IM&R Economic and Market Review Q3 2018

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Economic Review

"Our economy is strong. Growth is running at a healthy clip. Unemployment is low, the number of people working is rising steadily, and wages are up." That description is Federal Reserve ("Fed") Chair Jerome Powell's summary of the current state of the U.S. economy. And as expected, at their September meeting the Fed increased the target federal funds rate by 25 basis points to a range of 2.00 to 2.25 percent. Fed funds futures point to the likelihood of additional hike in December which would bring the total number of rate increases in 2018 to four.

U.S. economic growth increased at an annual rate of 4.2% in the second quarter according to the Bureau of Economic Analysis real gross domestic product (GDP) release. This marked the healthiest advance since the third quarter of 2014. The Atlanta Fed GDPNow forecast for third quarter 2018 real GDP currently stands at 3.8%.

"At this stage of a maturing business cycle, it doesn't get much better than this," said Conference Board Director Atama Ozyildirim in the latest Leading Economic Index release. The strengths among the LEI's components were very widespread, further supporting an outlook of above 3.0 percent growth for the remainder of 2018."

Core Personal Consumption Expenditures (PCE), the preferred Federal Reserve inflation gauge, stayed at the Fed target 2.0% for the fourth straight month.

Economic activity in the manufacturing sector expanded in August, and the overall economy grew for the 112th consecutive month, say the nation's supply executives in the latest *Manufacturing ISM Report On Business.* Demand is robust, but the nation's employment resources and supply chains continue to struggle. Respondents are again overwhelmingly concerned about tariff-related activity.

Housing data has been softer in recent months. The Pending Home Sales Index has now fallen on an annual basis for eight consecutive months according to the National Association of Realtors.

The University of Michigan Survey of Consumers remained upbeat in September with the most favorable financial prospects reading since 2004. Consumers anticipated continued growth in the economy and expected the unemployment rate to continue to slowly decline during the year ahead. The single issue that was cited as having a potential negative impact on the economy was tariffs.

Financial Markets Review: Domestic Stock Market

So much for "Sell in May and go away." The S&P leaped 7.19% in the third quarter (excluding dividends) setting a new record in the process before closing at 2,913.98. Likewise, the Dow Jones Industrial average marked a new high, jumping 9.01% to 26,458.31, And the NASDAQ Composite broke through 8,000 on its way to a 7.14% gain, finishing the quarter at 8,046.35.

We will say good bye to the telecommunication services sector, but hello to communication services, as The MSCI reshuffles the lineup beginning with the final quarter of 2018. In the third quarter, all 11 sectors gained ground. The top performers for the period were health care (+14.53%), industrials (+10.00%), and in a swan song telecommunication services (+9.94%). Sectors rising less than one percent included materials (+0.36%), energy (+0.61%), and real estate (0.86%).

Large cap growth stocks continued to dominate among market capitalizations and styles for the quarter, year-to-date and the past 1, 3, 5 and 10 years.

The top-performing stocks in the Dow Jones Industrials for the third quarter included Apple (+21.9%), Pfizer (+21.5%) and Walgreens (+21.5%). Detractors from the Dow's performance included Intel (-4.9%), Chevron (-3.3%) and DowDuPont (-2.4%).

The best performing S&P industry groups for the quarter were consumer electronics (+45.1%), computer hardware (+18.8%), and airlines (+17.4%). The worst performers were platinum & precious metals (-24.2%) gold mining (-19.0%) and nonferrous metals (-17.5%).

Looking ahead, consumer confidence is high and underlying fundamentals continue to show strength. Still, escalating trade tensions with U.S. allies and major trading partners remain at the forefront as the economy enters the fourth quarter.

In addition to the potential for prolonged U.S.-China frictions, other sources of geopolitical angst include European fragmentation led by Italy's new government, Latin America populism, oil price increases on fears of supply disruptions, an increasingly confrontational stance with Iran in the Middle East, a breakdown of the North Korea talks, an increase in Russia-NATO tensions, further military escalation in the South China Sea, and a major terror or cyberattack.

Nevertheless, the economic expansion remains intact. With no recession currently in sight and the potential for a post mid-term election bounce, we remain positive with a view of the markets continuing to advance.

	Total Returns (09/30/18)			Annualized Returns (09/30/18)		
Category/Style	3rd Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
S&P 500	7.71	10.56	17.91	17.31	13.95	11.97
S&P Midcap 400	3.86	7.49	14.21	15.68	11.91	12.49
S&P Small Cap 600	4.71	14.54	19.08	19.41	13.32	12.86
Russell 1000 Large Cap Growth	9.17	17.09	26.30	20.55	16.58	14.31
Russell 1000 Large Cap Value	5.70	3.92	9.45	13.55	10.72	9.79
Russell 2000 Small Cap Growth	5.52	15.76	21.06	17.98	12.14	12.65
Russell 2000 Small Cap Value	1.60	7.14	9.33	16.12	9.91	9.52

Source: Standard and Poor's, Frank Russell Company

International Stock Markets

Synchronized global expansion looked more like global divergence in the third quarter as US dollar strength and trade tensions took their toll on international markets.

The MSCI EAFE Index of developed markets managed a 1.35% return for the third quarter but remained 1.43% in the red year-to-date. Diverging significantly from the US, emerging markets had a rough quarter ending down 1.09%. Year-to-date EM stocks show a loss of 7.68%. Frontier markets fared worse, dropping 1.98% for the period and posted a double digit loss of 12.63% for the year-to-date.

In the Eurozone, the Euro Stoxx Index edged 0.36% higher to 378.27 in local currency. France's CAC-40 Index gained 3.19% to 5,493.49 while Germany's DAX Index slipped 0.48% to 12,246.73 and the UK's London FTSE 100 Index fell 1.66% to 7,510.20 on continuing Brexit uncertainty.

In Asia, Japan's Nikkei stock average advanced 8.14% to a decades high 24,120.04. In emerging markets, China's Shanghai Composite Index sank 0.91% to 2,821.35 in local dollars, while India's S&P BSE Sensex index gained 2.27% to 36,227.14.

The Americas DJ Americas index was up 6.41% for the quarter to 691.89. Brazil's Sao Paulo Bovespa Index rebounded 9.04% to 9,342.43. Canada's S&R/TSX composite index dropped 1.26% to 16,073.14 and Mexico's S&P/BMV IPC Index advanced 3.86% for the quarter to 49,504.16.

Top performing countries for the quarter (in $U.S.) based on the S&P Global BMI (Broad Market Index) were Thailand (+13.3%), Slovakia (+9.1%), and Qatar (+9.1%). Laggards included Kazakhstan (-24.8%), Turkey (-21.3%) and Sri Lanka (-15.8%).

The dollar moved slightly higher against world currencies edging up 0.64% according to the WSJ Dollar Index. The dollar advanced 2.67% against the yen, ending the quarter at 113.69 (JPY/USD) and was 0.67% stronger versus the euro at $1.16 (USD/EUR).

World Bond Markets

The U.S. 10-year note yield stood at 3.05% at quarter end. The yield curve flattened for the seventh consecutive quarter with the spread between the 2-year and 10-year bond narrowing to 23 basis points. Still, an imminent yield curve inversion appears unlikely.

The quarter was not kind to bond investors with the Barclays U.S. Aggregate Bond Index dropping 0.92%, the Barclays U.S. Treasury TIPS Index falling 0.82% and the Barclays Municipal Index slipping 0.15%. The average money market yield was 1.85% according to the Crane 100 Money Fund Index at the September close. Yields on foreign bonds climbed across the board in the third quarter, with the 10-year bond yield up 0.34% in the UK to 1.59%, ahead 0.33% to 2.42% in Canada, better by 0.21% to 0.53% in Germany and edging 0.09% higher in Japan to 0.13%.

Commodities

Commodities moved 2.43% lower in the third quarter to 625.37, as measured by the DJ commodity index. Among individual commodities, Gold fell $59.80 (4.78%), dropping below $1,200, to $1,191.50/troy oz. and is lower by 8.79% year-to-date. Crude oil slid a modest $0.90/barrel (1.21%) to $73.25 but the black gold remains 21.23% higher for the year and is up 41.48% from its 52 week low. The national average price of gas barely budged in the third quarter. According to AAA the price moved up two cents to $2.87.

Mutual Funds/Exchange-Traded Funds

The proliferation of passive investing and low cost Exchange-Traded Funds (ETFs) continues with another 140 ETF funds added to the ranks in the past 12 months, bringing the total number of choices to 1,923. ETF assets increased $614 billion over the past year to $3.68 trillion as of August 2018, according to the Investment Company Institute. Mutual funds still dwarf ETFs in total assets growing 9.2% over the same period to $19.47 trillion. But the mutual fund ranks continue to decline in the number with a loss of 103 selections to 7,915.

MUTUAL FUNDS OVERVIEW AS OF SEPTEMBER 30, 2018

	Total Returns			Annualized Returns		
Category	**3rd Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
Municipal Bond Interm-Term	-0.18	-0.44	-0.07	1.80	2.87	3.98
Short-Term Taxable Bond	0.50	0.45	0.43	1.37	1.24	2.56
Interm.-Term Taxable Bond	0.18	-1.38	-1.07	1.65	2.16	4.25
Long-Term Taxable Bond	-0.06	-3.52	-1.44	4.01	5.22	7.02
High Yield Bond	2.00	1.82	2.35	6.38	4.30	7.62
World Bond	-0.26	-1.82	-1.26	2.49	1.05	3.49
Small-Cap Blend	2.78	8.11	12.03	14.67	9.72	10.71
Mid-Cap Blend	3.95	5.93	11.66	12.75	9.74	10.67
Large-Cap Blend	6.70	8.44	15.39	15.18	11.91	10.84
World Large Stock	3.45	3.66	8.89	12.47	8.27	8.29
Foreign Large Blend	0.79	-2.33	1.51	8.74	4.10	5.04
Natural Resources	-0.33	-1.25	5.88	13.41	1.26	3.61
Real Estate	0.60	1.24	3.42	7.17	8.52	7.11

Source: Morningstar Category Returns, Morningstar, Inc.

Important Definitions and Disclosures

The opinions and material presented are provided for informational purposes only. No person or system can predict the market. Neither asset allocation nor diversification guarantee a profit or protect against a loss. All investments are subject to risk, including the risk of principal loss. There is no assurance that the investment goals and process described herein will consistently lead to successful investing. Asset allocation and diversification do not eliminate the risk of experiencing investment losses. The investment return and principal value of an investment will fluctuate, and an investor's shares, when redeemed, may be worth more or less than their original cost. Funds that invest in stocks of small-cap or mid-cap companies involve additional risks. The securities of these companies may be more volatile and less liquid than the securities of larger companies. Funds that invest in international securities involve special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investment in emerging markets may accentuate these risks. Alternative strategies, including those used in mutual funds, have risks that may substantially increase the potential for loss. Bonds are subject to interest rate risk. Bonds have interest rate risk and credit risk. As interest rates rise, existing bond prices fall and can cause the value of an investment to decline. Changes in interest rates generally have a greater effect on bonds with longer maturities than on those with shorter maturities. Funds that hold bonds are subject to declines and increases in value due to general changes in interest rates. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and/or interest payments.

The information shown does not constitute investment advice and does not consider the investment objectives, risk tolerance or financial circumstances of any specific investor. The information provided is not intended to be a complete analysis of every material fact with respect to any portfolio, security, or strategy and has been presented for educational purposes only. Data obtained from the sources cited is believed to be reliable and accurate at the time of compilation. Nothing contained herein should be construed as a recommendation to buy or sell any individual securities. It should not be assumed that an investment in any of the securities identified was or will be profitable.

Gross Domestic Product (GDP) is a measure of output from U.S factories and related consumption in the United States. It does not include products made by US companies in foreign markets. **Real Gross Domestic Product** (real GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). The **Federal Open Market Committee** (FOMC), a committee within the Federal Reserve System is charged under United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities). The **Atlanta Fed GDPNow** estimate is a model-based projection not subject to judgmental adjustments. It is not an official forecast of the Atlanta Fed, its president, the Federal Reserve System, or the Federal Open Market Committee. **Personal Consumption Expenditures** (PCE) is a measure of price changes in consumer goods and services and consist of the actual and imputed expenditures of households; the measure includes data pertaining to durables, non-durables and services. The **S&P/Case-Shiller Home Price Indices** are the leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate both nationally as well as in 20 metropolitan regions. . The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM). The ISM Manufacturing Index monitors employment, production, inventories, new orders and supplier deliveries. A composite diffusion index monitors conditions in national manufacturing and is based on the data from these surveys. The **unemployment rate** percentage of total workforce who are unemployed and are looking for a paid job. Unemployment rate is one of the most closely watched statistics because a rising rate is seen as a sign of weakening economy that may call for cut in interest rate. A falling rate, similarly, indicates a growing economy which is usually accompanied by higher inflation rate and may call for increase in interest rates. Labor force participation rate is the percentage of working age population that is part of the labor force. It is a measure of what proportion of a country's population is employed or actively looking for employment. The index of leading economic indicators is intended to predict future economic activity. Typically, three consecutive monthly LEI changes in the same direction suggest a turning point in the economy. **Inflation** is the rise in the prices of goods and services, as happens when spending increases relative to the supply of goods on the market. Moderate inflation is a common result of economic growth. Hyperinflation, with prices rising at 100% a year or more, causes people to lose confidence in the currency and put their assets in hard assets like real estate or gold, which usually retain their value in inflationary times. **Treasury Yield Curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. **The Conference Board Leading Economic Index® (LEI)** for the U.S. are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components. **The Michigan Consumer Sentiment Index** was created in the 1940s is conducted by the Survey Research Center and consists of at least 500 telephone interviews posed to a different cross-section of consumers in the continental U.S. each month. The survey questions consumers on their views of their own personal finances, as well as the short-term and long-term state of the U.S. economy. Each survey contains approximately 50 core questions, and each respondent is contacted again for another survey six months after completing the first one. The answers to these questions form the basis of the index. **S&P 500 Index** is an index of 500 of the largest exchange-traded stocks in the US from a broad range of industries whose collective performance mirrors the overall stock market. The **Dow Jones Industrial Average** is a widely watched index of 30 American stocks thought to represent the pulse of the American economy and markets. The **NASDAQ** is an index that tracks the cumulative results on a market capitalization basis of all stocks trading in the NASDAQ system. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment. The **S&P SmallCap 600 Index** (S&P600) covers roughly the small-cap range of US stocks, using a capitalization-weighted index. The index covers roughly three percent of the total US stock market. The **S&P MidCap 400 Index** (S&P400) is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the US mid-cap equities sector and is the most widely followed mid-cap index in existence. To be included in the index, a stock must have a total market capitalization that ranges from roughly $750 million to $3.3 billion. The **Russell 1000 Index** is a capitalization-weighted price-only index which is comprised of 1000 of the largest capitalized US-domiciled companies whose common stock trade in the United States on the New York Stock Exchange, American Stock Exchange and NASDAQ which are included in the Russell 3000 Index. This large cap market-oriented Index is highly correlated with the S&P 500 Index. **Russell 2000 Index** is a market-value-weighted index representing the 2,000 smallest companies in the Russell 3000 index, representative of the US small capitalization securities market. **NAREIT Equity Index** is comprised of real estate investment trusts which own or have an equity interest in rental real estate (rather than making loans secured by real estate collateral). REITs involve risk, including the loss of principal and the possible lack of liquidity. **Morgan Stanley Capital International** (MSCI) All Country World Index (ACWI) is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world.**MSCI EAFE Index** is a market capitalization-weighted index of the leading stocks in Europe, Australasia and Far East. Membership of the index is selected by MSCI and designed for leading stocks roughly to match market sector weights. The **MSCI Emerging Markets Index** is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index that consists of indices in 21 emerging economies: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. The **MSCI Frontier Markets Index** provides broad representation of the equity opportunity set while taking investability requirements into consideration within each market. MSCI classifies 34 countries as Frontier Markets, 26 of which are included in the MSCI Frontier Markets Index. The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. The **CAC 40 Index** is a benchmark French stock market index. The index represents a capitalization-weighted measure of the 40 most significant values among the 100 highest market caps on the Paris Bourse (now Euronext

Paris). The **DAX Index** is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The **FTSE 100** is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The **DJ Asia-Pacific Index** represents the leading stocks by dividend yield traded in the Asia/Pacific region.

The **Nikkei Index** is a stock market index for the Tokyo Stock Exchange (TSE). The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. **S&P BSE Sensex index**, is the benchmark index of the Bombay Stock Exchange (BSE). It is composed of 30 of the largest and most actively-traded stocks on the BSE, providing an accurate gauge of India's economy. The **BM&F Bovespa**, also known as the Sao Paul Stock Exchange, is Brazil's stock exchange. It is the third largest stock exchange in the world by market value with over 500 companies traded on the exchange. The IBOVESPA is an index of about 50 stocks and is the main indicator of the Brazilian stock market's average performance. **S&P/TSX 60 Index** is a stock market index of 60 large companies listed on the Toronto Stock Exchange. Maintained by the Canadian S&P Index Committee, a unit of Standard & Poor's, it exposes the investor to ten industry sectors. **S&P/BMV IPC Index** seeks to measure the performance of the largest and most liquid stocks listed on the Bolsa Mexicana de Valores. The index is designed to provide a broad, representative, yet easily replicable index covering the Mexican equities market. The constituents are weighted by modified market cap subject to diversification requirements. In exchange for greater growth potential, investments in foreign securities can have added risks. These include changes in currency rates, economic and monetary policy, differences in auditing standards and risks related to political and economic developments. The **S&P Global BMI (Broad Market Index)** comprises the S&P Developed BMI and S&P Emerging BMI, is a comprehensive, rules-based index measuring global stock market performance. **Barclays Aggregate Bond Index** is made up of the Lehman Brothers Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Based Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million. The **Barclays Municipal Bond Index** is a market value weighted index of investment grade municipal bonds with maturities of one year or more. The **Barclays Capital US Government Inflation-Linked Bond Index** (US TIPS) measures the performance of the TIPS market. TIPS form the largest component of the Barclays Capital Global Inflation-Linked Bond Index. Inflation-linked indices include only capital indexed bonds with a remaining maturity of one year or more. Treasury notes (T-notes) are intermediate securities with maturities of 1 to 10 years. Denominations range from $1000 to $1 million or more. The notes are sold by cash subscriptions, in exchange for outstanding or maturing government issues, or at auction. **Barclays Capital Global Aggregate ex-U.S. Index** measures the performance of the global bond market, excluding U.S. securities. **Bloomberg Commodity Index:** is a world-production weighted total return index, including reinvested dividends, measuring investor returns from a fully-collateralized commodity futures investment. Due to market fluctuation, the commodities represented by this index may experience loss of invested principal and are subject to investment risk. An exchange-traded fund (**ETF**) is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. Indexes are unmanaged and investors cannot invest directly in an index.

Morningstar Category Returns are composed of the average return for the funds in each Morningstar category over the indicated time period. Categories are defined by Morningstar based on holdings statistics. The category returns are adjusted for survivorship bias, meaning they include all investments even if liquidated, merged or otherwise now obsolete. The returns also include funds that were in a given Morningstar category, but have since changed to another category.