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Quarterly Financial Market Update: July 2018

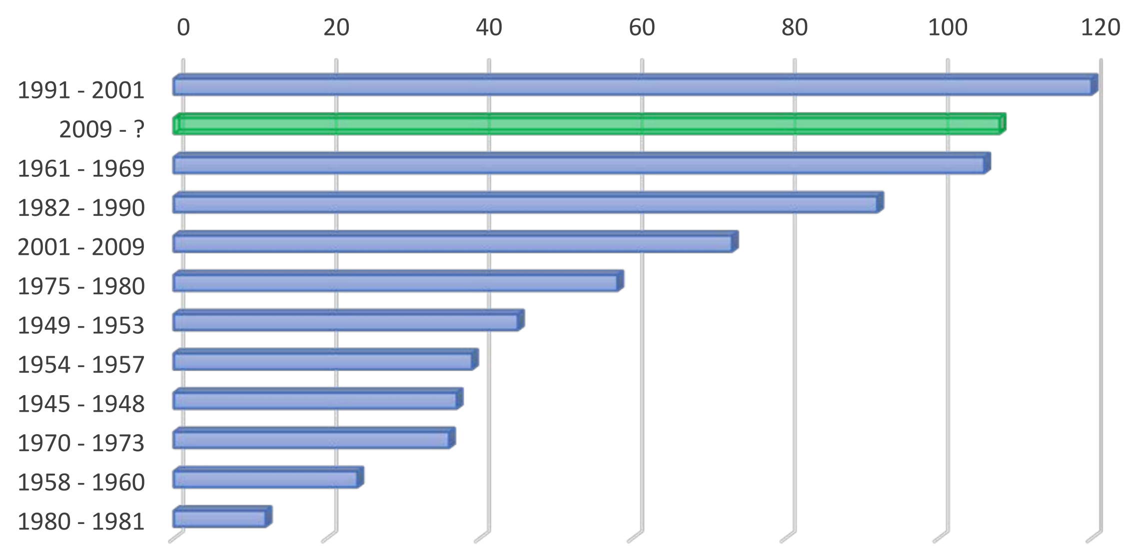
Nine Years Old

The economic recovery began in July 2009 – that according to the National Bureau of Economic Research, the official arbiter of recessions and economic expansions. A quick review of the math, and it means the current expansion just turned nine years old, or 108 months.

Let us put that into perspective. We have surpassed the long-running expansion of the 1960s by two months. We are within striking distance of the all-time longest expansion, which ran through the 1990s and lasted exactly ten years – see Figure 1.

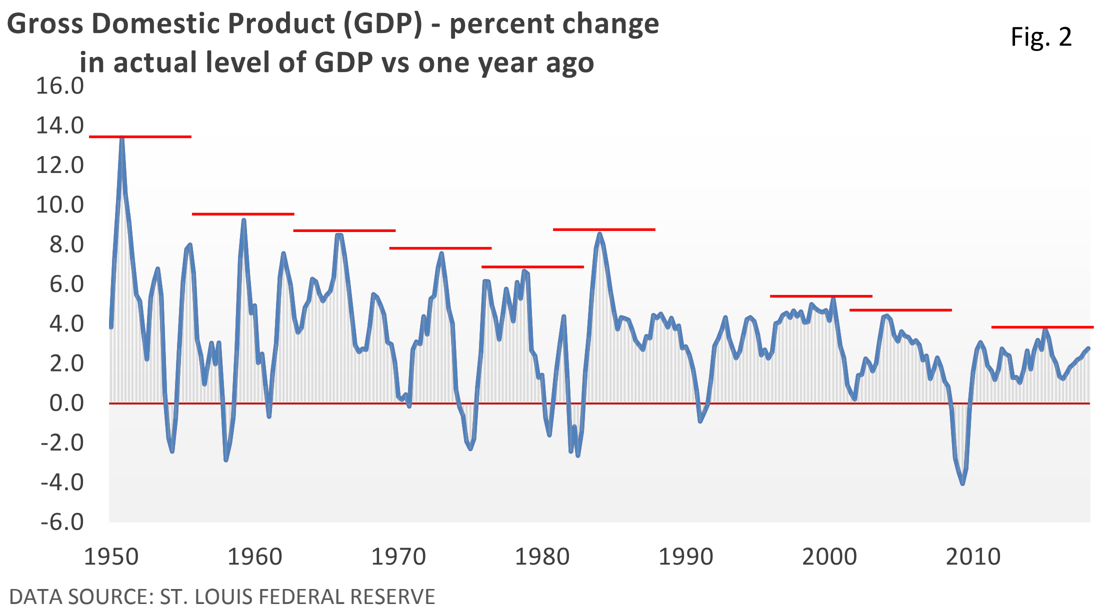
Length of Economic Expansions Since WWII in Months

Fig. 1



DATA SOURCE: NBER, LAST DATE: JUNE 2018

It has not been an impressive economic recovery, however, as can be seen in Figure 2. The graphic illustrates it has been the weakest growth since at least 1950 (the U.S. government began collecting quarterly data in 1947), but that is probably one reason for its longevity. You see, fast growth can sometimes force the Federal Reserve to quickly hike interest rates, which can stifle the economy. On the other hand, if the economy is allowed to overheat, it can create speculative excesses (think the housing boom of the early to mid 2000's) that sow the seeds for the next recession.



Upper bars represent peak growth rate in each expansion; 1954-57 and short 12-month 1980 economic recovery omitted.
GDP is the largest measure of goods and services produced in the economy.

Besides the general slowdown in growth post WWII, two things stand out:

- First, recessions are typically short interruptions in what otherwise has been a long-term upward trajectory for the economy.
- Second, the 2001 recession was so shallow, it failed to produce a year-over-year (y/y) decline in GDP. In fact, the U.S. economy generated an uninterrupted period of y/y GDP growth that lasted nearly 17 years (1991-2007)!

The current cycle is no longer young, and it generally leads to concerns that a recession could be lurking. Important to investors: recessions and bear markets historically go hand in hand.

With this as a backdrop, is a recession in the next year inevitable? Not necessarily. Optimists, led by Byron Wien, the respected vice chairman of Blackstone, said in his July commentary he believes the current cycle "has at least several more years left to run."

Bolstering his case, inflation is gradually moving higher but remains low, and wages are up but are not accelerating at a fast clip. Both factors are keeping the Federal Reserve from hiking interest rates too quickly. Moreover, fiscal stimulus, including the recently enacted tax cuts, is in the pipeline.

While Mr. Wien's confidence isn't shared by all analysts, most short-term leading economic indicators are not suggesting a recession will ensue this year or early next year.

Looking Ahead and the Upcoming Elections

Last year's strong rally carried over into early 2018 but quickly ran into a brick wall when longer-term Treasury yields tracked higher. The Dow Jones Industrials and the S&P 500 Index have failed to recapture January highs, but the tech-heavy NASDAQ Composite and closely followed measures of mid-sized and smaller-sized companies did set new highs in June.

As the 2nd quarter came to a close, escalating trade tensions have hampered sentiment, especially as it relates to large multinational companies, whose reach extends around the globe. An all-out global trade war would constitute a threat to U.S. and global economic growth and counter the economic stimulus from the tax cuts. So far, however, retaliatory actions have been measured but warrant ongoing monitoring.

While difficult to quantify the direct impact, the upcoming midterm elections may be creating headwinds. Yes, economic growth and corporate profits are a big factor in the longer-term direction of stocks, but political uncertainty can sometimes translate into shorter-term investor angst and thus, volatility.

A recent study published in the Wall Street Journal found that since the creation of the Dow Jones Industrials in the late 1890s, the oldest and best known of the market indexes has produced "an average annualized gain of just 1.4% in the six months before midterm elections, in contrast to a 21.8% annualized return in the six months thereafter."

The study noted the pattern was not as pronounced during presidential elections. It did not repeat itself during non-election years. Of course, these are just averages. Economic and international factors may come into play, and each cycle has its own unique features.

We enter the second half of the year with a modest pullback in global economic momentum, but growth in the United States remains strong. Corporate profits are likely to remain robust this year and only moderate in 2019 (not decline), while low interest rates, and a low level of inflation (at least for now) have helped counter the headwinds created by the ongoing spat in trade.

Index	Q2 Return*		2018 YTD Return %
S&P 500 (large)	+3.43%		+2.65%
S&P 400 (midsize)	+4.29%		+3.49%
Russell 2000 (small)	+7.75%		+7.66%
MSCI EAFE (intl.)	-1.24%		-2.75%
Bond Yields	**June 29 Yield & Qtr. Change**		**Dec 29, 2017 Yield**
3-month T-bill	1.93%	(+0.20%)	1.39%
2-year Treasury	2.52%	(+0.25%)	1.89%
10-year Treasury	2.85%	(+0.11%)	2.40%
30-year Treasury	2.98%	(+0.01%)	2.74%
Commodities	**June 29 Price & Qtr. Change**		**Year end 2017**
Oil per barrel[5]	$74.15	+9.21	$60.42
Gold per ounce[6]	$1,250.45	-73.40	$1,296.50

**Stock indices include reinvested dividends and are NOT annualized*

Final Thoughts

As we mentioned in our last quarterly letter, Hopwood Financial is celebrating our 15th year of being in business. We hope you each recognize how important you are to our success. As a thank you, we will be having a **15th Anniversary Party** on Saturday, September 22nd from 6-9 PM at our building. There will be heavy appetizers, beverages and live entertainment both in our lobby and on the roof (which incidentally has a wonderful view). We would love to see each of you there and offer a personal thank you. Invitations will be sent soon.

In addition, we have a new employee by the name of Erik Jensen who will be a Client Service and Operations Associate. Erik graduated from West Virginia University in 2014 with a degree in Business and a concentration in Finance and is currently working on his CFP® designation. Please say hi to Erik if you have a chance.

Thank you for your kind referrals this year. We have been able to maintain a prudent growth level which allows us to continually improve our offering to each and every one of you. Referrals are the ultimate compliment and are greatly appreciated.

Have a wonderful and safe summer.

Hopwood Financial Services, Inc.