MARKET REVIEW & COMMENTARY

MAY 2018

TELEMUS®

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MARKET REVIEW

MAY

U.S. equities were positive across the board with growth companies wildly outperforming their value counterparts and small trouncing larger capitalization names. International stocks fell hard across the board as the U.S dollar soared. Predictably, emerging and particularly, frontier markets lost the most. The outperformance of growth over value and small over large dichotomy held everywhere.

Specifically, the S&P500 rose +2.41%, large cap growth was up +4.38% but large cap value increased only +0.59%. Mid cap growth gained +4.53% and mid cap value was up +0.99%. Small cap growth rose +6.30% while its value counterpart gained +6.07%. High dividend payers lost their 'bond' taint this month, eking out a +1.55% return. Across the pond, European equities were broadly negative, falling -3.28% and EAFE was also down, falling -2.25%. Emerging markets fell -3.54% but frontier markets lost a massive -9.22%.

All flavors of U.S. fixed income rose in May; as rates fell all across the curve. Longer maturities gained the most. 10-20 year Treasuries gained +1.36%, the Bloomberg Barclays long credit index was up +0.46%, 10 year municipals gained +1.06% and TIPS rose +0.43%. Shorter term securities were also positive; with 3-5 year Treasuries up +0.67%, 3 year municipals +0.55% and 1-5 year credit up +0.45%. In general, municipals did better than similar duration Treasury and corporate counterparts. High yielders, in a reversal, were the lone loser, falling -0.03%. T-bills rose a skinny +0.15%. Despite smaller global interest rate increases, world bonds were down -1.21% and emerging market bonds fell -1.63%. Global fixed income underperformance was a consequence of emerging economies struggling to service their dollar denominated debt as the dollar soared.

Alternatives were modestly positive with the HFRX Global Hedge Fund Index rising +0.26%. Real assets continued their broad based ascent. The Bloomberg Commodity Index was up +1.42% while energy gained over +3.04%, on concerns about supply centering on Iraq and Venezuela. Global natural resources appreciated +0.81%, precious metals rose +0.10%, global real estate was up +2.76% and U.S. real estate rose +3.98%. The dollar gained +2.33% in the month and has more than fulfilled our January prediction that "the dollar may be basing." At this time further appreciation appears doubtful.

MARKET REVIEW

YEAR-TO-DATE

Volatility has been the only constant this year. As we approach the highs of January, February and March again, there is no reason to expect a major breakthrough now. However there remains plenty of room for opportunistic trimming/adding in the shorter term, and strategic portfolio shifts for the longer term. The disparity between returns remains wide and varied. The gap between the returns of ‘growth’ and ‘value’ stocks remains large, despite narrowing a bit in May. U.S. growth stocks are up between +8.85% (small cap growth) and +6.23% (large cap growth). U.S. value stocks on the other hand have returned between +4.81% (small cap value) and -1.93% (large cap value). Midcaps are following this playbook with midcap growth +5.00% and mid cap value -0.95%. The S&P500 is now modestly positive year-to-date, up +2.02%, while high dividend payers are down -1.63% as people focus unduly on their cheaper valuations (value taint) and their role as bond surrogates (interest rate taint). International bourses, which had been leading U.S. markets earlier in the year, are now underperforming as EAFE is down -1.55% and Europe has fallen -2.58%. Ditto for emerging and frontier markets which are now down -2.61% and -7.59% respectively.

Fixed income returns remain modestly negative despite a good showing in May. Municipal bonds are outperforming both corporates and Treasuries this year after a brief period of underperformance stemming from overstated expectations about tax reform. This wiggle highlights exactly the opportunity sets presented by the shifting domestic and foreign landscapes. In general, returns continue to follow duration lower. Short Treasuries are up +0.04%, 3 year municipals are up +0.36 % and 1-3 year corporate paper gained +0.10%. The 10-20 year Treasury Index is down -2.65% while the Bloomberg/Barclay Municipal 10yr Index has lost -0.79% year-to-date. TIPS fell only -0.42%, reflecting the tug-of-war between the growth of inflation-aware sentiment and longer duration. High yield bonds in the U.S. are now slightly negative, -0.24%, reflecting possibly enhanced risk-awareness while emerging market paper (EMBI) is down -5.11% as currency and interest rates become bigger global issues.

Alternatives have straddled the zero line for this volatile year while underperforming stocks during the bull’s long run, raising fundamental questions about creating uncorrelated returns more surely and economically. The HFRI Fund Weighted Composite Index is up 1.4% year-to-date, almost exclusively due to its 1% rise in May, while the HFRI Special Situations Index has risen +3.8% this year. Other strategies have varied around the zero line. Real assets also remain mixed year-to-date despite outstanding May returns. Precious metals are down -5.84% and world real estate is down -2.16%. However, energy is up +6.05%, commodities are up +3.62%, softs remain mixed worldwide and the dollar, after a strong May return, is now up +2.02% year-to-date.

Late-cycle angst continues to bubble to the surface as commentators discuss the sustainability of moderate global growth while quantitative easing slows and rates rise, causing currency and rising debt concern to ripple across markets.

INDEX RETURNS AS OF 5/31/2018

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)	0.32%	0.84%	0.19%	12.68%	25.23%	36.96%
HFRX GLOBAL HEDGE FUND INDEX	0.26%	0.36%	-0.66%	1.42%	5.54%	-4.52%
CPI - SEASONALLY ADJUSTED	0.00%	0.22%	0.85%	5.48%	7.84%	16.17%
S&P 500 COMPOSITE	2.41%	2.80%	2.02%	36.67%	84.05%	139.71%
LIPPER LARGE - CAP CORE	2.19%	2.52%	1.29%	32.71%	73.36%	117.19%
WISDOM TREE LARGE CAP DIVIDEND	1.55%	1.62%	-1.63%	31.45%	70.88%	129.34%
MSCI ALL COUNTRY WORLD INDEX NET	0.12%	1.08%	0.11%	24.32%	53.04%	62.14%
MSCI EAFE NET	-2.25%	-0.02%	-1.55%	13.55%	33.39%	23.04%
BLOOMBERG BARCLAYS MUNICIPAL BOND 5Y (4 - 6)	0.99%	0.60%	0.03%	4.94%	8.74%	38.66%
BLOOMBERG BARCLAYS US AGGREGATE	0.71%	-0.03%	-1.49%	4.23%	10.30%	44.15%
BANK OF AMERICA / MERRILL LYNCH US T - BILL 3MONTH	0.15%	0.29%	0.64%	1.88%	1.96%	3.60%

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	4.38%	4.75%	6.23%	47.88%	107.26%	181.05%
RUSSELL 1000 VALUE	0.59%	0.93%	-1.93%	24.04%	61.73%	103.78%
RUSSELL MIDCAP GROWTH	3.74%	2.76%	5.00%	33.05%	84.27%	149.51%
RUSSELL MIDCAP VALUE	1.09%	1.59%	-0.95%	24.48%	67.19%	135.73%
RUSSELL SMALL CAP COMP GROWTH	5.32%	4.97%	7.92%	36.93%	94.36%	175.70%
RUSSELL SMALL CAP COMP VALUE	4.19%	5.10%	2.52%	29.23%	63.73%	127.44%
MSCI EM (EMERGING MARKETS) NET	-3.54%	-3.97%	-2.61%	19.67%	24.76%	17.41%
BLOOMBERG BARCLAYS US TREASURY BILL 6 MONTH	0.17%	0.32%	0.66%	2.49%	2.82%	6.60%
BLOOMBERG BARCLAYS US AGENCY	0.64%	0.04%	-0.49%	2.95%	6.75%	29.76%
JP MORGAN EMERGING MARKET BOND INDEX(EMBI) + COMPOSITE	-1.63%	-3.14%	-5.11%	11.47%	16.63%	79.72%
CITI GROUP WORLD GOVERNMENT BOND	-1.21%	-3.08%	-0.66%	8.69%	5.34%	23.60%
BLOOMBERG COMMODITY	1.42%	4.04%	3.62%	-8.29%	-29.08%	-56.19%
ALERIAN ENERGY MLP	5.05%	13.55%	0.93%	-22.46%	-15.01%	80.65%
PHILADELPHIA STOCK EXCHANGE GOLD / SILVER	2.67%	2.71%	-2.29%	19.54%	-22.39%	-54.08%
LIPPER GLOBL NAT RES	0.81%	6.13%	1.20%	8.21%	3.30%	-30.55%
LIPPER PRECIOUS METAL FUND	0.10%	1.61%	-5.84%	13.08%	-15.33%	-40.22%
MSCI WORLD REAL ESTATE	0.79%	1.71%	-2.16%	13.05%	30.41%	39.04%
LIPPER REAL ESTATE FUND	2.76%	3.70%	-3.02%	14.68%	34.02%	53.38%

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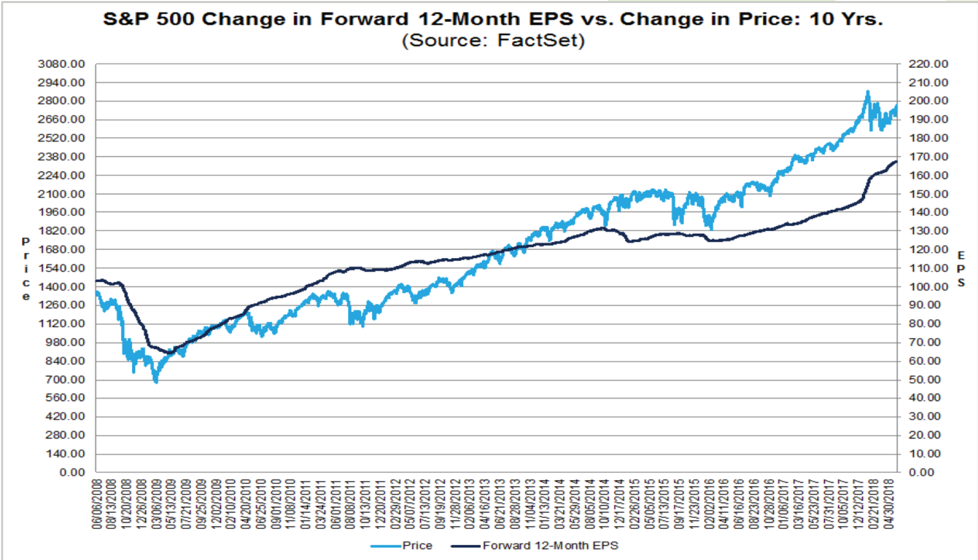
END OF CYCLE JITTERS (ANGST?)

Although global growth remains positive and moderate, investors are becoming more fractious as the Fed slowly removes the punchbowl. Simultaneously, our country is agitating our trading partners to level the playing field and rising interest rates in the U.S. are causing currency palpitations in emerging markets. It feels like it is moving out of control but really these factors (ex the trade tirades) are typically seen nearer the end of almost every economic cycle. We have short memories... .

The U.S. unemployment rate is at a 17 year low, wages are increasing and most regions of the globe are also growing. Globally, consumers are very optimistic and corporate profits are high. However, Goldilocks economies do not remain forever. Now that we have achieved 'perfection' all eyes are focused on what could go wrong. The very rise in wages that we have wished for must eventually begin to crimp corporate profit growth. However, the levels are so high that this may still take some time.



Source: John Butters, FactSet Earnings Insight, June 8th 2018

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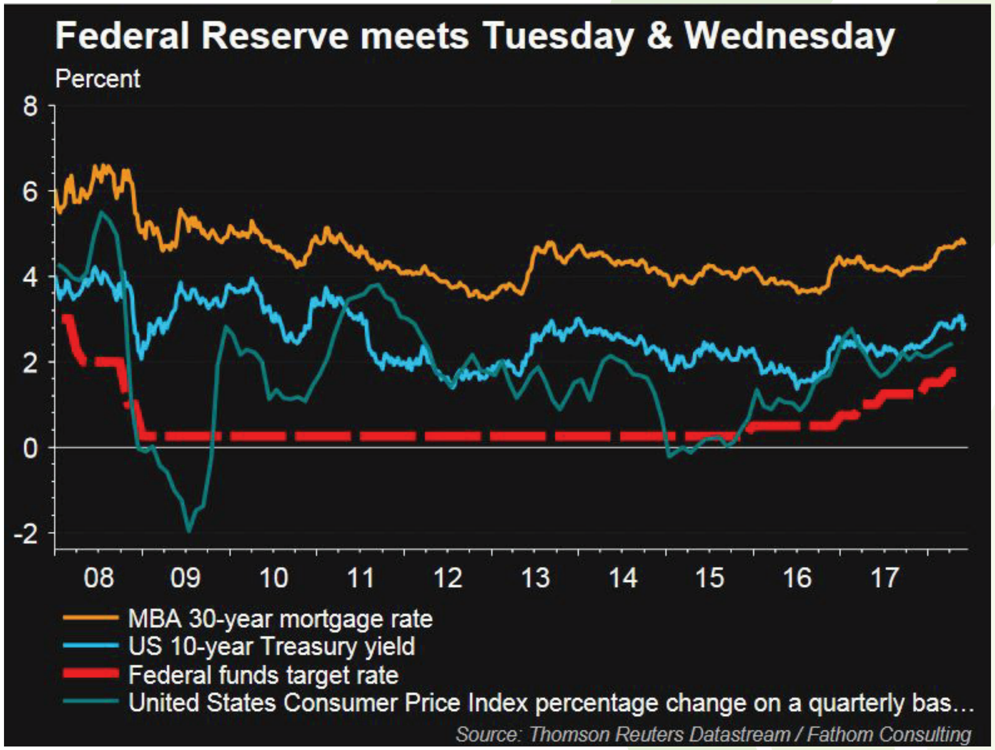
A slowdown in profit growth will also make valuations begin to appear too high, unless the 'p' in PE begins to fall or the 'e' (earnings) are able to continue rising. During the past year we have been relatively sanguine about equity valuations which did not appear demanding due to very high earnings growth. Earnings growth is topping out but earnings are still expected to increase the balance of the year. The forward PE ratio currently hovers around 16x and is not cause for undue concern. However, the unwinding of quantitative easing here in the U.S. and the likely cessation of QE by the Euro zone this year will dramatically reduce liquidity and may also roil the markets as the supply of bonds increases. Finally, our Fed will certainly raise interest rates by a quarter point this Wednesday, for the seventh time since the end of 2015.



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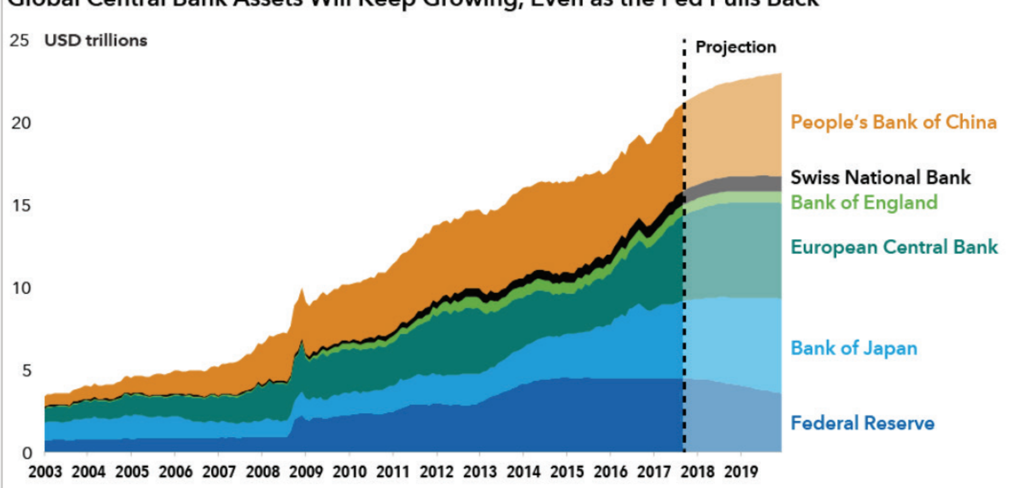
Finally, tariff talks have become contentious and by the time this is read President Trump will have had an historic meeting with Kim Jong Un. Despite the unorthodox complexion of the trade talks we think it likely that better terms for the U.S. will ultimately be negotiated. Coupled with the recent corporate tax breaks, these advances, should they occur, could elongate the economic cycle further. It is true that there are risks and we don't doubt some economic and market bumps along the way. However, we remain focused more intently on the longer term issues of QE reduction...



Sources: Capital Group, Thomson Reuters. As of 8/31/2017.

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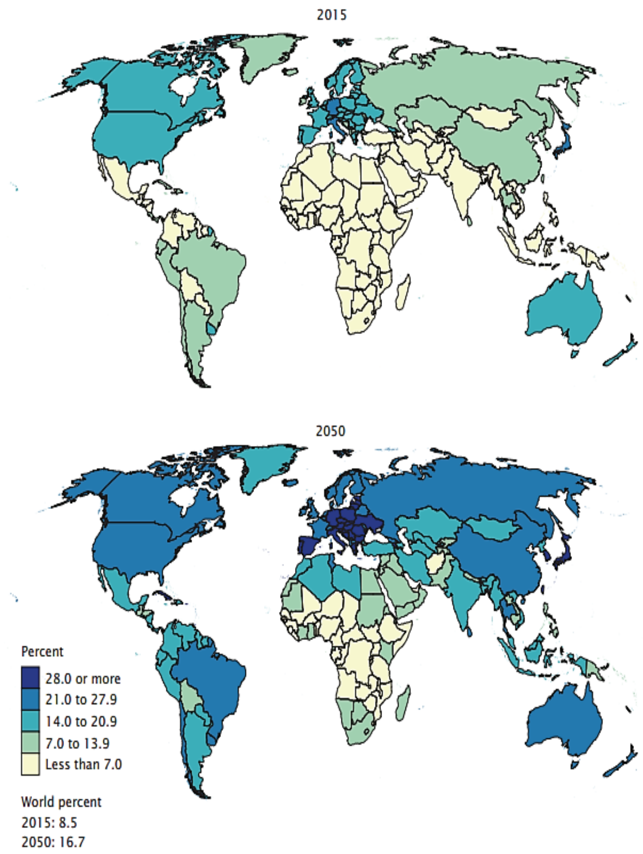
...and global demographics, which remain moribund and will continue to hold down the worlds' longer term growth rate.

Figure 2-1.
Percentage of Population Aged 65 and Over: 2015 and 2050



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