MARKET REVIEW & COMMENTARY

JULY 2018

TELEMUS®

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MARKET REVIEW

JULY

July was a good month for most flavors of stocks and bonds as financial markets ignored tariff tantrums and moved toward prior highs. The month reversed many of the dynamics which characterized the prior month and quarter. Stocks rose broadly, chalking up between 20%-50% of their gains for the year. However, unlike the past month, value outperformed growth across capitalizations, large caps beat small caps uniformly and foreign bourses rallied. Unlike last month, most bonds rallied. However, the behavior of fixed income was more nuanced. While municipals and corporates rallied, Treasuries- from bills to long bonds, lost value. It is likely that the looming tsunami of U. S. debt issuance dragged down the prices (and bumped up the yields) of all Treasury paper. Alternatives were mostly positive. Real assets were mostly negative, and the performance was lumpy as tariffs impacted supply and demand.

Specifically, the S&P500 rose +3.72%, large cap growth was up +2.94% while large cap value increased +3.96%, beating growth by a full percent. Mid cap growth gained +2.15% while mid cap value increased by more, up +2.72%. Small cap growth gained a more modest +1.27% while its value counterpart rose +1.67%. In a reversal, high dividend payers gained the most, up +4.04% as safety trumped interest rate sensitivity. International markets were positive in fact and in dollars, with Europe up +3.33% and EAFE up +2.46%. Emerging markets rose +2.20% and frontier markets were up +3.67% as currency and, trade issues receded for the moment.

U.S. fixed income returns followed duration up during the month excepting Treasury paper which was uniformly negative excepting the shortest, 3 month T-bills, which eked out a +0.16% positive return. Municipals slightly outperformed credit and both were modestly positive across the curve. Specifically, 1-5 year government/credit rose +0.22% while 1-5 year municipals gained +0.32% and 1-5 year Treasuries lost -0.10%. The Bloomberg Barclays long credit index soared +1.50% while 10 year municipals gained +0.38% and the Bloomberg Barclays long Treasury index sunk -1.47%. TIPS lost -0.48% as inflation awareness waned while high yielders gained +1.09%, almost their entire return for the year, as investors focus on elevated debt levels near the end of the cycle. World bonds were down -0.41%, in dollar terms but emerging market debt zoomed up +1.92%.

Alternatives were mostly positive with the HFRI Fund of Funds Composite Index up +0.12%, the HFRI Hedged Equity Index gaining +1.05%, Quantitative Directional rising a strong +1.96%, Event Driven gaining +0.50%, and Distressed up +1.63%. The HFRX Global Hedge Fund Index was down -0.15% while Macro continued to lag, losing -0.46%. Real assets were mostly down but mixed. The Bloomberg Commodity Index lost -2.13% in the month, The Philly Stock Exchange Gold/Silver Index plunged -5.26%, crude oil lost -3.80% and the dollar dipped a modest -0.15%. On the plus side, global natural resources appreciated +1.22%, global real estate was up +1.15% and U.S. real estate gained +0.54%.

MARKET REVIEW

YEAR-TO-DATE

Going nowhere fast! The recent choppy market action is reflective of the tug-of-war across the global economy. The global economy is humming but quantitative tightening is constrictive. U.S. tax cuts are expansive but raising U.S. interest rates is restrictive. Finally, trade tantrums are disconcerting, on any given day benefiting and harming a plethora of businesses, goods and groups. With many markets approaching prior highs this remains a fine time to use volatility to refine and rebalance our portfolios back to targets. The gap between the returns of 'growth' and 'value' stocks has lessened but continues. U.S. growth stocks are up between +10.46% (small cap growth) and +10.40% (large cap growth). U.S. value stocks on the other hand have returned between +4.48% (small cap value) and +2.20% (large cap value). The S&P500 is positive year-to-date, up +6.47%, high dividend payers are up a more modest +2.81%, and the tech heavy NASDAQ has gained +11.77%. International bourses, which had appeared ready to lead the performance derby early in the year, have lost their edge (in dollar terms). For the year-to-date EAFE is down -0.36%, and Europe has fallen -0.01%. Frontier and emerging markets while economically strong, have been hit with currency and trade issues. Year-to-date frontier markets are down -7.60%, and emerging bourses are down -4.61% (in dollar terms).

Fixed income returns remain modestly negative, but bonds have not experienced the Armageddon predicted by many. While the Fed is raising the short rate it controls, our Treasuries pay more and are safer than most other countries' government paper. Hence, the laws of supply and demand dictate that foreign and institutional buying will continue to sop up much of the supply at or near current rates unless / until rates rise across the globe. However, looming supply has recently caused Treasury yields to rise a bit (prices to fall) out of sync with their corporate and municipal counterparts. Municipal bonds have had the smallest declines as supply is slow and demand is high. Credit has performed in the middle but investors have begun to distinguish between the strong and the weak as concerns about prospects for over-leveraged companies near the end of the cycle, mount. In general, returns continue to follow duration lower. One-three year Treasuries are up +0.04%, 3 year municipals are up +1.08% and 1-3 year corporate paper gained +0.30%. The 10-20 year Treasury Index is down -2.61% while the Bloomberg/Barclay Municipal 10yr Index has lost -0.35% year-to-date. TIPS are down only -0.51%, reflecting the tug-of-war between the growth of inflation-aware sentiment and longer duration. High yield bonds in the U.S. are up +1.25%, while emerging market paper is down -4.29% as currency and interest rates become bigger global issues.

INDEX RETURNS AS OF 7/31/2018

BASIC INDEX RETURNS

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)	1.41%	1.41%	1.14%	15.19%	25.63%	46.30%
HFRX GLOBAL HEDGE FUND INDEX	-0.15%	-0.15%	-1.00%	2.38%	5.54%	-1.25%
CPI - SEASONALLY ADJUSTED	0.00%	0.00%	1.19%	5.36%	7.52%	14.50%
S&P 500 COMPOSITE	3.72%	3.72%	6.47%	42.46%	85.26%	175.51%
LIPPER LARGE - CAP CORE	3.98%	3.98%	5.86%	39.09%	74.92%	149.59%
WISDOM TREE LARGE CAP DIVIDEND	4.04%	4.04%	2.81%	39.30%	73.08%	164.06%
MSCI ALL COUNTRY WORLD INDEX NET	3.02%	3.02%	2.57%	29.32%	54.14%	85.81%
MSCI EAFE NET	2.46%	2.46%	-0.36%	15.87%	32.96%	40.12%
BLOOMBERG BARCLAYS MUNICIPAL BOND 5Y (4 - 6)	0.39%	0.39%	0.69%	4.79%	10.54%	39.06%
BLOOMBERG BARCLAYS US AGGREGATE	0.02%	0.02%	-1.59%	4.55%	11.77%	44.24%
BANK OF AMERICA / MERRILL LYNCH US T - BILL 3MONTH	0.16%	0.16%	0.97%	2.21%	2.27%	3.57%

EXTENDED INDEX RETURNS

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	2.94%	2.94%	10.40%	51.31%	108.47%	220.85%
RUSSELL 1000 VALUE	3.96%	3.96%	2.20%	31.32%	61.33%	135.70%
RUSSELL MIDCAP GROWTH	2.15%	2.15%	7.66%	36.46%	80.09%	186.94%
RUSSELL MIDCAP VALUE	2.72%	2.72%	2.56%	32.48%	66.34%	171.09%
RUSSELL SMALL CAP COMP GROWTH	1.27%	1.27%	10.46%	38.51%	85.94%	206.65%
RUSSELL SMALL CAP COMP VALUE	1.67%	1.67%	4.84%	35.64%	59.53%	154.56%
MSCI EM (EMERGING MARKETS) NET	2.20%	2.20%	-4.61%	29.30%	29.17%	32.76%
BLOOMBERG BARCLAYS US TREASURY BILL 6 MONTH	0.15%	0.15%	0.99%	2.81%	3.13%	6.47%
BLOOMBERG BARCLAYS US AGENCY	-0.18%	-0.18%	-0.70%	2.72%	7.62%	28.69%
JP MORGAN EMERGING MARKET BOND INDEX(EMBI) + COMPOSITE	1.92%	1.92%	-4.29%	13.83%	23.50%	82.89%
CITI GROUP WORLD GOVERNMENT BOND	-0.41%	-0.41%	-1.35%	7.72%	3.82%	21.93%
BLOOMBERG COMMODITY	-2.13%	-2.13%	-2.14%	-4.74%	-30.65%	-56.97%
ALERIAN ENERGY MLP	6.58%	6.58%	5.91%	-8.31%	-13.09%	102.80%
PHILADELPHIA STOCK EXCHANGE GOLD / SILVER	-5.26%	-5.26%	-9.35%	62.50%	-21.72%	-54.21%
LIPPER GLOBL NAT RES	1.22%	1.22%	1.50%	24.56%	2.80%	-19.64%
LIPPER PRECIOUS METAL FUND	-3.74%	-3.74%	-10.02%	42.63%	-12.20%	-36.23%
MSCI WORLD REAL ESTATE	1.15%	1.15%	0.38%	17.38%	36.73%	61.23%
LIPPER REAL ESTATE FUND	0.54%	0.54%	0.70%	17.92%	42.28%	68.70%

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

MARKET REVIEW

Alternative returns have been broadly mixed at very low levels. The HFRI Fund of Funds Composite Index is up +0.78% year-to-date, while the HFRX Global Hedge Fund Index is down -1.00%. Hedged Equity strategies are up +2.29%, event Driven strategies have gained +2.52% while Macro strategies have lost -2.19%. Real asset returns have been broadly mixed and volatile. Year-to-date the Brent crude oil is up +10.60%, but metal commodities have lost -4.26%, precious metals are down -6.52% and global real estate has lost -0.76%. The U.S. dollar has capped a roller coaster ride, down in the first quarter, then up in the second with a modest +2.73% year-to-date gain. The U.S. Fed's slow rate increases versus the rest of the world's low rates, bode well for the dollar to increase further but our burgeoning debt weighs the other way.

While the good times may roll for a while longer, thanks to global quantitative easing and a strong U.S. economy, we are probably closer to the end of this cycle than the beginning. Accordingly, paying attention to risk and rebalancing to targets is warranted.

MACRO REVIEW

The tug-of-war between great current economics, mid-late cycle jitters and trade tirades continues. The S&P 500 has moved up steadily of late to challenge this year's previous highs on the back of robust second quarter GDP growth, which exceeded 4%, and outstanding second quarter corporate earnings. According to FactSet, second quarter S&P 500 earnings growth was 24%, only a slight decline from last quarter's eight-year record of 24.7% growth. Approximately eighty percent of reporting companies beat already high estimates. If that number stands through the end of reporting season it will be the highest percentage of companies posting earnings above estimates since FactSet began recording this data in the third quarter of 2008.

Revenue rose a strong 9.8% reflecting that gains in sales, not just cost-cutting, contributed.

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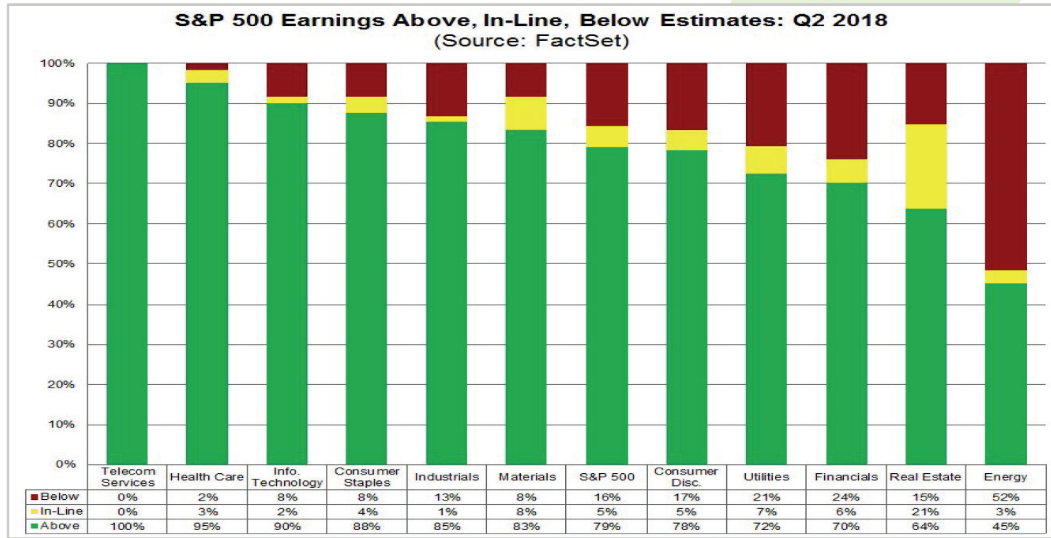
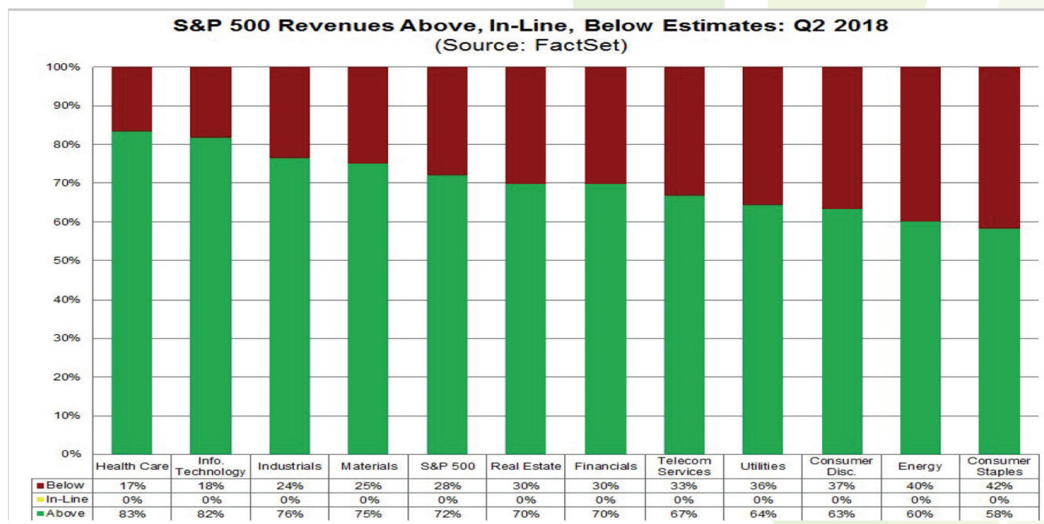


Source: Factset Earnings Insight August 2018

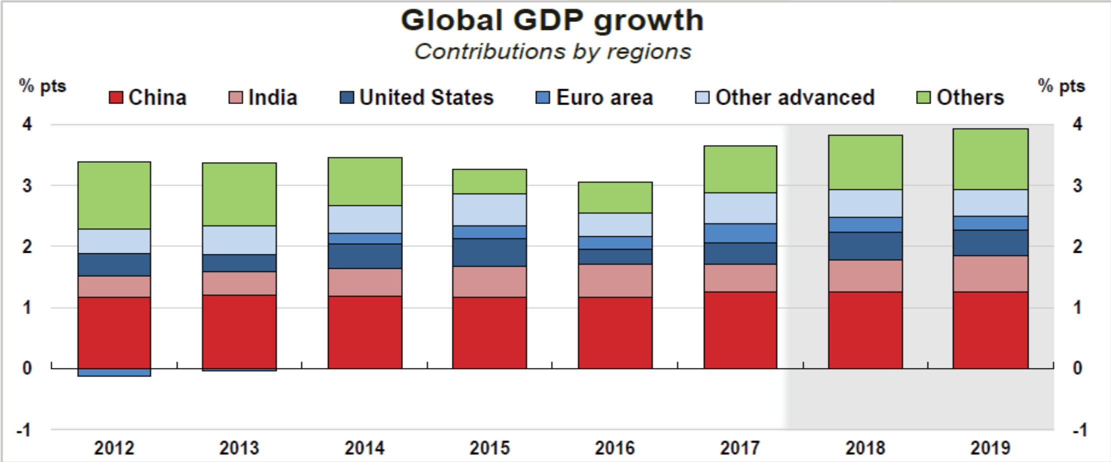


Source: Factset Earnings Insight August 2018

MACRO REVIEW

Earnings growth is expected to stay high but moderate to about 20% through 2018 after which it is expected to slow further but remain in double digits. We think that double digit gains in 2019 will moderate quickly. Accordingly, current valuations are arguably justified by strong, high quality growth, but may be less so 12-18 months out. Since the markets look ahead 6-10 months, valuations may begin to appear stretched.

This bright picture is accentuated by the continuation of synchronous global growth, although uniformity is fraying somewhat. The developed world continues to outperform projections while the developing world is hewing closely to prior projections.



Source: OECD May 2018 Economic Outlook

Consumer and business confidence remains elevated globally although trade tensions have recently dented small business optimism and purchasing managers' indices.

On the other hand, should the bull market last through the end of August, we will find ourselves in the longest bull market in history. Pop the champagne but we are in uncharted territory, much of it courtesy of unprecedented quantities of Quantitative Easing. We are also in the midst of the second longest economic expansion in history. Again, courtesy of the printing of over 33 trillion dollars worldwide. While recent tax cuts are expected to provide a short term jolt, it is more probable than not that this expansion will moderate or end in the next year or two. These records are bumping up against, tightening U.S. interest rates, modest global credit constriction, CPI price increases which have finally moved over 2% and chaos attributable to trade posturing. And then there is debt, a lot of it. A tsunami.

MACRO REVIEW

The Fed has raised the short term interest rates it controls, seven times since the end of 2015, as it has perceived the economy strong enough to withstand some normalization of interest rates and we need this dry powder in case of future economic storms. Short term rates have risen dramatically.

Source: Thomson Reuters Datastream Through July 2018

Source: Thomson Reuters Datastream Through July 2018

MACRO REVIEW

But long term rates have not moved much at all.

Source: Thomson Reuters Datastream Through July 2018

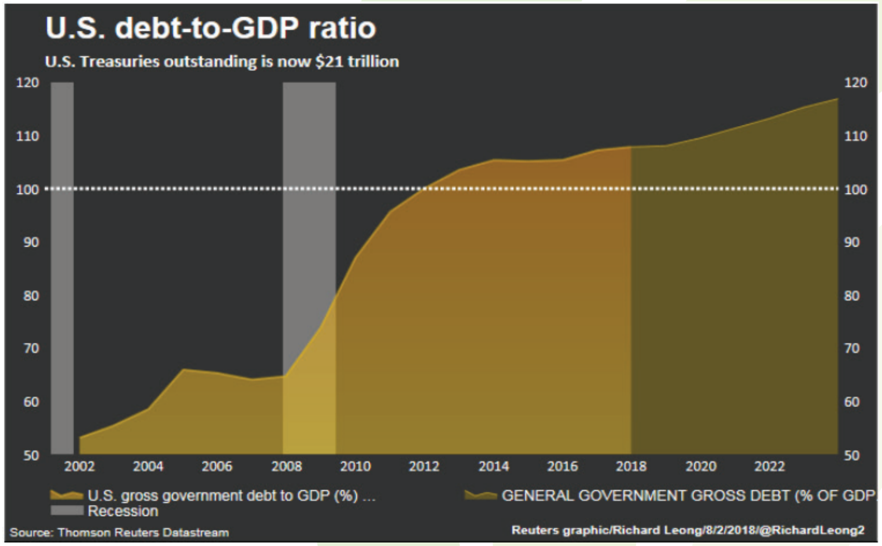
Source: Thomson Reuters Datastream Through July 2018

This reflects the current sentiment that longer term growth will be modest due to demographics and reduced productivity. However, some commentators see the flattening of the yield curve as evidence that interest rates will invert in the future. An inverted yield curve has often presaged recessions, but we think the timing plays into a tired bull market and tired economic growth cycle in late 2019-early 2020.

MACRO REVIEW

Finally, the tariff tempest has begun to take a toll. The Chinese and Turkish stock markets have tumbled as their currencies also fell against the dollar. President Trump announced 12 billion dollars in partial relief for U.S. farmers hit hard by his tough negotiations. This 12 billion is payable by the American taxpayers so there must be a future benefit. Many businesses are finding planning difficult and dealing with volatile prices and demand taking inordinate time.

The profusion of debt is the last headwind we will be running into as global growth is moderating. This year the U.S. is issuing far more debt to make up the expanding deficit caused by tax cuts and greater spending. We hit a record in March, issuing $294 billion but this level is expected to become the MONTHLY norm. According to the Congressional Budget Office, our deficit will hit $1 trillion dollars in 2020, up from 'just' $804 billion in 2018. As our debt climbs, so does our debt-to-GDP ratio.



And the U.S. is not alone. Global debt reached $247 trillion during the first quarter of 2018, according to the Institute of International Finance (IIF) recently. This would bring the global debt-to-GDP ratio to an almost unfathomable 318 percent. While debt is rising in all sectors, it is the corporate sector which causes most concern. During the last crisis governments could come to the rescue but after years of QE it is difficult to see who can come to the rescue if interest rates rise and/or the global economy slows somewhat, as it surely will.

CONCLUSION

The good times are rolling, but we can see the potholes. It is important to rebalance portfolios back to targets frequently and make sure your current asset allocation is diverse, thoughtful and right for you.

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