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**The Markets as of close on June 29, 2018 . . .**

The current rally in the US stock market is now in its $9^{th}$ year and appears to be on track to become the longest in history. Since its official start on March 9, 2009, the current US stock rally has returned a whopping 302%[1] from the market's low at the end of the Great Financial Crisis. And it has since has grown, uninterrupted by a decline of 20% or more – that being the definition of a bear market.

It's no surprise investors are grateful for the rewards it's provided, but are perhaps a bit anxious about what they can look forward to in such an "old" rally. Listening to the media may find you fretting about this geriatric market, predicting that surely death is near. Will the cause be rising interest rates, excessive valuations or trade policy? Take a deep breath and remind yourself that market returns are not earned evenly over time and that a financial strategy is a marathon, not a sprint. We believe any debate over the cause of death seems highly premature given that the economy doesn't currently seem to be suffering from any of these illnesses. Like people, market rallies don't die because they're old, they die when an illness becomes acute.

Many things are in the mix – hence the second quarter of the year can be called a lot of things, but boring isn't one of them. The potential for a trade war between the United States and China heated up in April as China responded to the threat of U.S. tariffs on Chinese imports by warning of the same magnitude of tariffs on American exports. Fortunately, favorable corporate earnings reports helped calm some of the global economic angst investors may have felt. The indexes listed below ended the month ahead of their March closing values – but only barely.

A strong jobs report kicked off the month of June on a mostly positive note. Stocks closed the first full week of June higher, led by the large caps of the S&P 500 and the Dow. However, by the middle of the month, investors were hit with China's threat of increased tariffs on U.S. exports, while Canada pledged to impose retaliatory penalties as well. By the end of the month, the Dow and Global Dow lost some value, while the remaining indexes listed here posted marginal gains.

Overall, the second quarter saw the tech-heavy Nasdaq gain over 6%, only to be bested by small caps of the Russell 2000, which grew by almost 7.5%. The S&P also closed the quarter ahead of its first-quarter closing values. The Dow, however, didn't fare as well, finishing the quarter up by less than 1%. Crude oil prices closed the quarter at about $74.25 per barrel by the end of June, almost $10 per barrel higher than prices at the close of the first quarter.

| **Market/Index** | **2017 Close** | **As of June 29** | **Month Change** | **Quarter Change** | **YTD Change** |
|---|---|---|---|---|---|
| **DJIA** | 24719.22 | 24271.41 | -0.59% | 0.70% | -1.81% |
| **NASDAQ** | 6903.39 | 7510.30 | 0.92% | 6.33% | 8.79% |
| **S&P 500** | 2673.61 | 2718.37 | 0.48% | 2.93% | 1.67% |
| **Russell 2000** | 1535.51 | 1643.07 | 0.58% | 7.43% | 7.00% |

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|---|---|---|---|---|---|
| **Global Dow** | 3085.41 | 2979.52 | -0.75% | -1.56% | -3.43% |
| **Fed. Funds** | 1.25%-1.50% | 1.75%-2.00% | 25 bps | 25 bps | 50 bps |
| **10-year Treasuries** | 2.41% | 2.86% | 0 bps | 13 bps | 45 bps |

Chart reflects price changes, not total return. Because it does not include dividends or splits, it should not be used to benchmark performance of specific investments.

**Valuations seem defensible**

While there is no question this rally is old(er), it still seems in surprisingly good health. Economic growth appears to be strong, corporate earnings continue to grow and even though interest rates have been rising, credit availability is still easy.

Bear markets do not come out of nowhere. They are associated with recessions that generally come with warning signs like declines in manufacturing and housing, and increases in jobless claims. Right now, business sentiment, new home sales and unemployment claims all seem to be trending in a positive direction, with healthy spending by consumers and capital expenditures by business. Both very good signs for the economy.

The longevity of the current economic expansion may be explained by its slow rate of growth relative to other periods of economic expansion. More importantly, tax cuts, increased federal spending and a monetary policy that is still accommodative are like a multi-vitamin for an old market, which means this rally will not necessarily act its age. Recognizing this, we should expect the drugs to wear off at some point in 2019.

Inflation does appear to be on the rise. The Fed's preferred measure of inflation (which excludes energy and food) finally hit its 2% target for the first time in almost six years, and rising prices here and abroad have central banks either in tightening mode (U.S.) or non-easing mode (Europe)[2]. We won't talk about the rising cost of care in a long-term care facility here – that's a topic for another day. Rising interest rates and on-going trade friction do support a revived US dollar which will likely depress international equity returns for the remainder of the year. Nonetheless, we believe international exposure is still important to a well-diversified portfolio.

We believe that concerns about debt levels miss the point that the drag on profitability is not the debt itself, but the cost of servicing that debt. The silver lining in that cloud is that thanks to low interest rates – servicing cost should not become burdensome in the near-term.

No one knows for certain whether the aggressive US stance on trade policy is actually aimed at eliminating trade deficits, or just a negotiating tactic aimed at more balanced trade agreements. Having said this, the pace of the rise in rates is not pre-ordained. The Fed has made clear that it will be guided by the data and while the numbers currently appear to be able to support and even warrant higher rates, Fed forecasts of quarterly growth vary over time and among the regional Federal Reserve banks.

When the Fed increases rates, it is both positive and negative for stock investors. On the one hand, it signals that the Fed feels the economy is growing strongly enough to warrant higher rates. On the other hand, it brings monetary policy one step closer to being restrictive. And while it's possible that the Fed finds the perfect pace of rate hikes to control growth without stopping it, the Fed does not have a promising track record of tightening without triggering a recession. Only time will tell.

Given the positive earnings surprises and stock buy-back announcements from corporations, it would be fair to wonder why the market results have not been stronger for 2018. One answer may be that the focus of analysts and investors recently has been on trade policy and the potential impact of President Trump's announced tariffs on the global economy. We think it's important that investors keep in mind that this is a rally that has survived the Brexit vote, a series of eurozone crises, and worries about nuclear war and kept on chugging so long as corporate earnings were growing and monetary policy was accommodative. We have been lucky to date that the tariffs announced or imposed by our trading partners in response to US tariffs have been reassuringly measured, rather than escalating the threat.

**Market Outlook and Portfolio Positioning**

We think the environment is likely to favor stocks over bonds for the next six to twelve months. This view stems from our belief that earnings will continue to grow, even if earnings rate starts to slow.  Our preference for stocks is relative, however, and does not imply we expect them to deliver an above-average return for the full year.

Although US equity returns for the first half of 2018 have been lackluster, this is not atypical for US stock market returns in a mid-term election year and is usually followed by a bounce toward year-end after the elections. Beyond continued strength for the global economic expansion and equity markets over the next 12 months, we believe some sectors are better positioned than others to benefit in this current phase of the market cycle.

Small-cap stocks were due to rally having underperformed large-cap stocks over the last several years. As a result, their outperformance of almost 4.5% relative to US large caps in the second quarter served to simply bring their trailing 3-year return in line with those for large-cap stocks.  While we are generally cautious regarding interest rate risk and the outlook for bonds (it's not clear that two more rate hikes this year are fully reflected in current prices), the typically shorter duration and participation in earnings growth of high-yield bonds should make them less vulnerable than higher grade debt to continuing rate hikes in the U.S.

We feel that the relative strength of the US economy, the tone of news around trade policy, the role of rising rates in strengthening the US dollar and political challenges in Europe could be headwinds for US investors holding international assets in the near term. "Okay," you might say, "shouldn't I be moving out of international stocks completely?"  Remember, timing the "turn" in the Foreign Exchange markets is always difficult for international stocks. Their relatively attractive valuations suggest that investors should always hold some international equities. That said, we think they are unlikely to best US equity returns in the next six to twelve months.

**Prepare for the Unexpected:** For these reasons and more, we think prudent investors are best served by well-diversified portfolios including some international equity exposure as well as "hedges" such as core fixed income, perhaps some managed futures and tactical de-risking strategies such as certain variable annuities and carefully selected real estate investment trusts when appropriate.  So, despite the pundits' lament that the bull is old, it's not sick.  Many an investor and financial advisor is hoping for a continuation of the run and it might happen. But markets can, at any time, correct if the right shock comes along. When it comes, and it will, it will probably be for an unexpected reason. And it will also provide an ideal opportunity for dip buyers.

Best Regards,
Barbara, Gloria and Kate

[1] Source: Barron's 6/30/2018 S&P 500 Index
2 Source: CNBC, 6/29/2018
*The opinions and forecasts expressed are those of the author, and may not actually come to pass. This information is subject to change at any time, based on market and other conditions and should not be construed as a recommendation of any specific security or investment plan. Past performance does not guarantee future results.*

*Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation);U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S.Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates).*

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*The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading* *companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. The U.S. Dollar Index is a geometrically weighted index of the value of the U.S. dollar relative to six foreign currencies. Market indices listed are unmanaged and are not available for direct investment.*

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