primary developed-world contributor but the Eurozone, Japan, and indeed most of the G20 are exceeding expectations as well. The light blue shading in the chart reflects growth revisions in the OECD forecast occurring just since their November, 2017 projections.



Source: OECD Interim Economic Outlook March 2018

THE GLOBAL ECONOMY - SYNCHRONIZED EXPANSION CONTINUES BUT RANGE OF OUTCOMES WIDENS

The entire G20 is growing, albeit at fluctuating paces for 2018 and 2019.

Real GDP growth							
Year-on-year, %							
	2017	2018	2019		2017	2018	2019
World	3.7	3.8	3.9	G20	3.8	4.0	4.1
Australia	2.3	2.9	3.0	Argentina	2.9	2.0	2.6
Canada	3.0	2.1	2.2	Brazil	1.0	2.0	2.8
Euro area	2.6	2.2	2.1	China	6.9	6.7	6.4
Germany	2.5	2.1	2.1	India¹	6.5	7.4	7.5
France	2.3	1.9	1.9	Indonesia	5.1	5.3	5.4
Italy	1.6	1.4	1.1	Mexico	2.3	2.5	2.8
Japan	1.7	1.2	1.2	Russia	1.5	1.8	1.5
Korea	3.1	3.0	3.0	Saudi Arabia	-0.7	1.6	2.1
United Kingdom	1.8	1.4	1.3	South Africa	1.3	1.9	2.2
United States	2.3	2.9	2.8	Turkey	7.4	5.1	5.0

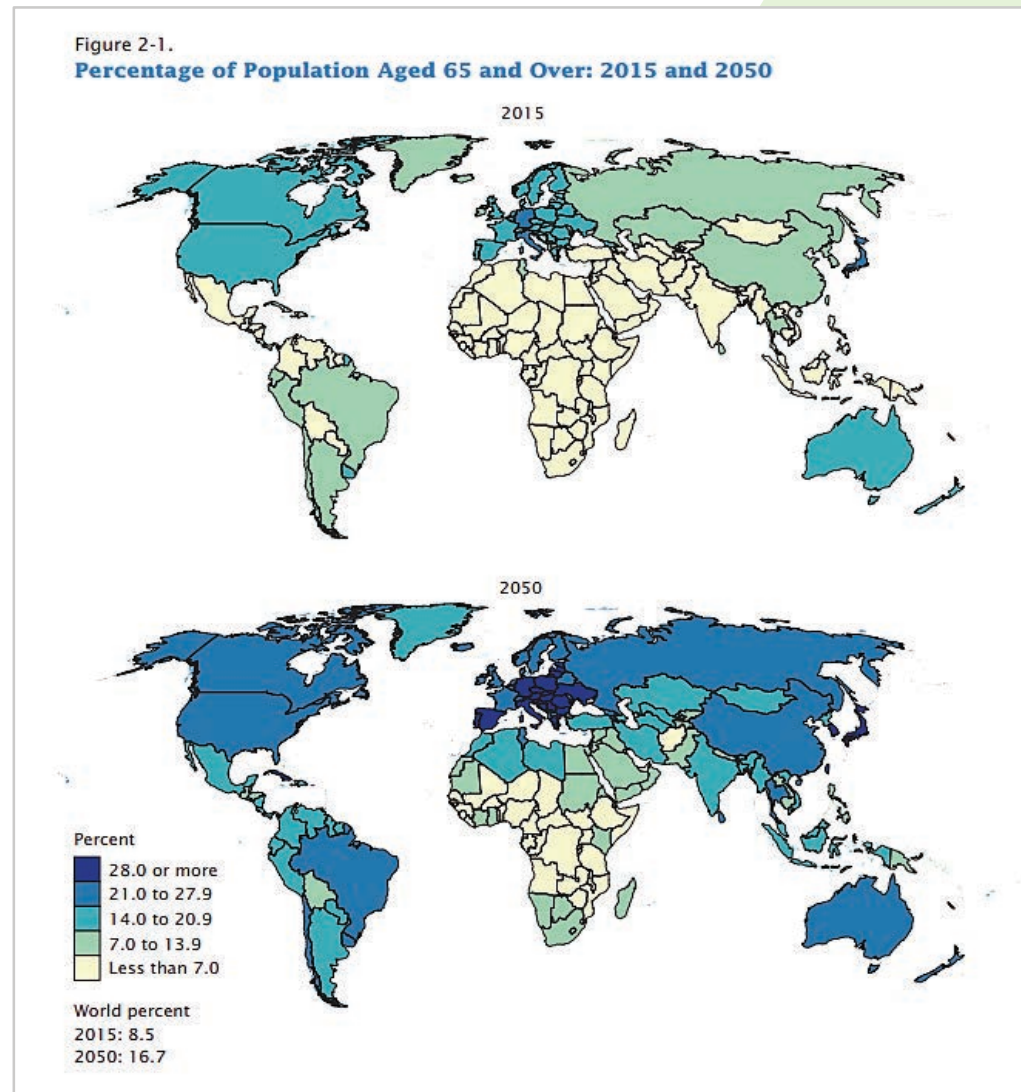
Note: The European Union is a full member of the G20, but the G20 aggregate only includes countries which are also members in their own right.
1. Fiscal years starting in April.

Source: OECD Interim Economic Outlook May 2018

Globally, unemployment has fallen and is below or near levels last seen before the 2008 crisis. Fiscal policy is loosening and business investment is strong. This is a remarkably positive achievement given that the world was close to Depression nine years ago. However, structural issues point towards normalization at lower worldwide growth levels in the future. By late 2019-2020, we expect the tailwinds to wane and the headwinds to gain strength. The sea-change in demographics is spreading beyond the developed world.

THE GLOBAL ECONOMY – SYNCHRONIZED EXPANSION CONTINUES BUT RANGE OF OUTCOMES WIDENS

The aging of the world will continue to moderate longer-term growth. “Specifically, productivity-enhancing reforms have become urgent as the pressures on potential growth from aging populations intensify.” Ayhan Kose, Development Economics Prospects Director, World Bank. While interest rates remain low they are rising in some countries, notably the U.S.; the world debt burden is growing; the rate of Quantitative Easing is slowing; inflation has perked up slightly, but for now it remains quiescent. And, despite great gains in employment, an unprecedented stagnation in wages persists globally. Wage stickiness has caused commentators to question the continued validity of the Phillips Curve, which we all learned in Econ 101, says that when employment is full, wages will rise. Finally, there are ever-present more transient issues which can have a substantial impact. Like trade and tariffs...



Source: An Aging World: 2015 International Population, March 2016

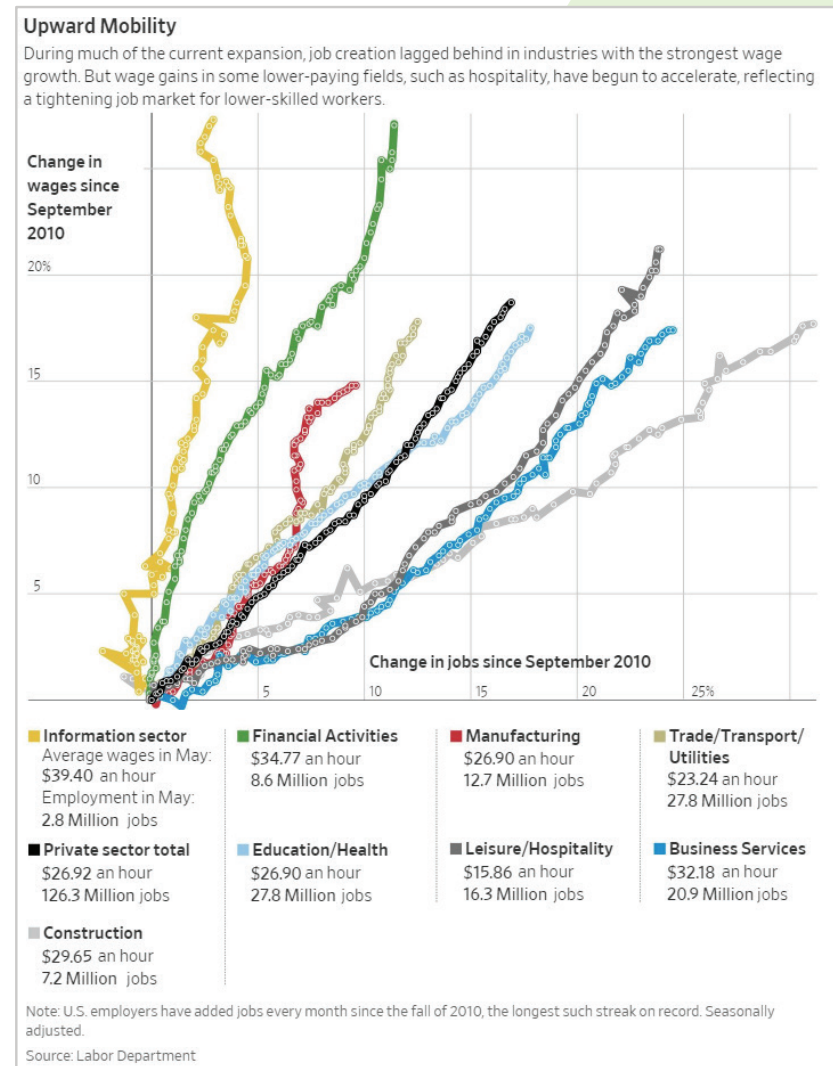
THE GLOBAL ECONOMY – SYNCHRONIZED EXPANSION CONTINUES BUT RANGE OF OUTCOMES WIDENS

President Trump's jawboning progressed into the possibility of a global trade war this month. Garden-variety trade wars typically engender higher prices, falling availability of goods and lower economic output. If the rhetoric is indicative, this trade war could be far more destructive. First, businesses are reeling in all directions, wasting time and productivity. The non-linear results are already manifest. Just in the U.S. Whirlpool added 200 jobs in Ohio in advance of imposition of tariffs on imported washing machines, while corporations with U.S. manufacturing facilities such as BMW AG and General Motors are looking to move production (and jobs) from our shores. Secondly, trade accounts for a substantial amount of growth and impairment could impede much recent progress. Trade has risen to slightly more than 30% of global GDP and slightly more than 25% of U.S. GDP. "Changes in trade policy could cause us to question the [economic] outlook" according to Federal Reserve Chairman Jerome Powell at a recent European Central Bank conference.

However, there is a widely held belief in the investment community that President Trump leads with ballistics and concludes with compromise. Hence the equanimity of U.S. markets, although foreign bourses, particularly in Asia, have not been so sanguine. There is no doubt that these tactics have achieved short term results, as Tesla opens in China without the previously obligatory Chinese partner and Shanghai, days ago, sped up the cancellation of foreign ownership limits which have hobbled American businesses for decades. The question is whether real, long term reforms can be accomplished before too much damage is done.

THE U.S. ECONOMY – PEDALING FASTER THAN EXPECTED

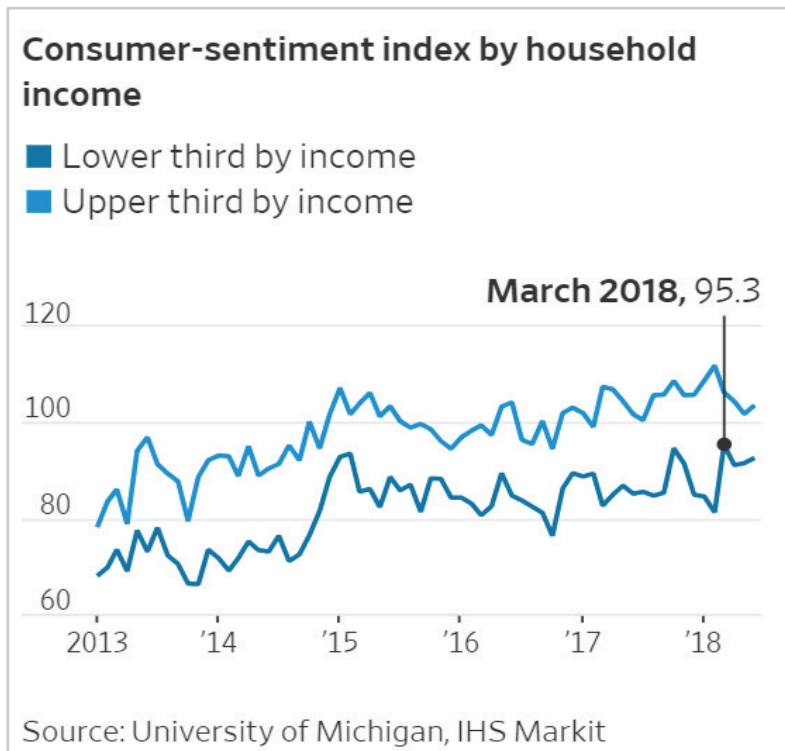
First quarter growth came in around 2.0%, better than recent adjustment-challenged first quarters seen over the past few years. Second quarter growth was expected to see a resumption of 2017 momentum but projections have been rising. The Conference Board projects 4.2% in the second quarter on the back of the twin fiscal stimuli of government spending and tax cuts. Most forecasters have also raised their full year and 2019 projections for U.S. growth. The OECD thinks America will grow at a 2.9% rate for 2018 and a 2.8% rate for 2019 while the Conference Board projects 3.1% growth for both years. Tax cuts have put money in the pockets of consumers and businesses alike bolstering retail sales and business investment. The jobless rate in the United States has plummeted to an eighteen-year low, and while it recently climbed from 3.8% to 4.0%, the increase was attributable to 600,000 workers, many formerly discouraged, joining the labor force in June. As well, many industries are reporting acute labor shortages, although in a peculiar twist, the wage gains in these fields remain inconsequential. However, the growth in jobs and wages during this expansion is clear.



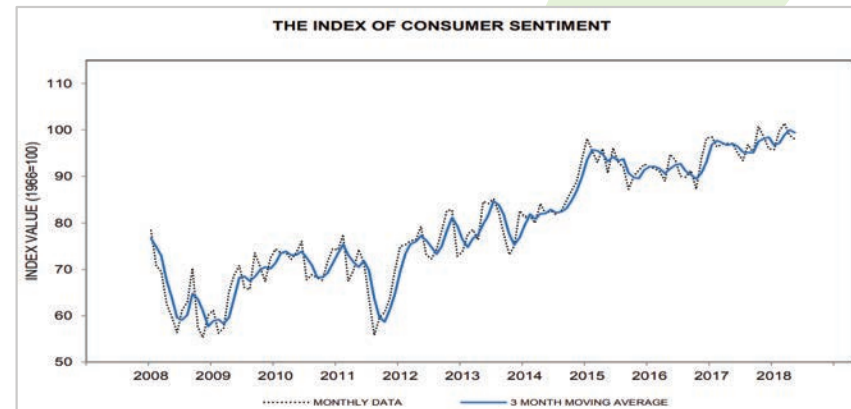
Source: Wall Street Journal, June 1, 2018, "Unemployment Rate Falls to 18-Year Low; Solid Hiring in May"

THE U.S. ECONOMY - PEDALING FASTER THAN EXPECTED

Household net worth has surpassed prior highs. Bolstering already elevated consumer sentiment.



Source: : Wall Street Journal, June 18, 2018, "Economic Confidence Rises Among Lower-Income Americans"



Source: University of Michigan, May 2018

Sentiment should be able to drive growth for a year or two more but the economic expansion is the second longest on record and, the impact of one-time increases in government spending and tax cuts should lessen just about the time that the seventh inning comes into view.

INTEREST RATES AND BONDS

Interest rates in many developed countries have pulled back somewhat from their 2018 highs. Countries with issues such as Italy and Turkey however, have seen rates rise further. While developing countries, despite inflammatory rhetoric, have only seen small negative bond market returns due to recent trade and currency issues. While it is no secret that our Fed is attempting to normalize rates, having hiked the Fed funds rate in quarter point increments seven times since 2015, it has stated that its moves are data dependent. Consequently, we see possibly two more hikes in 2018 but expect the upward trajectory to slow as world demographics and an aging expansion conspire to limit further increases. Neither the 10 year Treasury nor the 30 year Treasury have decisively pierced and remained above their 2013 taper-trantrum highs. This is our acid test for calling an upward reversal of more than forty years of falling rates.

However, the explosion of government and corporate credit is of longer-term concern. Should confidence in one or more players be compromised, the world could begin to demand higher rates for lending that entity money at exactly the time that entity can least afford to pay. Additionally, the speed at which central banks begin to reduce Quantitative Easing and embark upon Quantitative Tightening might be another factor in what happens to global rates. The sums are enormous and the potential impact on fixed income markets cannot be overstated. The United States has stopped QE and begun QT. The ECB plans to halt QE at the end of this year. As the chart below reflects, this will remove a significant percentage of QE growth from the global system. Since market returns are highly correlated to money-printing we expect, all else equal, more volatility and reduced returns as Central banks try to restore normalcy.



Source: Thomson Reuters Datastream

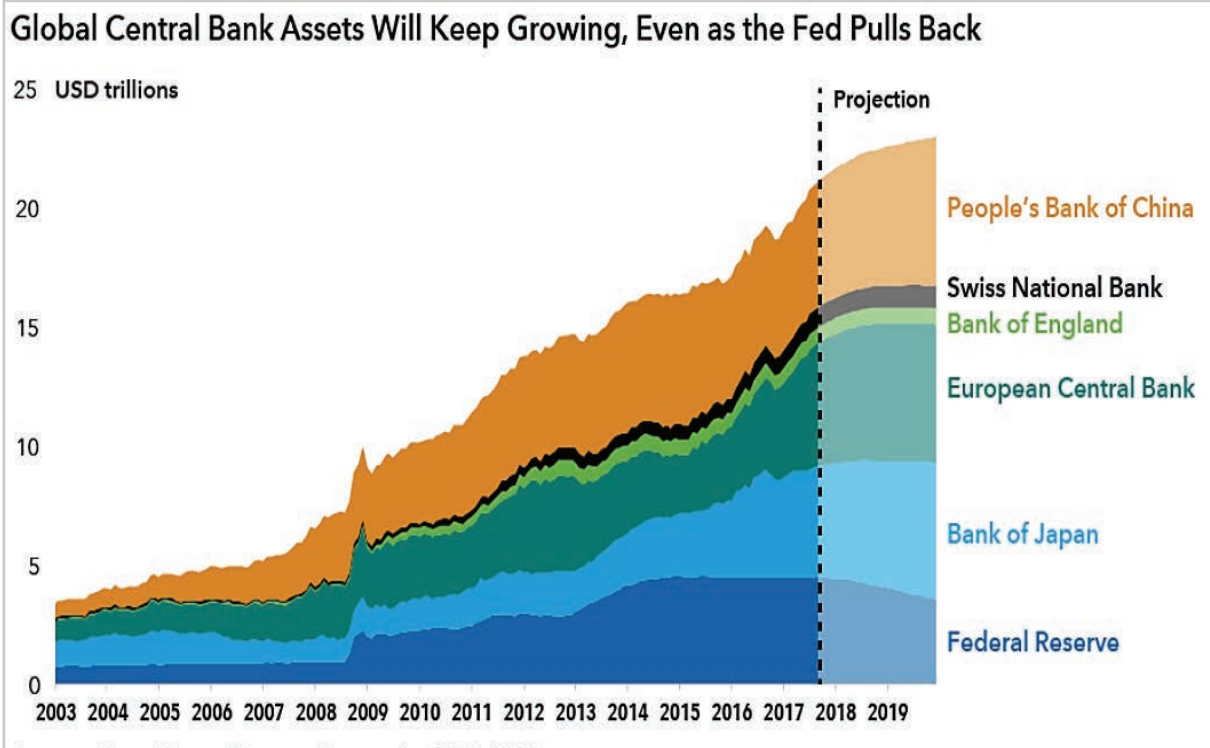
Through June 2018



Source: Thomson Reuters Datastream

Through June 2018

INTEREST RATES AND BONDS



Source: Capital Group, Thomson Reuters. As of 08/31/2017.

MARKET REVIEW

The markets have not disappointed our low expectations for this year. The reduction in the growth of worldwide QE will continue to deflate returns at the margin and result in the additional volatility extant. However, market overreactions will continue to provide good immediate and longer-term opportunities in asset classes, sectors and individual names. The U.S. and global economies remain strong despite headwinds from tariff troubles. Perspective is paramount. As Roseanne Danna would say, “It’s always something”, and there will always be something to worry about in the world. According to Factset, corporate earnings will grow 18.9% year-over-year in this second quarter. Importantly, revenues continue to grow with Factset estimating 8.6% revenue growth for the quarter and high double-digit earnings increases for the remainder of the year. The forward PE ratio is 16.2% which is under the earnings growth expected for the year making valuations reasonable. However, markets are forward looking and, it is likely that earnings growth is peaking so future valuation is critical. Returns for most asset classes have been positive but uninspiring.

EQUITIES

Energy, technology and small caps led the quarter in the U.S. while industrials fell broadly on tariff concerns. Israel, Canada and Australia led international equity markets (local currency) and did better than the U.S. Brazil, Turkey and Ukraine performed the worst on country specific issues. Do not be confused by positive and negative returns shown variously for the same international bourses. During the quarter, international returns were generally single digit positive in local currencies but U.S. investors that had international exposure via unhedged strategies, lost money despite being directionally correct. Throughout the world growth strategies continued to lead value strategies. The reason is not a mystery. Valuations have compressed so much in recent years that there is very little distinction between the two strategies. Accordingly, value, in many cases now tends to imply 'slow-growing' or 'turnaround' in many instances. Given that PE's are close, the 'growth' companies are actually growing faster and sport lower PE's.

In the U.S., small caps continued to outperform large. During the quarter, the Russell Microcap Index surged +9.97%; the S&P 500 gained +3.43%; the Russell 1000 Growth advanced +5.76%; and the Russell 1000 Value eked out a +1.17% return. High dividend payers continued to underperform, gaining only +2.09%, as they suffer both a bond and value taint. For an unhedged U.S. investor, Europe was down -1.27%, EFA lost -1.22%, emerging markets fell -4.15% and frontier markets were down -3.54%.

The second quarter really 'made' the year-to-date as approximately 70% of gains for positive positions were accomplished during this period while year-to-date losses were smaller as a result of the second quarter.

For the year, the Russell 1000 Growth Index is up +7.25% while its value counterpart is down -1.68%. The Russell Midcap Growth Index is up +5.40% while its value counterpart is down -0.16%. Microcaps have climbed +10.72% this year, while the S&P 500 is up +2.65%. Conversely, international equities for dollar investors just continued to experience losses although the underlying markets were positive. In dollar terms, EAFE is -2.75% and Europe lost -3.23%. Only emerging and frontier markets annual returns were deep-sixed by their returns this quarter. For the year, emerging markets have fallen -6.66% and frontier markets are down -10.87%.

FIXED INCOME

Fixed income returns during the quarter were modestly positive as interest rate increases continued to be more subdued than some had projected. Municipal bonds are slightly ahead of their Treasury and credit counterparts and gains were seen in shorter durations with losses in longer durations. This pattern held for the quarter and for the year. In the quarter, three-month T-bills were up +0.81%, the 1-3 year Barclays Gov/Credit was up +0.11 and, 3 year municipals were up +0.76%. Floating rate paper climbed +0.73% while high yielders were up +1.03%. The Barclays U.S. Credit Long Bond lost -2.65% while the Citigroup World Government Bond Index fell -3.35% primarily on currency for U.S. investors, and EMBI lost -4.14%, in fact, and on currency.

Year-to-date returns are mostly modestly lower and negative returns were correlated to higher durations. 1-3 year Treasuries are up +0.05%, 3 year municipals have gained +0.73% and 1-3 year corporate paper is up a skinny +0.11%. The 10-20 year Treasury Index is down -2.61% and the 10 year Municipal Index has lost -0.77%. TIPS are down only -0.07%, high-yielders have gained a scant +0.24% while emerging market paper is down -6.09% of which over half is currency.

REAL ASSETS

The returns of real assets varied widely in the quarter and some were arguably impacted by trade rhetoric. Hog prices climbed over 40% while wheat and crude oil prices gained over 10%. U.S. real estate gained over 7% but many other real assets lost value. Silver, copper and gold lost -0.73%, -2.25% and -5.41% respectively while corn dropped -9.67%. Hard asset traditionally do well during rising interest rate cycles and provide portfolio diversification. At the moment however, rates aren't rising in many places excepting the U.S. and Canada. For this year, crude oil has been the star performer as everyone with a car is aware! The HFRX Energy Index is up +13.49% while West Texas Intermediate oil is up almost 23%. However, REIT's are up a paltry +1.82%, commodity metals as a group are down -4.26% and, the Philly Stock Exchange Gold/Silver Index is down 4.32%. Highly touted and formerly well-performing infrastructure has not been a panacea, losing -0.6% for this year. Select positions in this sector appear very attractive following their first-quarter slump. U.S. home prices continue to chug along as the S&P Case Shiller 20-City Composite logged a 6.6% year-over-year gain through May.

ALTERNATIVES

Alternative returns for the second quarter were broadly mixed in a mostly narrow range. The HFRI Fund of Funds Index was up +1.07% while the HFRX Global Hedge Fund Index eked out a +0.17% return. Event Driven led the muted pack with a +2.26% gain, Relative Value provided a +1.24% return and Macro lost -0.21%. The full year was not much better. The HFRI Fund of Funds Composite gained +1.35%, and the HFRX Global Hedge Fund Index actually lost -0.85%. Event Driven continued to lead, providing a muted +2.37% for the six months through June and, Macro has lost -1.81% as the unpredictable came true.

CURRENCIES

Currencies was where the action was! The dollar gained +4.98% in the second quarter as virtually all other currencies lost. The Canadian dollar fell -1.77%, the Japanese yen lost -4.03%, the Chinese yuan declined -5.00% and the Euro fell -5.20% (as the potential impacts of trade wars roiled foreign currencies, and particularly those of the emerging markets). The U.S. dollar has been bolstered by the fact that we are raising interest rates when most countries are not. Hence, strong international returns in the first quarter (for U.S. investors) became losses for the year for U.S. investors, even as international markets sported positive performance. For the year, the dollar gains are a modest +2.73%.

CONCLUSIONS

The pervasive issues of the global debt buildup, the beginning of quantitative tightening and how to navigate what is likely to be the 7th inning of this global economic and asset boom loom large. It is appropriate to continue to focus on valuations and the potential return for each unit of risk taken. Yet, no immediate gross imbalances are apparent and the global economy continues apace. So we continue to focus on the propriety of our asset allocations to our goals, act a little more quickly to pare positions which have hit targets and postulate much lower growth into investments that interest us.



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