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Quarterly Market Update

Second Quarter 2018

The summary below is for educational purposes only. Please call us with any questions or if you would like to schedule a review or discuss other financial matters.

Looking Ahead and the Upcoming Midterm Elections

Last year's strong rally carried over into 2018 but quickly ran into a brick wall when longer-term Treasury yields tracked higher. The Dow Jones Industrials and the S&P 500 Indexes have failed to recapture January highs, but the tech-heavy NASDAQ Composite and some closely followed measures of mid-sized and smaller-sized companies, managed to set new highs in June (MarketWatch data).

As June came to a close, escalating trade tensions have hampered sentiment, especially as it relates to large multinationals, whose reach extends around the globe.

An all-out global trade war would compose a threat to U.S. and global economic growth and counter any economic stimulus from the tax cuts. So far, however, retaliatory actions have been measured.

Index	Q2 Return*		2018 YTD Return
DJIA[1]	+0.70%		-1.81%
NASDAQ Composite[2]	+6.33%		+8.79%
S&P 500 Index[3]	+2.93%		+1.67%
FTSE Developed ex North America Index[4]	-2.50%		-4.57%
Bond Yields	**Yield as of June 29 & Change***		**Yield as of Dec 29, 2017**
3-month T-bill	1.93%	+0.20%	1.39%
2-year Treasury	2.52%	+0.25%	1.89%
10-year Treasury	2.85%	+0.11%	2.40%
30-year Treasury	2.98%	+0.01%	2.74%
Commodities	**June 29 Price**	**Monthly Change***	**Year end 2017**
Oil per barrel[5]	$74.15	+$9.21	$60.42
Gold per ounce[6]	$1,250.45	-$73.40	$1,296.50

Sources: U.S. Treasury, MarketWatch, St. Louis Federal Reserve, CNBC
** Quarterly: March 29, 2018 – June 29, 2018*

While difficult to quantify the direct impact, the upcoming midterm elections may be creating headwinds. Yes, economic growth and corporate profits are a big factor in the longer-term direction of stocks, but political uncertainty can sometimes translate into shorter-term investor anxiety.

A recent study published in the Wall Street Journal found that since the creation of the Dow Jones Industrials in the late 1890s, it has averaged "an annualized gain of just 1.4% in the six months before midterm elections, in contrast to an average annualized return of 21.8% in the six months after." The study also noted that the pattern was not as pronounced during presidential elections nor did it repeat itself during non-election years. Of course, these are just averages, economic and international factors may come into play, and each cycle has its own unique features.

As we enter the second half of the year with a modest pullback in global economic momentum, growth at home remains strong and corporate profit growth is likely to remain strong this year and moderate in 2019.

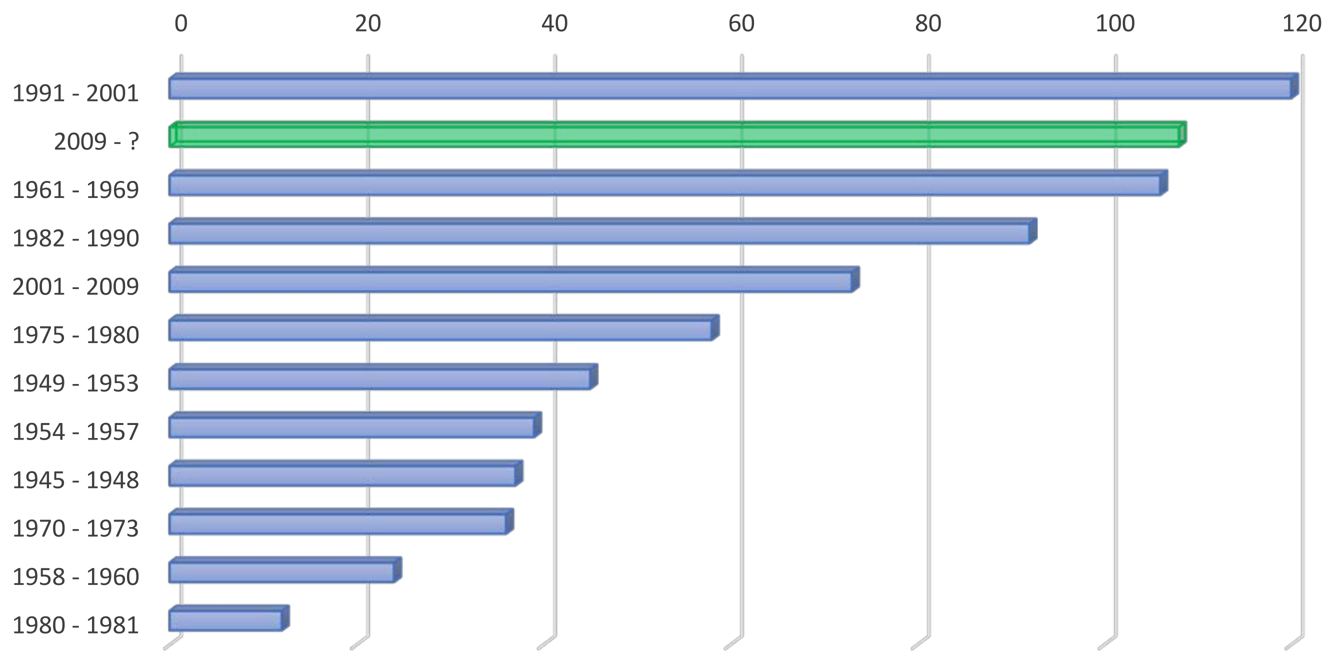
Nine Years Old

The economic recovery began in July 2009 – according to the National Bureau of Economic Research, the official arbiter of recessions and economic expansions. A quick review of the math and it means the current expansion just turned nine years old, or 108 months.

Let's put that into perspective. We've surpassed the long-running expansion of the 1960s by two months and we are within striking distance of the all-time longest expansion, which ran through the 1990s and lasted exactly ten years – see Figure 1.

Length of Economic Expansions Since WWII in Months

Fig. 1



DATA SOURCE: NBER, LAST DATE: JUNE 2018

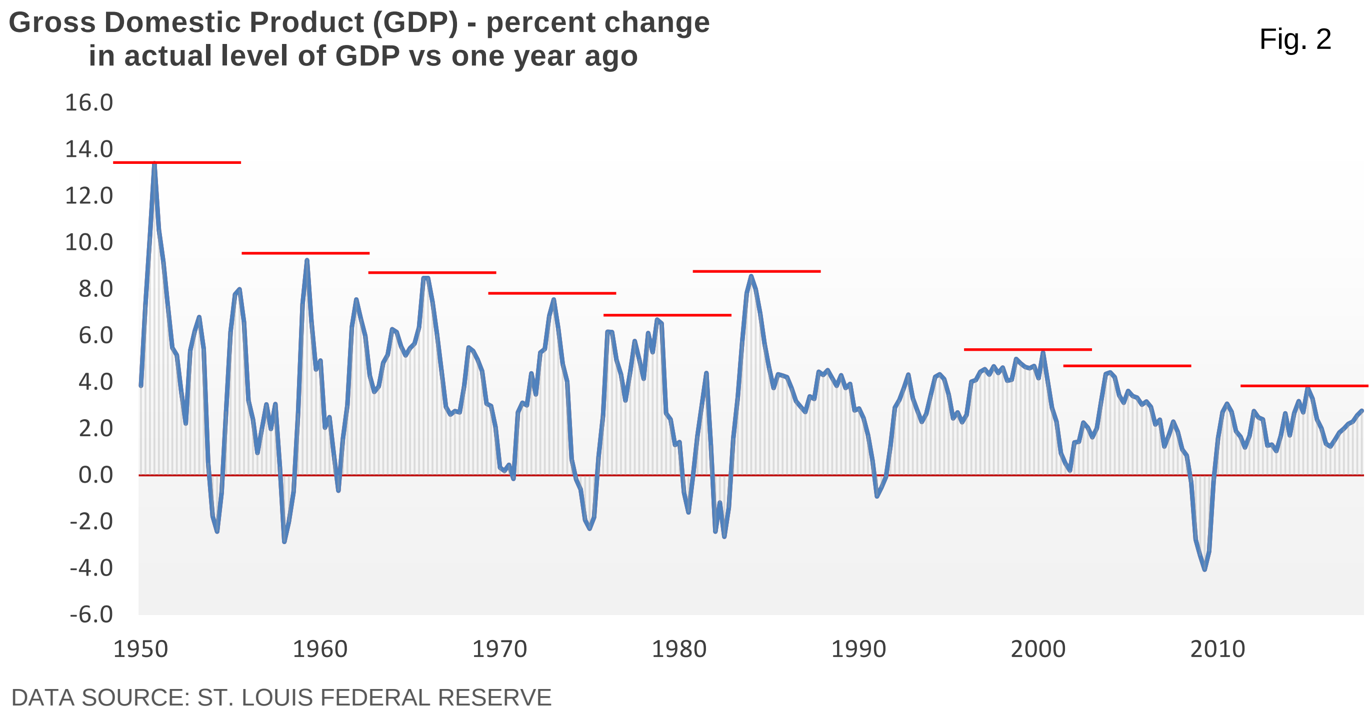
It has not been an impressive economic recovery – see Figure 2. The graphic illustrates that it has been the weakest recovery since at least 1950 (the U.S. government began collecting quarterly data in 1947), but that's probably a reason for its longevity.

You see, fast growth can sometimes force the Fed to quickly hike interest rates, which can stifle the economy. Or, it can create speculative excesses – economic booms – that sow the seeds of the next recession, which we experienced in the late 1990s.

Besides the general slowdown in growth post WWII, two things stand out. First, recessions are typically short interruptions in what otherwise has been a long-term upward trajectory for the economy. Second, the 2001 recession was so shallow, it failed to produce a year-over-year (y/y) decline in GDP. In fact, the U.S. economy generated an uninterrupted period of y/y GDP growth that lasted nearly 17 years!

Still, growth stalled in 2001, the jobless rate rose, and the shallow recession was enough to prick the bubble in stocks, which had become extremely overvalued.

Fig. 2



Red bars represent peak growth rate in each expansion; 1954-57 and short 12-month 1980 economic recovery omitted.
GDP is the largest measure of goods and services produced in the economy

The current cycle is no longer young, and it generally leads to concerns that a recession could be lurking. **Importance to investors:** recessions and bear markets historically go hand in hand.

But is a recession in the next year inevitable? Not necessarily. Optimists, led by Byron Wien, the respected vice chairman of Blackstone, said in his July commentary that he believes the current cycle "has at least several more years left to run."

Bolstering his case, inflation is gradually moving higher but remains low, and wages are up but aren't accelerating at a fast clip. Both factors are keeping the Federal Reserve from hiking interest rates too quickly. Moreover, fiscal stimulus is in the pipeline, including the recently enacted tax cuts.

While Mr. Wien's confidence isn't shared by all analysts, most short-term leading economic indicators aren't suggesting a recession will ensue this year or early next year.

[1] The Dow Jones Industrials Average is an unmanaged index of 30 major companies which cannot be invested into directly. Past performance does not guarantee future results.

[2] The NASDAQ Composite is an unmanaged index of companies which cannot be invested into directly. Past performance does not guarantee future results.

[3] The S&P 500 Index is an unmanaged index of 500 larger companies which cannot be invested into directly. Past performance does not guarantee future results.

[4] The FTSE Developed ex North America Index is an unmanaged index of large and mid-cap stocks providing coverage of developed markets, excluding the US and Canada. It cannot be invested into directly. Past performance does not guarantee future results.

[5] New York Mercantile Exchange front-month contract; Prices can and do vary; past performance does not guarantee future results.

[6] London Bullion Market Association; gold fixing pricing; Prices can and do vary; past performance does not guarantee future results.

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- ✓ **Add a name to our mailing list,**
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Please call Chris Hartrich or Eric Rechtin at (314) 394-2354 and we will be happy to assist you!