MURRAY
INVESTMENT MANAGEMENT

2nd Quarter 2018 Update

Tariffs and trade disputes dominated the financial headlines during the 2nd quarter, but on the strength of a good economy and rising earnings, the S&P 500 posted a solid 3.43% return. The energy and technology sectors were among the better performers, and small cap companies generally outperformed their larger peers. The international space was under pressure during the quarter and produced a (-1.24%) return with emerging markets down (-7.86%).

In June, the U.S. Federal Reserve raised interest rates .25% to a range of 1.75% - 2.00% with the expectation for 1-2 additional increases this year. Rate increases should be taken as a good sign as they indicate that the overall economic environment is improving, but as interest rates have risen during the year, the fixed income space has been under pressure and generally produced negative returns (Barclays Aggregate is down -1.62% for the year). Higher rates are, however, providing more attractive yields for fixed income investments.

The employment situation continues to be strong, and overall, the U.S. economy is doing well, which should continue to produce very strong corporate earnings. While we are currently in an economic sweet spot (good growth with moderate inflation), the strength in the economy is causing some concern regarding rising inflation and the Fed responding with faster rate increases. Since rising rates increase business and consumer costs and impact company earnings and ultimately the stock market, it's very important that the Fed gets the pace and magnitude of rate increases correct. If the Fed moves too quickly, they could derail the economy, but if they move too slowly, inflation could get out of hand. It is a fine line to walk. Inflation risk is one of the more important investment factors to watch for the remainder of the year and into 2019.

In addition, the potential for a trade war has injected a great deal of uncertainty in the markets and increased volatility. The tariff discussion seems to be more about politics than economics and should be resolved without an all-out trade war that raises prices (inflation) and damages the U.S. and global economies. A resolution will take some time, so in the short term, expect higher volatility (large market swings) as the tariff situation is worked out.

Domestic equity market valuations are trading at multiples that are on the higher end of their long-term averages, but as earnings have improved, market valuations do look better. Elevated equity valuations, low interest rates and a pricey fixed income market have created a very challenging investment environment as most asset classes are expensive. However, if global growth continues to produce strong earnings without too much inflation, equity markets could grind higher throughout the year, but it will likely be a volatile, bumpy ride.

Please give me a call with any questions.

Source: Morningstar, federalreserve.gov
The performance data shown represents past performance, which is not a guarantee of future results.
Return data is as of 06/30/2018. Index returns are total returns except for MSCI EAFE which is a net return.

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