

CAPITAL MARKET REVIEW

Second Quarter 2018



The Economy

Negotiating is almost always ugly, and we have learned to not like haggling. Well, this administration haggles and so do the Chinese. The markets, let's face it, are dominated by young professionals (or the computers those youngsters program) who never had to bargain for anything. I learned this the hard way a few years ago when my wife and I sold our old house. A young couple made an offer, we countered and they disappeared. They are probably still crying in a real estate agent's office somewhere. They don't like negotiating, and they sure don't like doing it the way this administration does it.

This market is becoming more and more fixated on trade and it is getting ahead of itself. The market after all does not reflect the present, it reflects the consensus of what the future will look like. When the trade talk started it reflected winners and losers, now in the past few days it has seemingly shifted to predicting that everyone will lose. The market is telling us that the trade disputes with China will offset the economic benefits of tax and regulatory reform and plunge us back to the new normal. This means people are selling everything except the high growth FANG stocks. It is 2016 all over again. For a quarter anyway.

The market is not always right, and at the very least it would seem that it is early. The real economy doesn't change that quickly. It is also possible that Trump could win this. The market isn't giving him much of a chance, and I readily admit that I have my doubts. China doesn't have to do anything. Trump is guaranteed just two more years in office and if he were to win re-election that would be six years. It is doubtful regardless of party affiliation that the next President will be as aggressive with China. Long-term to the Chinese is more than one generation. They have just given their leader a lifetime term. Six years is nothing. Time is on their side and time matters when one is trying to perform the art of the deal.



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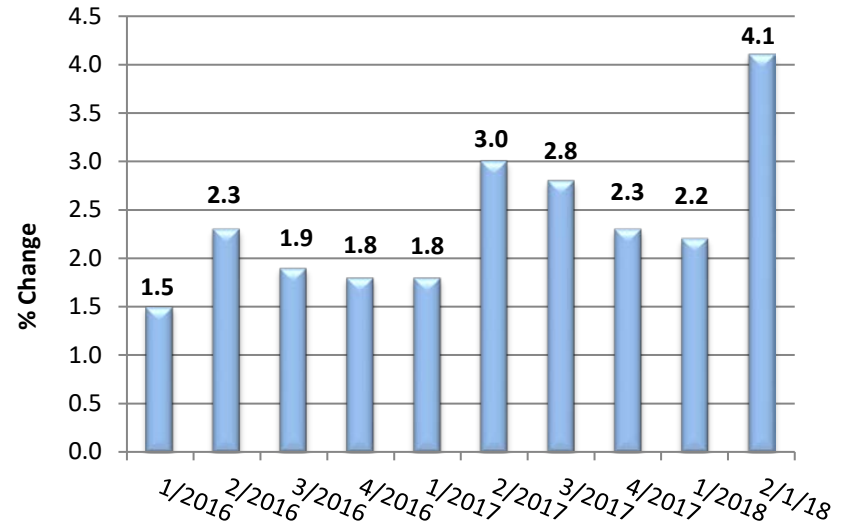
The Economy

First estimate for 2nd quarter GDP growth came in at 4.1 percent. We may finally be breaking out of the so-called new normal, and the impact of tax reform is just beginning to be seen.

The official unemployment rate dropped to 4.0 percent in June. The labor market keeps improving and perhaps more importantly we are seeing wage growth of 2.7 percent. That is an encouraging sign.

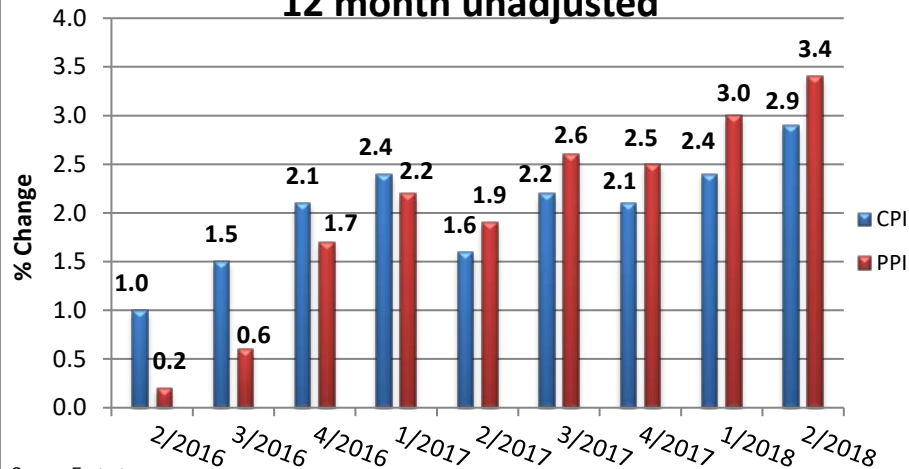
Inflation is at 2.9 percent based on the latest consumer price index report. Core inflation stands below the Fed target at 2.3 percent. This is higher than it has been in some time and will likely lead to further rate hikes from the Federal Reserve.

Domestic GDP



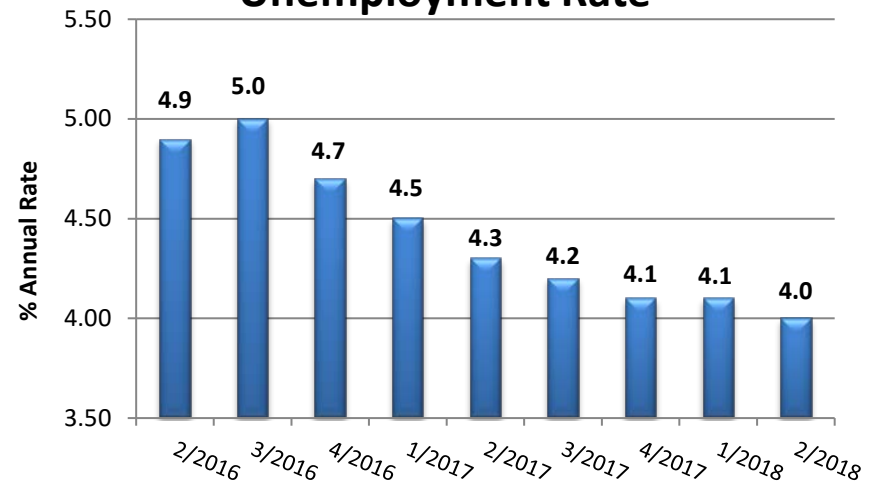
Source: Factset

Inflation Indicator 12 month unadjusted



Source: Factset

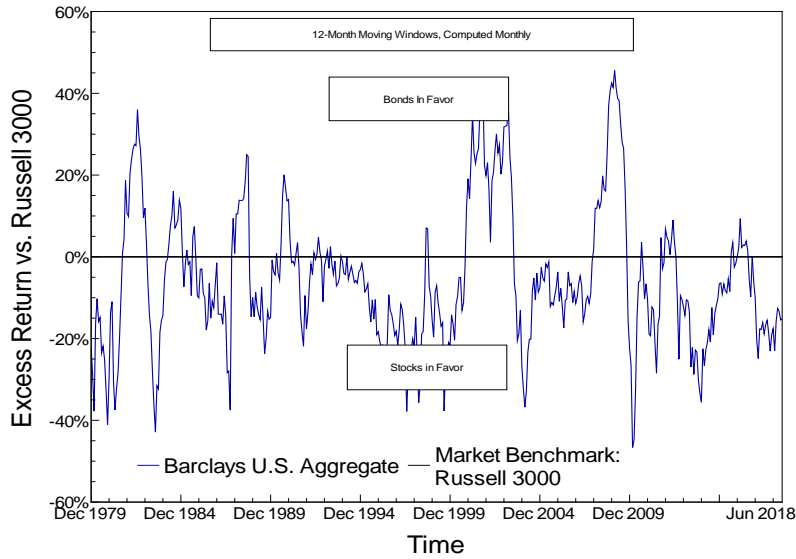
Unemployment Rate



Source: Factset

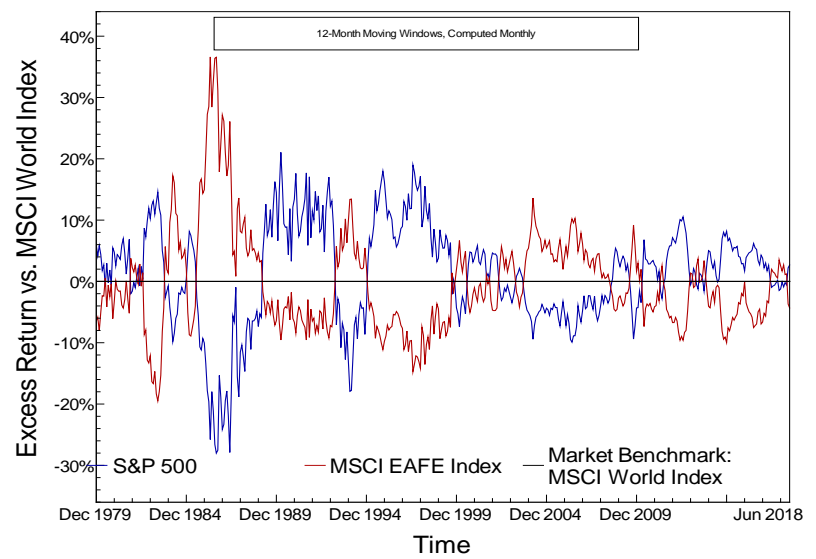
Bonds vs. Stocks

Zephyr StyleADVISOR: Iron Capital Advisors



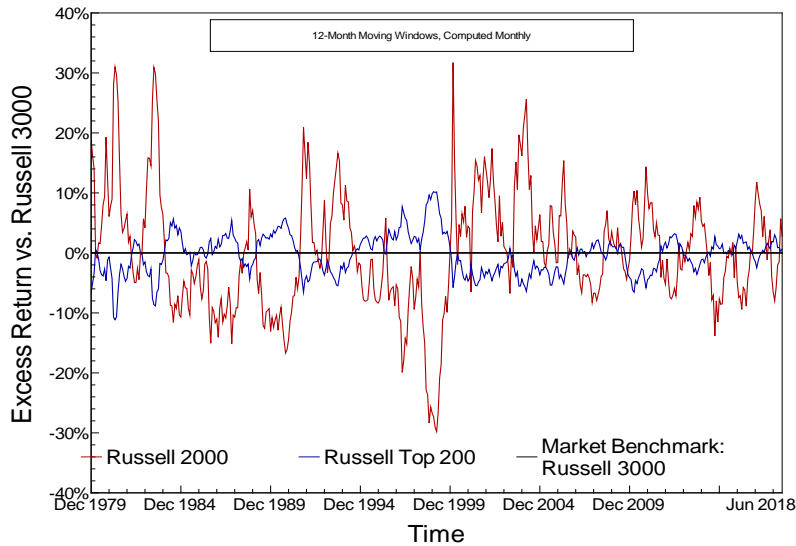
International Vs. Domestic

Zephyr StyleADVISOR: Iron Capital Advisors

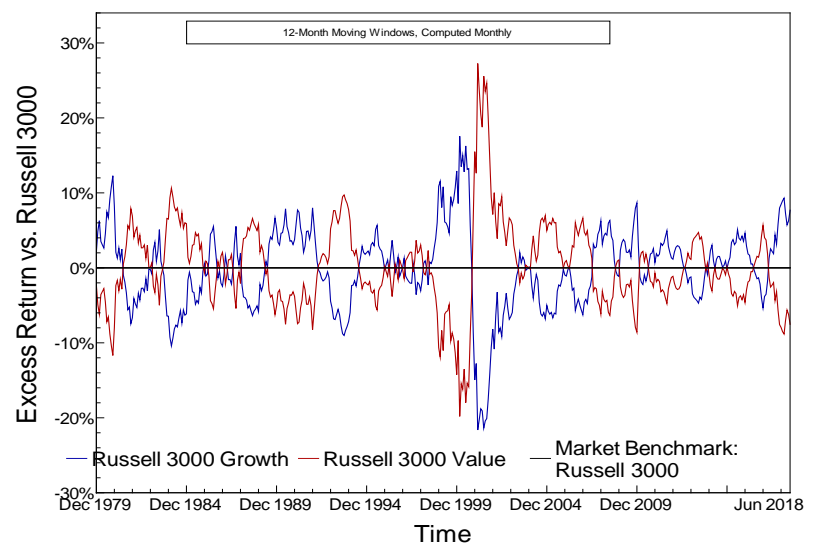


Large vs. Small

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Value vs. Growth



Domestic Equity Markets

Tariff talk put a scare in the market. For the quarter the S&P 500 finished up 3.43 percent but how we got there was the real story. Growth outpaced value for the sixth quarter in a row. The Russell 1000 Growth index finished up 5.76 percent, while its value counterpart was up only 1.18 percent. Small companies led the way with the Russell 2000 up 7.75 percent.

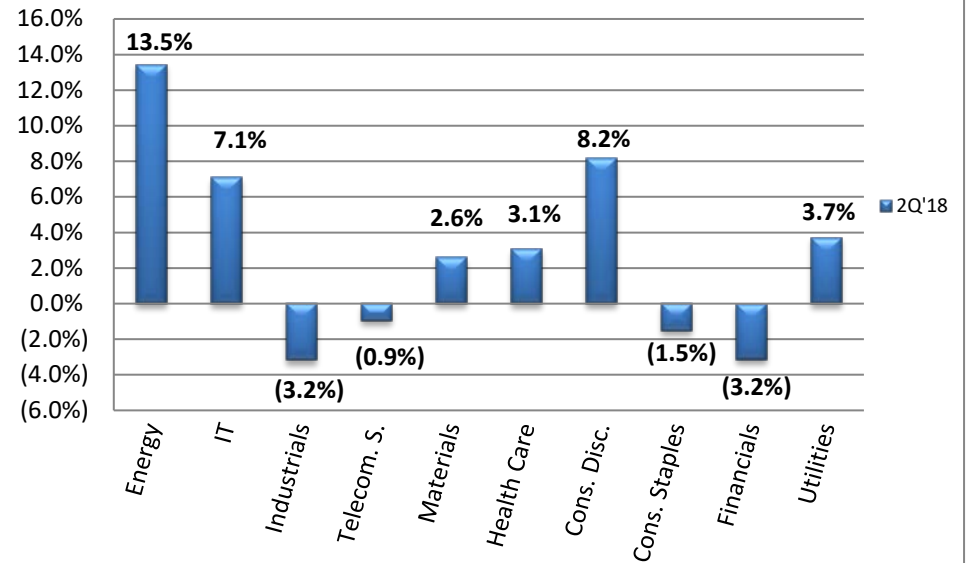
In other words the market ran back to what works if the economy does not continue to grow because of trade wars, and into smaller companies who theoretically are less tied to international trade.

Industrials and financials that benefit from the global economy were the worst places to be.

**Domestic Indices Three Months
Ending June 30, 2018**

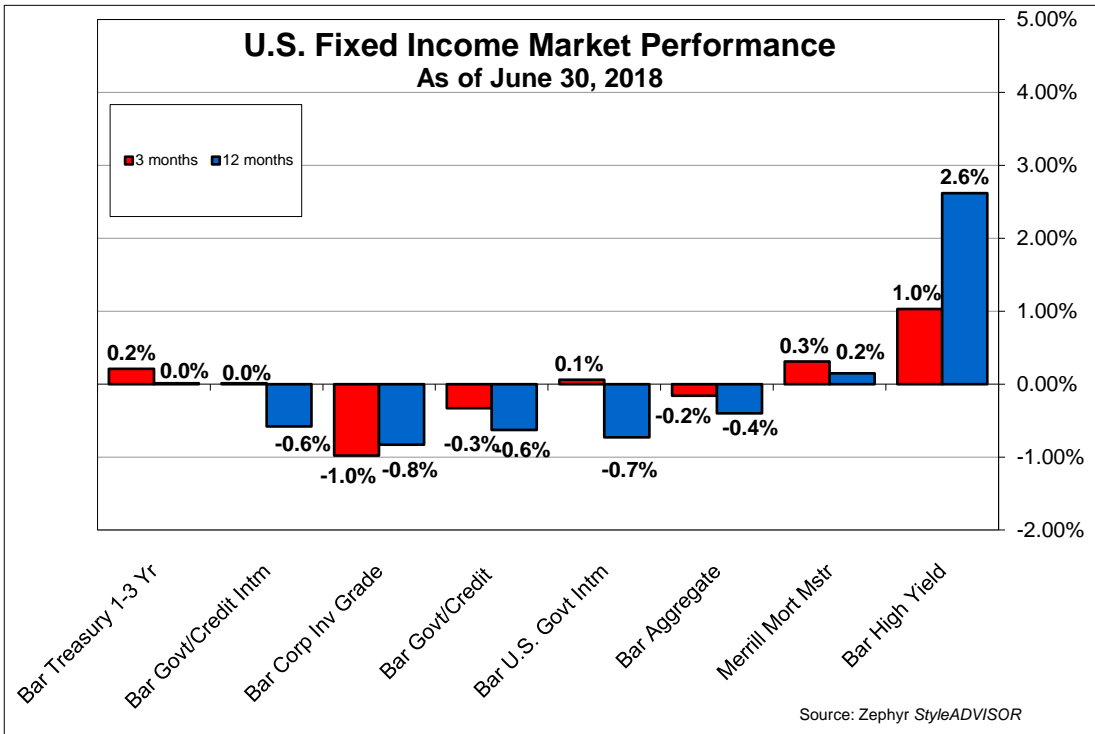
	Yield	Price/Earnings	Price/Book
S&P 500	1.83%	21.3	3.25
Russell 1000 Gr	1.14%	28.7	7.34
Russell 1000 Val	2.39%	17.4	2.03
Russell Midcap	1.57%	22.1	2.75
Russell 2000 Gr	0.56%	78.8	4.61
Russell 2000 Va	1.89%	24.6	1.53

S&P GICS Sector Returns



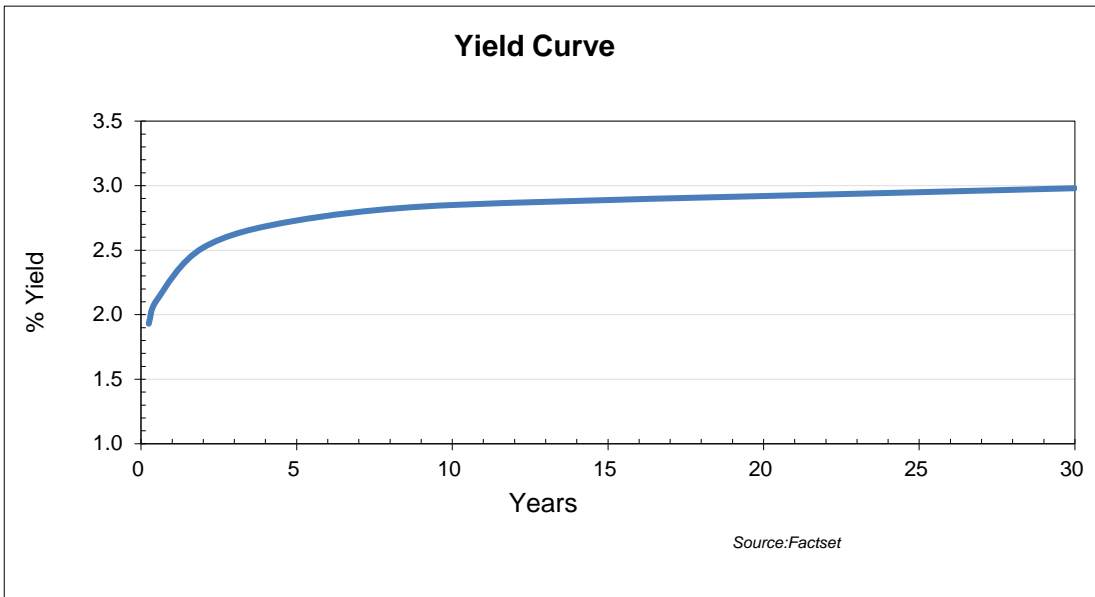
Source: Factset

DOMESTIC FIXED INCOME MARKET



Bonds dropped during the quarter as interest rate crept higher. The Barclays US Aggregate Bond index ended down 0.16 percent. High yield bonds ended the quarter up 1.00 percent.

We are knocking on the door of the 3 percent threshold for the 10 year Treasury.



Yield Curve as of June 30, 2018

Time to Maturity	Interest Rate
3 Month	1.93
6 Month	2.11
2 Year	2.52
5 Year	2.73
10 Year	2.85
30 Year	2.98

INTERNATIONAL MARKETS

International stocks suffered over trade. The EAFE index finished down 0.97 percent while the MSCI Emerging Markets index ended the quarter down 7.86 percent.

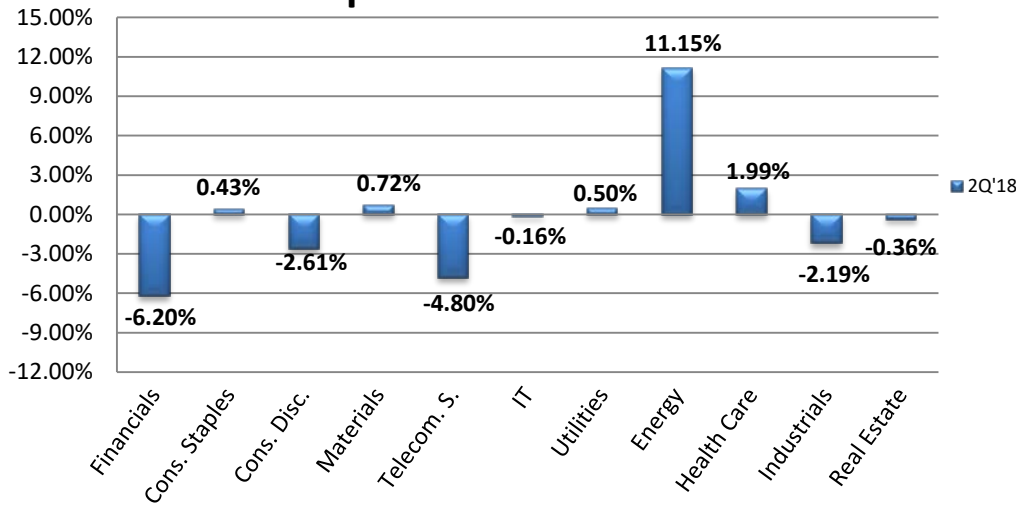
The international story is really all about trade talk and interest rates here at home. Both rising rates and the threat of tariffs caused the dollar to spike relative to the euro. Europe's markets were actually up 4.51 percent in local terms, but had an incredible -5.38 percent currency impact.

Emerging markets were led down by China whose markets lost ground with every mention of trade, and Brazil who has seemingly fallen into chaos. All of this has more to do with politics than market fundamentals.

MSCI Country Returns Three Months Ending June 30, 2018

	Return US\$ (%)	Return Local Currency (%)	Currency Effect(%)
Austria	-10.39%	-5.61%	-4.78%
Belgium	-5.28%	-0.22%	-5.06%
Denmark	-6.93%	-2.01%	-4.92%
Finland	2.17%	7.62%	-5.45%
France	0.32%	5.67%	-5.35%
Germany	-3.36%	1.79%	-5.15%
Ireland	2.07%	7.51%	-5.44%
Italy	-6.76%	-1.78%	-4.98%
Netherlands	-1.55%	3.19%	-4.74%
Norway	2.97%	6.90%	-3.93%
Portugal	2.19%	7.64%	-5.45%
Spain	-4.10%	1.02%	-5.12%
Sweden	-3.14%	3.47%	-6.61%
Switzerland	-2.22%	1.39%	-3.61%
UK	2.96%	9.40%	-6.44%
Europe Total	-0.87%	4.51%	-5.38%
Australia	5.26%	9.28%	-4.02%
Hong Kong	-1.18%	-1.22%	0.04%
Japan	-2.80%	1.23%	-4.03%
New Zealand	5.79%	12.72%	-6.93%
Singapore	-7.49%	-3.82%	-3.67%
Pacific Total	-1.32%	2.30%	-3.62%
Brazil	-26.37%	-14.76%	-11.61%
Canada	4.89%	7.02%	-2.13%
China	-3.44%	-3.43%	-0.01%
Greece	-2.04%	3.19%	-5.23%
Hungary	0.31%	-14.07%	14.38%
India	-0.60%	4.42%	-5.02%
Indonesia	-12.19%	-8.60%	-3.59%
Korea	-9.09%	-4.94%	-4.15%
Mexico	-3.49%	3.93%	-7.42%
Poland	-11.59%	-3.37%	-8.22%
Russia	-5.79%	1.52%	-7.31%
Thailand	-14.92%	-9.86%	-5.06%
Emerging Markets	-7.86%	-3.41%	-4.45%

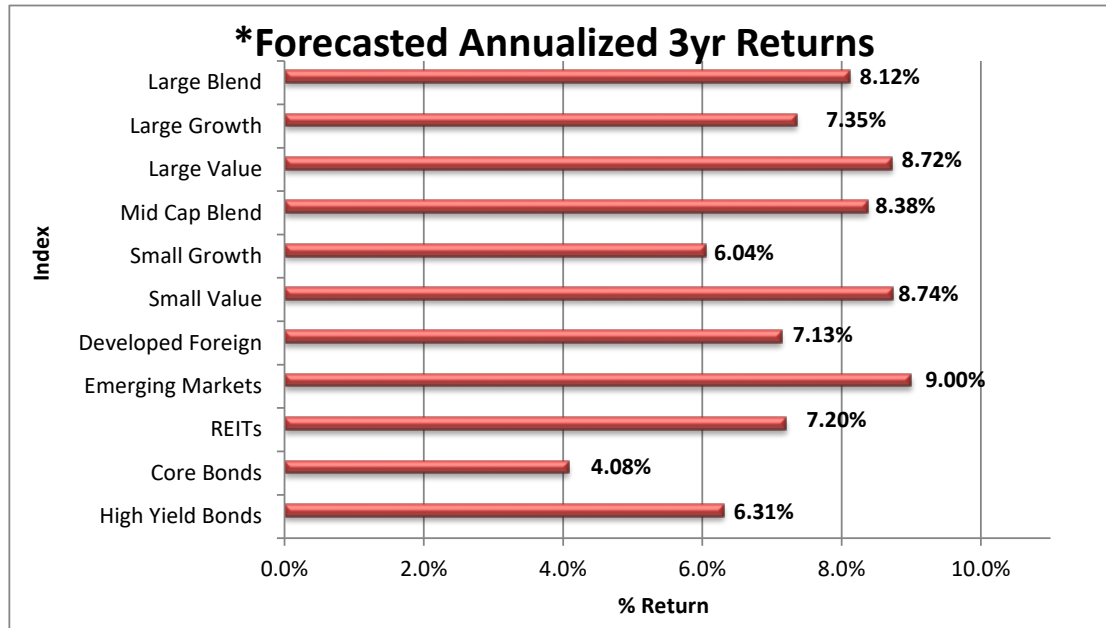
Developed Int'l Sector Returns*



Source: Harbor Capital

* MSCI EAFE Index

Market Forecast



Indices Three Months Ending June 30, 2018

	Yield	Frwd Earnings Yield	**Hist. Return	***Hist. Risk Prem. + RF Rate
Large Blend	1.83%	8.00%	10.02%	6.37%
Large Growth	1.14%	6.06%	10.05%	6.37%
Large Value	2.39%	9.66%	9.83%	6.37%
Mid Cap Blend	1.57%	7.63%	11.39%	6.37%
Small Growth	0.56%	3.28%	8.40%	7.37%
Small Value	1.89%	8.31%	10.67%	7.37%
Developed Foreign	3.03%	10.41%	5.40%	4.50%
Emerging Markets	2.10%	10.94%	9.41%	6.00%
REITs	4.24%	6.58%	10.30%	4.94%
Core Bonds	3.30%	3.30%	5.93%	3.27%
High Yield Bonds	6.40%	6.40%	8.06%	4.44%

Volatility has returned and is likely to stay. We are still positive on the markets for the year as the economy and corporate earnings are still strong. Those are the things that really matter. In the meantime any threat of a trade war or other political unrest will continue to cause day to day fluctuations.

Small company stocks should do well. Emerging markets still look attractive as do international stocks but momentum has turned negative with trade talk.

Bonds remain our biggest concern over the long term and will until the yield on the 10 year Treasury exceeds 3 percent. It has gotten closer but is still not there.

* Weighted average using 40% earnings yield, 30% historic return and 30% historic risk premium + RF rate

**Annualized 29 Yr return

***Hist. risk premium of domestic and international equity as defined by Zyphyr Style Advisor's GFD Long Term Index database except for REITs and High Yield which are based on average 20 year rolling returns of the NAREIT Equity REIT Index and the Barclays Corporate High Yield Index minus the average 20 year rolling returns of the 3-month T-Bill and scaled using proprietary data. The Current 3-month T-Bill yield (as of 06-30-2018) is added back to each risk premium.

SELECTED INDEX RETURNS - PERIODS ENDING June 30, 2018

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
US EQUITIES						
Broad Stock Market - Russell 3000	3.89%	3.22%	14.78%	11.58%	13.29%	10.23%
Large Stocks - S&P 500	3.43%	2.65%	14.37%	11.93%	13.42%	10.17%
Dow Jones Industrial Average	1.26%	-0.73%	16.31%	14.07%	12.96%	10.78%
Medium-Size Stocks - Russell Mid-Cap	2.82%	2.35%	12.33%	9.58%	12.22%	10.23%
Small Stocks - Russell 2000	7.75%	7.66%	17.57%	10.96%	12.46%	10.60%
Small Value Stocks- Russell 2000 Value	8.30%	5.44%	13.10%	11.22%	11.18%	9.88%
Small Growth Stocks- Russell 2000 Growth	7.23%	9.70%	21.86%	10.60%	13.65%	11.24%
Large Value Stocks - Russell 1000 Value	1.18%	-1.69%	6.77%	8.26%	10.34%	8.49%
Large Growth Stocks - Russell 1000 Growth	5.76%	7.25%	22.51%	14.98%	16.36%	11.83%
US FIXED INCOME						
1-3 Yr Treasury (Gov't) Bonds - Barclays Capital	0.21%	0.05%	0.01%	0.40%	0.58%	1.25%
US Government Bonds Int - Barclays Capital	0.06%	-0.67%	-0.73%	0.63%	1.04%	2.41%
US Corporate Inv Grade Bonds - Barclays Capital	-0.98%	-3.27%	-0.83%	3.07%	3.51%	5.39%
Government/Credit (Corp) Bonds - Barclays Capital	-0.33%	-1.90%	-0.63%	1.83%	2.29%	3.78%
Int Govt/Credit (Corp) Bond - Barclays Capital	0.01%	-0.97%	-0.58%	1.16%	1.60%	3.08%
US Aggregate Bond Market - Barclays Capital	-0.16%	-1.62%	-0.40%	1.72%	2.27%	3.72%
Mortgage Master - Merrill Lynch	0.31%	-0.90%	0.15%	1.48%	2.25%	3.54%
US Corp High Yield Bonds - Barclays Capital	1.03%	0.16%	2.62%	5.53%	5.51%	8.19%
INTERNATIONAL (Measured in US Dollars)						
Non-US Stocks - MSCI EAFE	-0.97%	-2.37%	7.37%	5.41%	6.93%	3.33%
World Stocks (includes US) - MSCI World	1.93%	0.76%	11.70%	9.10%	10.55%	6.86%
European Stocks - MSCI Europe	-0.87%	-2.71%	5.94%	4.85%	6.82%	2.98%
Japanese Stocks - MSCI Japan	-2.80%	-1.85%	10.88%	6.60%	7.70%	3.78%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	1.81%	-1.97%	8.82%	6.71%	6.17%	4.82%
Chinese Stocks - MSCI China	-3.44%	-1.69%	21.42%	7.26%	12.32%	6.21%
Indian Stocks - MSCI India	-0.60%	-7.51%	6.47%	5.34%	8.99%	5.18%
Emerging Markets - MSCI EM	-7.86%	-6.51%	8.59%	5.98%	5.39%	2.60%
Int'l Gov't Bonds -Citi World Gov't Bond (Non USD)	-5.11%	-0.92%	3.22%	3.74%	1.01%	1.78%
REAL ESTATE						
FTSE NAREIT Equity-Reits Index	10.04%	1.02%	3.50%	8.06%	8.31%	7.94%
SHORT TERM INTEREST RATES						
T-Bills	0.44%	0.79%	1.33%	0.64%	0.39%	0.31%

Note: Returns for periods longer than 12 months are annualized.