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QUARTERLY MARKET INSIGHTS
2ND QUARTER 2018

SPOTLIGHT

THE U.S.-CHINA TRADE RELATIONSHIP

After spending the majority of 2017 working with Congress on changes to health care and tax policy, the Trump Administration has prioritized U.S. trade policy in 2018. While previously the realm of academics and bureaucrats, trade policy and trade disputes have permeated national headlines since early March, when President Trump announced plans for tariffs on all steel and aluminum imported to the U.S. The administration's stance is an extension of President Trump's campaign trail message on trade policy; namely that the U.S. must take steps to create a global trade system that is fairer towards American manufacturers and exporters, and to prevent China from industrial espionage and forcing U.S. firms to transfer technology.

The major players in the administration's efforts to re-set trade policy can be loosely categorized as those desiring a more aggressive approach (especially towards China) and those who argue for a more measured approach. The group in favor of a more forceful set of policies includes U.S. Trade Representative Robert Lighthizer and White House Director of Trade and Industrial Policy Peter Navarro. Lighthizer is an international trade lawyer who served as U.S. Trade Representative during the Reagan Administration, while Navarro is an economics professor and stringent critic of the effects of Chinese and German industrial and trade policy on the American economy and its workers. Prominent members of the group seen as preferring a less aggressive approach to trade conflict include Treasury Secretary Steven Mnuchin, and Director of the U.S. National Economic Council, Larry Kudlow.

As the second quarter ended, negotiations between the U.S. and China on avoiding a round of $50 billion worth of tit-for-tat tariffs stalled before a July 6 deadline. The timeline of events leading to the current situation began on January 22, when the U.S. placed tariffs on imports of large residential washing machines and solar cells and modules in response to requests from several U.S. companies including Whirlpool, Inc. which said they were unable to compete with cheap imports. On March 1, President Trump announced his intention to impose a 25% tariff on imported steel and a 10% tariff on imported aluminum applicable to all trading partners with a temporary exemption given to Canada and Mexico. The Administration cited Section 232 of the Trade Expansion Act of 1962 as its legal basis for the tariffs. Section 232 allows the president to impose tariffs based on the recommendation from the U.S. Secretary of Commerce if "an article is being imported into the United States in such quantities or under such circumstances as to threaten or impair the national security." China and the European Union ("EU") both initiated WTO complaints against the U.S. steel and aluminum tariffs in the second quarter. Notably, the EU placed retaliatory tariffs on $3 billion of U.S. goods targeting industries and companies located in Congressional districts which backed President Trump in the 2016 election including motorcycle manufacturer Harley Davidson, Inc. After the EU tariffs came into effect in June, the Administration threatened a 20% tariff on automobile imports from the EU. In May, China reportedly offered to buy an additional $100 billion of U.S. goods to narrow the $375 billion U.S. trade deficit with China. (The U.S. imported $505 billion of Chinese goods in 2017, but exported just $135 billion of goods to China). However, the Trump Administration rejected the offer, citing their objective of pushing China to make structural changes to its trade policy.

On June 15, President Trump said he was moving forward with imposing a 25% tariff on $50 billion of Chinese goods on more than 800 strategically relevant areas of the Chinese economy. These areas include industries which comprise China's Made in China 2025 strategic plan to dominate a set of high-technology industries including robotics, electric vehicles, aviation, semiconductors and biopharmaceuticals. U.S. Trade Representative Lighthizer and Peter Navarro have remarked publicly that the $50 billion of tariffs are partly retribution for China's alleged intellectual property theft of U.S. corporations' technology. China immediately announced retaliatory tariffs of an equivalent amount on U.S. goods including soybeans, aircraft, automobiles and chemicals. American soybean farmers now face a 28% tariff when their product hits Chinese shores, while most other competitors are exempt from duties. U.S. automakers now face a 40% tariff to sell into the Chinese market, up from 15% previously.

While it is too early to point to any long-lasting investment implications from the burgeoning trade conflict, several recent developments are notable. First, the Chinese stock market as measured by the Shanghai Composite has declined more than 20% since late January, while the Chinese yuan fell 3.4% in June versus the U.S. dollar as the U.S. Federal Reserve continues on their path of gradual interest rate hikes. While the broad U.S. stock market has held up during this period of trade uncertainty, the industrial sector struggled in the second quarter likely due to concern about increased costs for U.S. manufacturers importing parts from China which fall under the new tariffs' umbrella. Shares of construction and mining machinery giant Caterpillar Inc. and blue chip aerospace firm The Boeing Company (both Dow components) underperformed the S&P 500 Index by 7.1% and 11.4%, respectively from June 13 to June 29.

ECONOMY

ECONOMIC OUTLOOK POSITIVE DESPITE SLOWER Q1

Economic growth was slower at the beginning of the year than previously reported, as consumers pulled back spending and the housing market weighed down output. According to the Commerce Department, real (inflation-adjusted) Gross Domestic Product (GDP) expanded at a seasonally adjusted annualized rate of 2.0% in the first quarter which was weaker than an earlier estimate of 2.2% growth. Health care purchases by non-profit organizations and spending on finance and insurance services were all weaker than previously reported. The investment outside of the housing market, including purchases of computer software and spending on research and development, was stronger than earlier reported, growing by the fastest pace in about three years. Most economists expect the full impact of tax cuts and increased government spending to contribute to above 2.5% GDP growth in 2018 despite slowing productivity.

As expected, the Federal Reserve raised short-term interest rates for the second time this year in June, raising its federal funds rate by 0.25% to the target range of 1.75%-2.00%. Eight of the Fed's 15 officials forecast two additional rate increases this year, up from seven officials in March and four in December. The majority of officials anticipate at least three interest rate increases next year and one in 2020, bringing the federal funds rate to the range of 3.25%-3.50% by 2020. The interest rate spread between the U.S. and foreign developed countries may continue to widen as the Fed raises rates while the European Central Bank (ECB) and Bank of Japan (BOJ) leave rates unchanged. The ECB indicated recently it will not raise interest rates before next summer, but it will end its bond buying program in December. The BOJ has also kept interest rates unchanged this year. BOJ Governor Haruhiko Kuroda said it is too early to talk about exiting its accommodative monetary policy given Japan's 0.6% inflation rate is well below the central bank's 2.0% target.

HOUSING

Sales of new U.S. single-family homes increased more than expected in May as sales in the south surged to their highest level in nearly 11 years. The Commerce Department announced that

ECONOMIC INDICATORS	LATEST	3MO PRIOR	CHANGE*
REAL GDP (QoQ ANNUALIZED)	2.0%	2.9%	▼
TRADE BALANCE	-43.1	-55.5	▲
UNEMPLOYMENT RATE	4.0%	4.1%	▲
NON-FARM PAYROLLS	213K	155K	▲
ISM MANUFACTURING	60.2	59.3	▲
ISM NON-MANUFACTURING	59.1	58.8	▲
RETAIL SALES (LESS AUTOS)	0.8%	0.4%	▲
INDUSTRIAL PRODUCTION	-0.1%	0.4%	▼
HOUSING STARTS	1350M	1290M	▲
CONSUMER PRICE INDEX (YoY)	2.8%	2.2%	▼
CONSUMER CONFIDENCE	126.4	127.0	▼
EXISTING HOME SALES	5.43M	5.54M	▼
CONSUMER CREDIT	24.55B	11.19B	▲
CRUDE OIL PRICE	74.15	64.94	▼

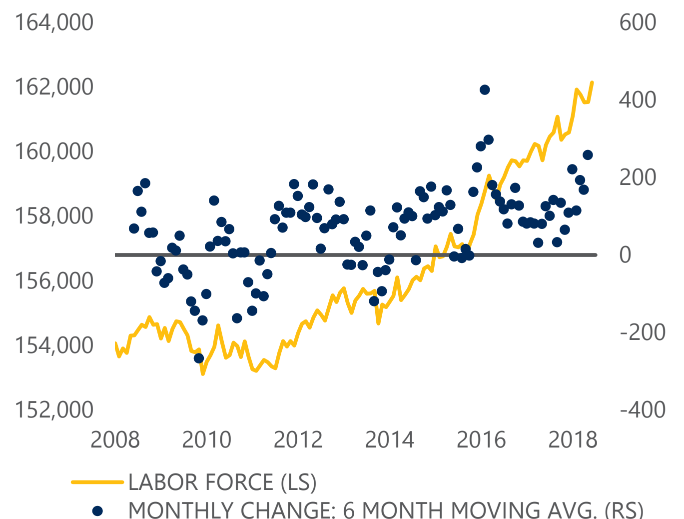
Source: Bloomberg. Past performance does not guarantee future results. *The change arrow is indicative of a positive or negative change in the economic nature of the data series. For example, a downward-pointing change arrow assigned to the crude oil price field will correspond with an increase in the actual price of crude oil over the last three months. This is because a short-term increase in the price of crude oil has historically been detrimental to U.S. economic growth.

new home sales jumped 6.7% to a seasonally adjusted annualized rate of 689,000 units last month, the highest level since November 2017. April's sales pace was revised down to 646,000 units from the previously reported 662,000 units. Sales in the south, which account for the bulk of transactions, rebounded 17.9% to a rate of 409,000 units in May, the highest level since July 2007. Contracts to buy previously owned homes unexpectedly declined for the second straight month in May, mostly due to a shortage of properties for sale. Housing starts in May were relatively robust, coming in at a seasonally adjusted annual rate of 1.35 million units, a 5.0% increase compared to the number of starts in April, according to the U.S. Census Bureau. Existing-home sales in the U.S. unexpectedly declined with Lawrence Yun, National Association of Realtors' chief economist, noting, "Incredibly low supply continues to be the primary impediment to more sales, but there's no question the combination of higher prices and mortgage rates are pinching the budgets of prospective buyers." ATTOM Data Solutions' index of housing affordability indicated home prices in the second quarter were at their least affordable level since the third quarter of 2008.

EMPLOYMENT AND MANUFACTURING

Employment growth remained strong in June as the economy added 213,000 jobs despite worker shortages and rising U.S. trade tensions. The unemployment rate rose from an 18-year low of 3.8% to 4.0% as an additional 600,000 Americans, including many discouraged workers on the sidelines, came back into the favorable job market, according to the Labor Department. Economists had expected 195,000 job gains, according to a Bloomberg survey. Monthly additions have averaged above 200,000 this year. Average hourly earnings increased to $26.98, keeping the annual increase unchanged at 2.7%. Wage increases have not picked up as much as anticipated in light of the historically low jobless rate, but economists expect annual gains to reach 3% by the end of the year. Any significant acceleration of wage growth could prompt the Federal Reserve to raise interest rates more sharply to head off a spike in inflation.

Economic activity in the manufacturing sector expanded in June with the overall economy growing for the 110th consecutive month, according to the latest PMI report from the Institute for Supply Management. The June PMI came in at 60.2%, an increase of 1.5% from the May reading of 58.7%. The New Orders Index registered 63.5%, a decrease of 0.2% from the May reading of 63.7%. Of the 18 manufacturing industries measured, 17 reported growth in June. Comments from the panel reflect continued expanding business strength. Demand remains strong, with the New Orders Index at 60% or above for the 14th straight month, and the Customers' Inventories Index remaining low. The Backlog of Orders Index continued to expand, reading at 60% or higher for the third consecutive month.



Source: Bloomberg. Past performance does not guarantee future results.

EQUITY

MAJOR EQUITY ASSET CLASSES DECOUPLE

The spring quarter brought divergent paths for major parts of the global equity market. U.S. stocks powered forward led by shares of high-growth companies, small capitalization firms and the energy sector. On the other side of the ledger, international stocks sputtered. The technology-heavy NASDAQ Composite reached an all-time closing high of 7,781.52 on June 20 on its way to a quarterly total return of 6.6%. The more diversified S&P 500 Index and thirty-stock Dow Jones Industrial Average generated more modest quarterly returns of 3.4% and 1.3%, respectively. Social media bellwether Facebook, Inc., and video streaming service Netflix, Inc., two of the NASDAQ's most heavily weighted members, saw their shares advance in the second quarter by a lofty 21.6% and 32.5%, respectively.

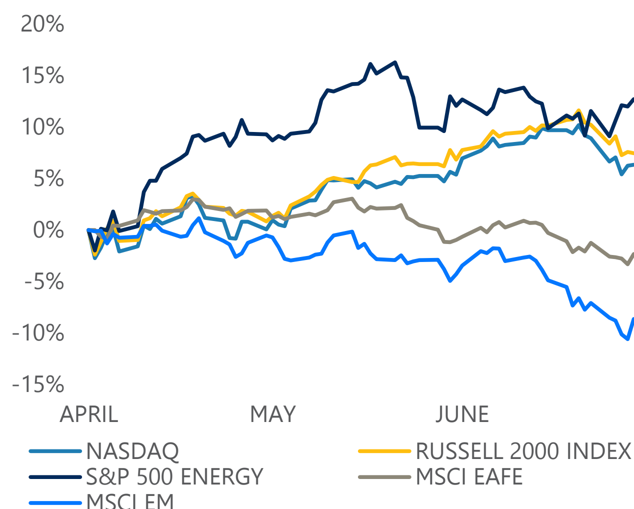
Small cap stocks also performed well in aggregate, headlined by the Russell 2000 Index's 7.8% total return over the period. Investors were attracted to shares of smaller U.S. companies given expectations that they stand to benefit more from the recent corporate tax cuts than their larger peers. They also tend to have less exposure to foreign sales, which may come under pressure from a stronger dollar and recent trade tensions with both China and the EU. Notably, the health care and consumer staples sectors were among the top performing areas of the Russell 2000 Index, while those sectors were average to poor performers in the S&P 500 Index.

There was no shortage of headlines which moved equity markets over an eventful last three months. President Trump met North Korean leader Kim Jung Un at an unprecedented mid-June summit in Singapore, the U.S. and China threatened to slap billions of dollars' worth of tariffs on each other's imports, and Mexico was on the verge of electing a new populist-leaning president in the final days of June. In domestic markets, the media and communications industries drove headlines, as national carrier AT&T Inc. won an appellate court ruling against the U.S. Department of Justice's anti-trust division to proceed with its acquisition of Time Warner Inc., owner of CNN and HBO networks. Meanwhile, entertainment heavyweight Walt Disney Co. received approval to purchase most of Twenty-First Century Fox's media assets including Fox's movie and TV studios and various television networks including FX. E-commerce and cloud computing giant Amazon.com officially entered the U.S. health care industry with its acquisition of online pharmacy PillPack, Inc.

Recent weakness outside the U.S. has halted the so-called synchronized global recovery of 2017, when most regions across the world experience simultaneous economic expansion and strong stock market returns. Higher U.S. interest rates, a slightly more hawkish Federal Reserve, recent strength in the U.S dollar and expectations of strong U.S. economic growth explain at least part of the weakness in the emerging market equity asset class.

MARKETS DECOUPLED IN SECOND QUARTER

APRIL 2018 THROUGH JUNE 2018



Source: Bloomberg. Past performance does not guarantee future results.

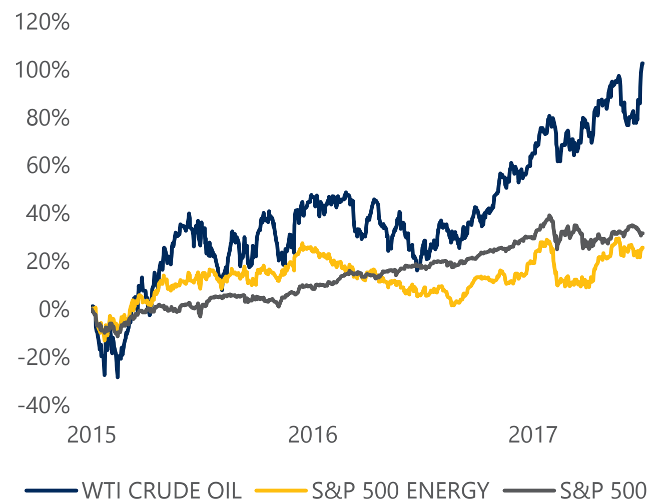
This was highlighted by the struggles of central banks in Brazil, South Africa, Turkey and Argentina to prevent dramatic currency weakness and capital outflows. In an extreme example, the Argentine central bank lifted its benchmark rates three times in eight days to an eventual level of 40% on May 4. The MSCI Argentina Index fell a crippling 42.3% in U.S. dollar terms in the second quarter.

While Argentina remains on the periphery of the emerging markets world, China is very much at its core given its status as the world's second largest national economy. The Chinese stock market has stumbled thus far in 2018 against a backdrop of escalating trade tensions with the U.S. and recent actions taken by authorities in Beijing to slow credit growth. Some investors and market commentators believe the Chinese economy would suffer more pain in a sustained trade conflict than would the U.S. The mainland Shanghai Composite Index declined 14.3% in U.S. dollar terms during the second quarter; it touched bear market territory in the last week of June, down 21% from its multi-year high on January 24. Headwinds in developed international equity markets included German Chancellor Angela Merkel's struggle to form a coalition government, the formation of a populist government in Italy and a slowdown in broad euro zone manufacturing activity.

Turning to more cyclical areas of the U.S. market, the long-maligned energy sector showed signs of life in the second quarter. Weighed down by overinvestment and plummeting oil prices in recent years, shares of companies involved in the supply chains surrounding the exploration, extraction, production, transportation and refinement of oil and gas bounced back this spring. The S&P 500 energy sector index outperformed the broad S&P 500 Index by 10.1% in the second quarter. From the most recent peak of West Texas Intermediate (WTI) crude oil futures at over $107 per barrel on June 20, 2014 to the end of the first quarter this year, the S&P 500 energy sector index has trailed the broad S&P 500 by a staggering 69.7%.

Since WTI crude futures bottomed below $27 per barrel on February 11, 2016 until the end of the second quarter of 2018, the S&P 500 energy sector index has still trailed the broad market by 8.1%, despite a near tripling of oil prices to over $74 per barrel on June 29 of this year. Gains in crude oil prices and the energy sector in the second quarter were supported by expectations of supply disruptions related to the likely reinstatement of Iranian sanctions, the ongoing economic crisis in Venezuela, bottlenecks in the West Texas Permian Basin region and, last but not least, steady global demand for crude.

ENERGY SECTOR TRAILS OIL PRICE RECOVERY
DECEMBER 2015 THROUGH JUNE 2018



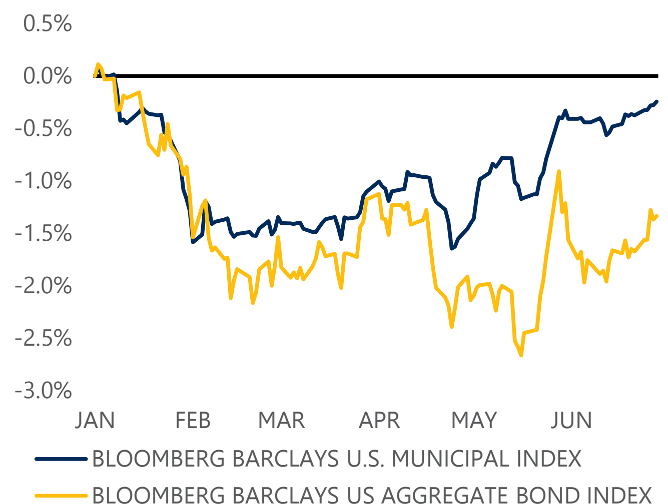
Source: Bloomberg. Past performance does not guarantee future results.

FIXED INCOME

NOT SO "TARIFFYING" TREASURY YIELDS

After suffering a loss of 1.46% in the first quarter of 2018, the Bloomberg Barclays US Aggregate Bond Index declined a much more benign 0.16% in the second quarter, sending the widely used fixed income benchmark to a return of -1.62% through the first half of the year. The second quarter was very much a tale of two halves. Until about mid-May, investors appeared concerned that inflation pressures were finally driving core inflation higher. This took a toll on interest rates in the U.S., as the ten-year Treasury note climbed to a yield of 3.11% by May 17. On roughly the same date the U.S. ten-year breakeven inflation rate hit its highest level since August 2014. The discussion of Treasury curve inversion became top of mind for many investors, with even some Fed officials addressing it in their speaking engagements. Subsequently, many market participants began to wonder if the Fed would tolerate higher levels of inflation going forward, which may have helped yields drift higher at that time. While many suspect that higher inflation will be transitory, that is not what turned the tide in the second half of the quarter. Rather, talks of tariffs and trade wars created uncertainty driving investors toward safe-haven assets.

As rates declined and uncertainty increased, spreads on both investment grade and high yield corporate bonds widened. That said, to this point in the year credit has performed well while long duration bonds have struggled. Given the current credit outlook, Moody's Investors Service has projected that 2018 will see a significant decline from 2017 in the rate of speculative grade defaults; it would not be outlandish to think that a similar pattern of returns could persist through the end of the year. Some caveats to that do exist, including the potential for a continued flattening of the yield curve; it appears many investors and even some Fed presidents like Robert Kaplan are wary of an inverted curve. An inverted curve could be the impetus for an actual credit selloff instead of the gentle drift higher in spreads we have seen thus far. Another caveat would be a more hawkish Fed than that for which the market is prepared. This could serve to choke off inflation, or at least the expectation of it, and drive longer duration bond yields lower, leading to outperformance of these securities versus the broad bond market. The opportunity cost of taking on duration exposure at this time is significant though, and there are other ways to enhance fixed income returns, such as investment grade floating bonds, that make more sense to us at this point.



Source: Bloomberg. Past performance does not guarantee future results.

FIXED INCOME CONTINUED

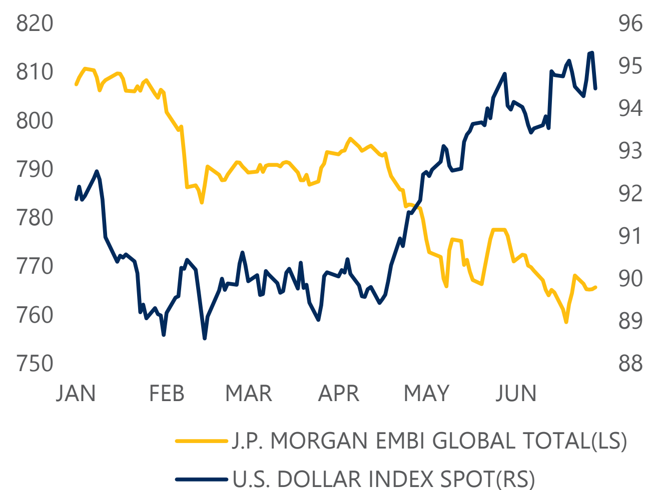
Municipal bonds have had a different experience in 2018 than taxable bonds. In fact, the Bloomberg Barclays U.S. Municipal Index has only lost 0.25% year to date and posted a positive 0.87% return in the second quarter. While many argue that a lack of supply is the main driver, and it certainly may have played a role, that argument seems somewhat simplistic. It is true that average 30-day visible supply year to date has only been 75% of what it was over the first six months of 2017. Yet, some of the broad returns in the muni market can also be explained by better-than-expected returns of lower quality credits, such as Illinois and New Jersey. Finally, California and New York indexes performed well too as the state tax exemption of those bonds became more attractive following the tax law changes at the end of last year. Currently, the ratios of muni yields to Treasury yields are lower in the 1-3 year part of the curve than they were at this point last year, while those ratios are higher in the 5-10 year area of the curve. This suggests to us there may be some value in going a little further out on the curve in municipal bonds.

With global central banks likely to grow more hawkish on balance, investors will need to pay closer attention to the satellite portions of their fixed income portfolios and be prepared to adjust their allocations accordingly. A prime example of this is the poor performance of emerging market bonds thus far this year as the U.S. dollar has appreciated on the back of increased Fed rate hike expectations. At the beginning of the year, the Fed funds futures market was pricing in just a 12% chance that the Fed funds rate would end the year in the 2.25%-2.50% range.

At the end of the second quarter, reaching that range by year end was essentially a coin flip, according to that same market. In that time, the J.P. Morgan EMBI Global Total Return Index has posted a loss of 5.23% while bank loans, high yield bonds, and investment grade floater indexes have all posted positive returns. While it has been popular to blame trade war threats recently for movements in the financial markets, other events such as Brexit and recent Italian political turmoil likely played a larger role in the appreciation of the U.S. dollar as the Fed became relatively more hawkish compared to the Bank of England and the European Central Bank, with the latter pushing back its timeline for its initial rate hike. That appreciation likely explains why the 10-year U.S. Treasury yield fell and remained lower in the second quarter. Any reversal in that relationship between global central banks could drive U.S. interest rates higher and provide some relief to emerging market bonds.

EM BONDS SELL OFF AS DOLLAR APPRECIATES

JANUARY 2018 THROUGH JUNE 2018



Source: Bloomberg. Past performance does not guarantee future results.

OUTLOOK

REVISITING GLOBALLY SYNCHRONIZED MARKETS

It is noteworthy that last year's strong equity performance did not develop sufficient momentum to continue into the first half of 2018. Considering the near consensus view at the end of 2017 that global synchronized economic growth (historically, a rare phenomenon), would provide the necessary backdrop for continued profit growth by global corporations, the diverging results of the world's stock markets might seem surprising.

It turns out, the viewpoint that synchronized global growth would endure appears mistaken. As shown in the table below, global annualized GDP growth rates were fairly strong through the third quarter of 2017. But, by the fourth quarter, a modest deceleration must not have been viewed with concern. In fact, the deceleration worsened in 2018. Japan shrunk, China had decelerated by nearly 25% from its second quarter's pace, and European GDP had been cut in half from its 2017 peak rate.

GDP BY COUNTRY	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
U.S	2.0%	2.9%	3.2%	3.1%	1.2%
EURO ZONE	1.5%	2.8%	2.9%	3.0%	2.7%
CHINA	5.7%	6.5%	7.4%	7.8%	5.7%
JAPAN	-0.6%	1.0%	2.0%	2.1%	2.7%

Source: Bloomberg

As stock markets can be viewed as discounting mechanisms for future growth, performance measured at different intervals ending on June 30, 2018 ought to reflect the divergence in global economic growth rates. As shown in the table below, recent equity returns are markedly different compared to their strength in 2017. Equity momentum seems to be faltering in just about every major equity market, with the exception of technology stocks and small caps, as represented by the NASDAQ and Russell 2000, respectively.

EQUITY MARKET RETURNS	2017	TTM	YTD	Q2 2018
DJIA	28.1%	15.5%	-0.9%	2.1%
S&P 500	21.8%	13.5%	2.6%	4.8%
NASDAQ	29.7%	21.7%	9.3%	8.3%
RUSSEL 2000	14.6%	16.9%	7.8%	9.0%
MSCI EAFE	25.1%	4.3%	-3.4%	-1.6%
MSCI EM	37.8%	6.1%	-8.6%	-9.2%

Source: Bloomberg

Despite the recent divergence in global equity markets, the backdrop for the U.S. remains constructive in our view, but less so compared to previous quarters' readings of our favored indicators. Of the eight macroeconomic factors we track to gauge how strongly or weakly the economic fundamentals support the stock market over the near to intermediate-term, just barely a majority remain constructive. Four indicators are bullish, three are bearish and one is neutral.

ECONOMIC INDICATOR	LATEST	SIGNAL
FED FUNDS POLICY	2.00%	BEAR
STEEPNESS OF YIELD CURVE	0.95%	BULL
UNEMPLOYMENT RATE	3.80%	BULL
WTI OIL PRICE	$ 74.15	BEAR
S&P 500 INDEX	2178.00	BULL
S&P/CASE-SHILLER HOME PRICE INDEX	210.17	BULL
PRODUCER PRICE INDEX	4.10%	BEAR
PHILADELPHIA FED SURVEY	19.90	NEUTRAL

Source: Bloomberg

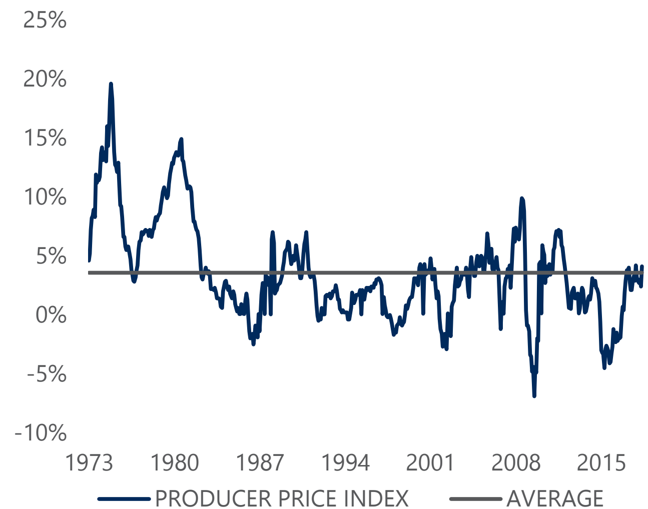
The Federal Reserve continues its gradual pace of rate hikes, resulting in a bearish signal from monetary policy. The inflation gauge has recently turned bearish, with the Producer Price Index rising 4.1%, which is higher than the long-term average of 3.8%. Oil prices remain more than 20% above last year's reading, another bearish indicator, given the negative impact of abruptly higher gasoline prices on consumer sentiment and expenditures. The labor market continues to remain stronger than many would have expected in an environment of very low unemployment. Home prices have recently begun to accelerate, possibly reflecting either their typical seasonal rally, record high employment, rising levels of personal wealth or a combination of all of these factors. Despite the sideways move in stocks year to date, the S&P 500 Index remains modestly above its trailing ten-month average, indicating equity momentum remains intact. We see a neutral reading in the Philadelphia Federal Reserve Business Sentiment index, yet the previous month's reading showed excessive optimism, which has been a contrarian indicator.

PRODUCER PRICE INDEX (PPI)

Our analysis for the impact of inflation on near-term equity results has revealed that producer prices matter more than consumer prices. Over the last 40 years, when producer inflation has been measured at a pace greater than average, equity returns over the following twelve months have been less than the average twelve-month equity returns. This does not always materialize, but occurs more often than not. The chart to the right shows the change in the PPI on an annualized basis, measured monthly. We see a deflationary trend for much of 2015 and 2016, followed by an increase towards the average in 2017. In 2018, the data series has oscillated slightly above and below the long-term average.

As this economic expansion is the second longest on record, the Federal Reserve has been actively hiking short-term rates to prevent inflation from overheating. As such, it does not surprise us that inflation is back to its long-run average level. Our hope is that the Fed will continue to gradually hike rates at a pace that is fast enough to keep inflation in check, but not so fast that it squelches economic growth rates. Monitoring the PPI and global growth rates can inform us of the success Fed policymakers achieve in their effort to balance these forces.

PRODUCER PRICE INDEX ANNUAL % CHANGE
JANUARY 1973 THROUGH JUNE 2018



Source: Bloomberg. Past performance does not guarantee future results.

ECONOMIC OUTLOOK

ECONOMIC FACTORS	CURRENT OUTLOOK
U.S. GDP Growth	At the June FOMC meeting, Fed officials increased their median forecast for U.S. GDP growth in 2018 from 2.7% to 2.8%.
Federal Funds Rate	The FOMC hiked its benchmark federal funds rate to a range of 1.75% - 2.00% in June and expects two more quarter point hikes in 2018.
Inflation	Year-over-year core domestic inflation was above 2.0% for the third consecutive month in May.
Employment	The unemployment rate may struggle to move lower in the second half of 2018 as more previously unemployed Americans join the labor force.
Consumer Confidence	Despite recent trade disputes, consumer optimism should remain high in 2018 given stock market gains in 2017 and healthy job market.
Oil	Potential production disruptions in Venezuela and Iran combined with steady global demand could support oil prices in the third quarter.
Housing	A shortage of inventory and elevated prices in the previously owned U.S. home market may continue to weigh on sales in the second half of 2018.
International Economies	Any escalation in trade disagreements might magnify recent slowdowns in the euro zone, Japan and China.

FIXED INCOME

	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
FIXED INCOME	●				
Core Bonds				●	
TIPS				●	
Non-Investment Grade		●			
International	●				

CURRENT OUTLOOK

We expect the U.S. Federal Reserve to remain on its path of steady interest rate hikes in 2018 and the U.S. economy to continue its expansion against a backdrop of healthy consumer and business confidence. This suggests to us that the path of least resistance for U.S. bond yields in the second half of 2018 is likely higher. As such, we believe an underweight to the broad fixed income asset class relative to our strategic target allocations remains justified. Outside of core, investment grade allocation, we believe our recently increased exposure to floating rate securities could serve as an effective hedge against both rate hikes and inflation in the second half of 2018.

Benchmark: BB BC Intermediate Government/Credit Index

EQUITIES

	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
EQUITIES				●	
Large Cap			●		
Mid Cap			●		
Small Cap		●			
Developed International				●	
Emerging Markets		●			

CURRENT OUTLOOK

We believe an overweight to equities relative to our strategic allocation remains appropriate. Current valuations of many global equity indexes are not much higher than long-term averages and appear well supported given a backdrop of still-accomodative monetary policy in Europe and Japan and a resurgence in U.S. corporate profits. We acknowledge the risk that escalating trade disputes pose to global equities, however, we believe it is still too early to project with any confidence a meaningful impact on economic growth and corporate profits.

Benchmark: MSCI All Country World Index (ACWI)

ALTERNATIVES*

	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
ALTERNATIVES*				●	

	CAP PRES	IWSG	BAL	GWSI	GROWTH
Global Real Estate				●	●
Global Infrastructure	●	●	●	●	●
Hedged Equity	●	●	●	●	●
Arbitrage	●	●	●		
Strategic Income		●	●	●	

CURRENT OUTLOOK

Given our expectation for a continuation of volatility in both equity and fixed income markets in the second half of 2018 and beginning of 2019, we believe an overweight to alternative investments is sensible. It is our view that the broad fixed income asset is most likely overvalued, while the broad equity asset class is near full valuation and becoming increasingly exposed to Fed interest rate hikes and a deceleration of economic growth outside of the U.S. As such, we have constructed diversified alternatives portfolios meant to decrease the risk profile of their respective recommended total Alternative Investment portfolios, which are listed to the left (CAP PRES, IWSG, BAL, GWSI, GROWTH).

Benchmark: HFRX Global Hedge Fund Index

The above underweight/neutral/overweight calls represent the MainStreet Advisors, LLC current positions relative to our Strategic Asset Allocation weights.
*Cap Pres: Capital Preservation, IWSG: Income with some growth, Bal: Balanced, GWSI: Growth with some income.

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There are substantial risks involved with investing in Alternative Investments. Alternative Investments represent speculative investments and involve a high degree of risk. An investor could lose all or a substantial portion of his/her investment. Investors must have the financial ability, sophistication/experience and willingness to bear the risks of an investment in an Alternative Investment.

Traditional and Efficient Portfolio Statistics include various indices that are unmanaged and are a common measure of performance of their respective asset classes. The indices are not available for direct investment. Past performance is not indicative of future results, which may vary. The value of investments and the income derived from investments can go down as well as up. Future returns are not guaranteed, and a loss of principal may occur. Investing for short periods may make losses more likely. Any investments purchased or sold are not deposit accounts and are not endorsed by or insured by the Federal Deposit Insurance Corporation (FDIC), are not obligations of the Bank, are not guaranteed by the Bank or any other entity and involve investment risk, including possible loss of principal.

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