DNB FIRST Wealth Management

Investment Commentary Q2 2018

The U.S. equity markets rose during the second quarter of 2018 despite higher short-term U.S. interest rates and trade tensions between the U.S. and China. Large, Mid, and Small Cap stocks rose 3%, 3%, and 8% respectively during the quarter as U.S. corporations benefitted from lower taxes and higher consumer spending. The Energy and Consumer Discretionary sectors rose 13% and 8% respectively due to higher crude oil prices and consumer spending during the quarter. The Industrial and Consumer Staples sectors fell 3% and 2% respectively during the quarter as trade tensions escalated between the U.S., China, and the European Union. International-Developed Market equities fell 1% during the quarter due to slower European economic growth. Emerging Market stocks fell 7% during the quarter as global investors reacted to slower Asian economic growth and capital outflows from South American countries such as Brazil and Argentina. U.S. bonds fell 1% during the quarter as the Federal Reserve raised its fed funds benchmark rate by 0.25% to 2.00% in June. International-Developed Markets and Emerging Markets bonds fell 1% and 3% respectively during the second quarter as global bond investors reacted to higher capital outflows and currency fluctuations within the European, Asian, and South American regions.

The U.S. economy grew at an annualized pace of 4.1% during the second quarter of 2018, its fastest annualized growth rate since 2014. The higher growth rate was attributed to higher consumer spending, exports, and government spending. Corporate earnings also grew during the second quarter as U.S. small and large firms continue to benefit from the Tax Cuts and Jobs Act of 2017. Companies that comprise the S & P 500 Index are projected to see earnings increases of approximately 20% (year-over-year) from 2017 to 2018. The increase in corporate earnings can be attributed to lower regulatory costs, higher global consumer demand, and lower corporate taxes. Investors and analysts now wonder if the U.S. economy will continue on this pace or reach the peak of its economic cycle. The "peak" of an economic cycle is defined as the end of an economy's expansionary stage and beginning of contraction within the economy. This period is normally categorized by falling housing starts, slower credit growth, and rising inflationary pressures. We believe that trade negotiations between the U.S., European Union, and China will be critical in maintaining a stable economic environment for domestic and international firms and consumers.

International and Emerging Market economies continued to underperform during the second quarter due to Brexit and trade concerns between the European Union ("EU"), China, and the U.S. The Eurozone GDP grew at an annualized rate of only 0.3% during the second quarter while the overall unemployment rate remained at 8.3%. Eurozone GDP grew at an annualized rate of 2.1% during 2017. The Trump Administration placed tariffs on imports such as aluminum and steel products while the EU placed tariffs on Harley-Davidson motorcycles. According to the Associated Press, surveys of European business leaders showed concerns about the short-term effects from the trade disputes. Emerging Market economic growth rates also fell during the quarter due to China's industrial slowdown, debt concerns, capital outflows, and currency fluctuations due to rising U.S. interest rates and political instability in South America. Despite recent economic and market volatility, economists forecast that Emerging Market economies will have the fastest GDP growth rates over the next several years.

We modestly reduced our Emerging Market equity positions due to continued market volatility in the South American and Asian regions. We added a Market Neutral position to our client portfolios due to our concern that the global equity and bond markets will experience higher volatility during the remainder of 2018. We will continue to utilize lower-cost investment choices and provide our clients with a repeatable, disciplined, and transparent investment process.

As always, we welcome your thoughts and concerns. Please contact your DNB First Wealth Management Advisor to discuss your portfolio in further detail.