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Q1 2018 – Market Overview Newsletter

Economic Update

Volatility itself isn't necessarily a bad thing, nor is it unusual. Given the length of the current bull market, some investors may fear that we are "overdue" for a recession and are concerned when there is a pullback in the market. We are now in the tenth year of a bull market which is slightly longer than average but more than three years away from being the longest in history. Following the smooth sailing of investing in 2017 the market movement we have seen since the beginning of February may have many feeling that much more uncomfortable. The continual upward performance of last year was unusual and unsustainable. We see volatility trending back to normal levels as a sign that the checks and balances of the stock market are alive and well.

Early in the year, the threat of higher inflation brought on fears of rapidly rising interest rates. Inflation has been relatively low for years, so why wouldn't some acceleration be welcome? Up until this point hadn't the fear been that there wasn't enough inflation? In March inflation was stated at 2.4%, which shouldn't be a level that is likely to become a drag on equities.

For years we have been thinking and talking about rising interest rates. The federal reserve has been very forthcoming about their plans for increasing the federal funds rate gradually and the course hasn't seemed to change under the direction of fed chairman Jerome Powell. Our underlying economy continues to show strength we have reached the Fed's targets for unemployment and inflation. In March they voted to raise the rates by 25 basis points, as expected, and the general consensus is that we will see an additional three rate hikes this year. Time will tell but Powell's job, after all, is to keep the economy going without starting a recession.

Geopolitically, there is a potential trade war to consider, but even China doesn't want a full-blown trade war. In the short-term changes in trade policy may be disruptive, but long-term we still see opportunities for investments both in the United States and around the world. While we may see some restriction in the trade of physical goods, data and capital are still likely to flow freely. Even so, not all multinational companies ship goods. There are companies across the globe that have multiple subsidiaries doing business as though they are local companies.

Companies in the United States still seem to be doing well and estimates for earnings look strong. The changes to the tax code should be a boost for many corporations. Valuations that were for a time beginning to look expensive were down to 16.4x earnings as of 3/31/18, which is only slightly above the 25-year average of 16.1x. Although the first few months have been rocky, we still feel this could be a positive year for U.S. equities.

International countries and companies have continued to grow as well. International markets have not yet had the same earnings we have seen in U.S. markets, providing lower valuations and opportunities for potential growth going forward. The value of the US Dollar also has an impact on international investment returns. We have been seeing a decline in the value of the dollar relative to other currencies which acts as a tail wind, increasing international returns. This will likely be a continuing trend for the next several years.

While there are plenty risks out there, we also see opportunities and potential for continued growth. Anything can happen in a few months or a year. As always, having a diversified portfolio, a long-term perspective and staying the course can help guide you toward success. -LS

For more market details, see the "Capital Analysts Q1 2018 Market Review" in the commentaries page on our website at www.langdonshaw.com/commentaries

DISCLOSURE INFORMATION

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, 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 respecting 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. None of the information in this document should be considered as tax advice. You should consult your tax advisor for information concerning your individual situation. The Federal Reserve System (also known as the Federal Reserve, and informally as the Fed) is the central banking system of the United States. The Federal Reserve System is composed of 12 regional Reserve banks which supervise state member banks. The Federal Reserve System controls the Federal Funds Rate (aka Fed Rate), an important benchmark in financial markets used to influence the supply of money in the U.S. economy. Quantitative easing is an unconventional monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity. Quantitative easing is considered when short-term interest rates are at or approaching zero, and does not involve the printing of new banknotes. 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. 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 U.S. Treasury yield is the return on investment, expressed as a percentage, on the U.S. government's debt obligations (bonds, notes and bills). The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market. **Benchmark Definitions 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 S&P Small Cap 600 Index** 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 Mid Cap 400** is a capitalization weighted index that measures the performance of the mid-range sector of the U.S. stock market. Morgan Stanley Capital International **(MSCI) EAFE Index** (Europe, Australasia and Far East) is an index created by Morgan Stanley Capital International (MSCI) that serves as a benchmark of the performance in major international equity markets as represented by major MSCI indexes from Europe, Australia and Southeast Asia. **The MSCI Emerging Markets Index** is a float-adjusted market capitalization index that is designed to measure equity market performance in emerging markets. It consists of indices in 23 emerging market country indexes: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and Arab Emirates. With 834 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Investors cannot invest directly in an index. Participation in a 529 College Savings Plan (529 Plan) does not guarantee that contributions and investment return on contributions, if any, will be adequate to cover future tuition and other higher education expenses or that a beneficiary will be admitted to or permitted to continue to attend an institution of higher education. Contributors to the program assume all investment risk, including potential loss of principal and liability for penalties such as those levied for non-educational withdrawals. Depending upon the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by such home state for investing in 529 college savings plans may be available only if the customer invests in the home state's 529 college savings plan. Consult with your financial, tax or other adviser to learn more about how state-based benefits (including any limitations) would apply to your specific circumstances. You may also wish to contact your home state or any other 529 college savings plan to learn more about the features, benefits and limitations of that state's 529 college savings plan. For more complete information, including a description of fees, expenses and risks, see the offering statement or program description.

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.
A recession is a significant decline in activity across the economy, lasting longer than a few months. It is visible in industrial production, employment, real income and wholesale-retail trade. The technical indicator of a recession is two consecutive quarters of negative economic growth as measured by a country's gross domestic product (GDP); although the National Bureau of Economic Research (NBER) does not necessarily need to see this occur to call a recession.