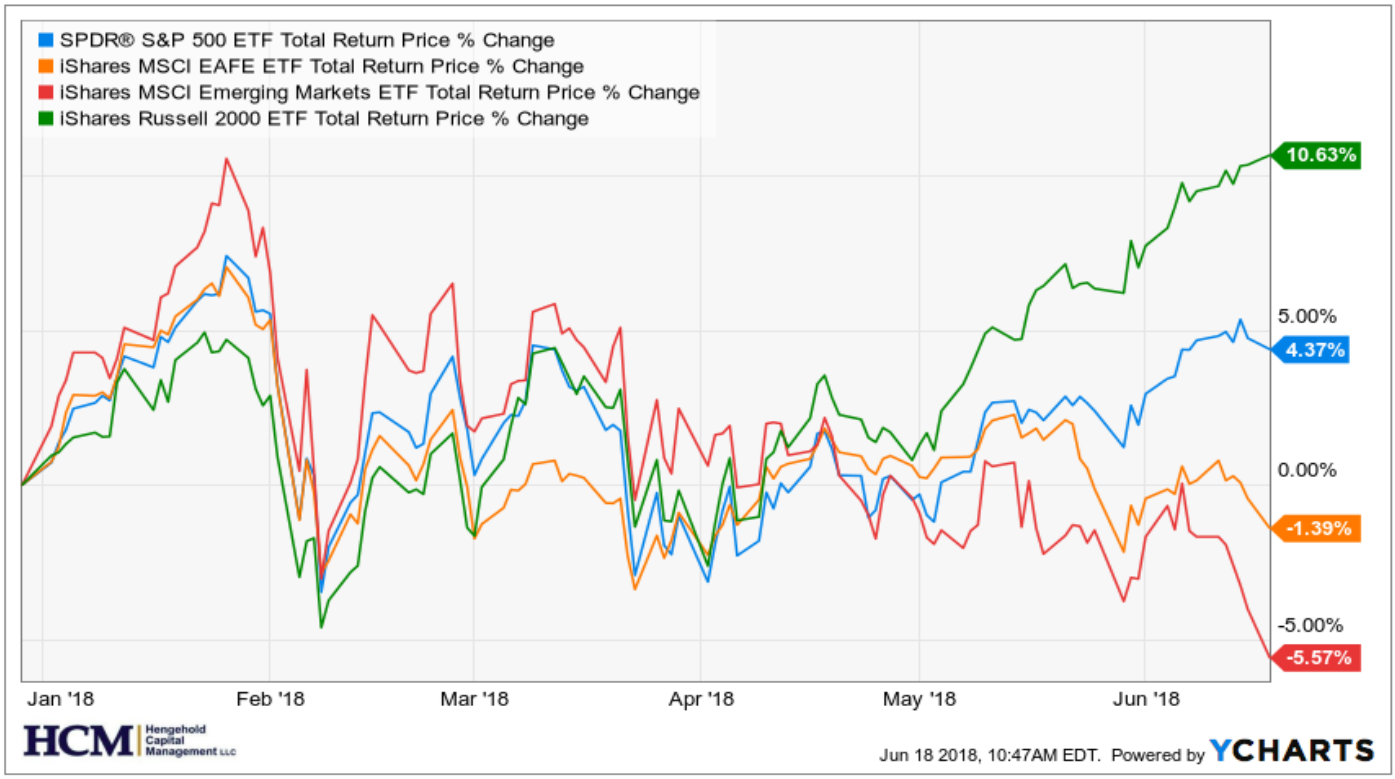
Market Insights for Week Ending June 15, 2018

Forks In The Road

Yogi Berra, while being known primarily as a great catcher, is also known for his collection of funny and oftentimes nonsensical quips. In fact, Yogi's malapropisms became so popular that they eventually received special recognition as "Yogiisms." One of my favorites is this: "When you come to a fork in the road, take it." The market has certainly done its fair share of forking recently. After trading in a fairly tight range over the first 4 months of the year, the beginning of May marked an inflection point for various asset classes.



The chart above shows the total return for 4 popular asset classes. The green line is the iShares Russell 2000(small cap), the blue line is the SPDR S&P 500, the orange line is the iShares MSCI EAFE(foreign stocks) and the red line is the iShares MSCI Emerging Markets. Over the past 45 days, these 4 major asset classes have performed very differently, with a 15% differential between the top performer, small cap, and the worst performer, emerging markets.

Two main culprits are at work here, one is happening now and investors are now concerned about the other. The first has been the strength of the US Dollar. As short-term rates have moved up over the last 9 months, US money market yields have moved up as well. This has made US cash markets a favorable place for investors to park money, even for those outside the US. This in turn, drives demand for US dollars and pushes the value of the dollar up against other currencies. These currency movements also have an effect on Emerging Market securities because many countries have debt payable in US dollars. As the dollar gets stronger against something like, the Brazilian Real, it becomes more expensive for Brazil to make interest payments in dollars. This helps explain the

recent underperformance of emerging markets shown in the chart above.

The second culprit is a little harder to pin down. The term "trade war" gets thrown around a great deal, but a better description is probably a "tariff war". So far, President Trump has announced tariffs on goods from various countries. To counter this, these countries have announced their own set of tariffs in a back and forth game of political brinksmanship. While the ultimate economic outcome is a topic for another day, these concerns have created volatility and uncertainty around growth forecasts.

What Do We Care?

Going back to Yogi's wisdom, there are several forks in the investment road that have formed over the past month and a half. The good thing about investing is that we don't have to limit ourselves to a single path. Diversification allows us to divide our commitments among multiple paths. And while some will be better than others, this process allows us to adjust our portfolios in a way that we believe best manages the balance between risk and return.

A portfolio change that took place recently was the elimination of Vanguard Europe(VGK) from HCM portfolios. The proceeds were repositioned into a combination of US and diversified Foreign equities. Our taste for an overweight to Europe has soured a bit recently because of a new bout of political turmoil and recent changes to European profit forecasts. We no longer had sufficient conviction to hold Europe as a dedicated overweight allocation. The result of this portfolio modification is to slightly reduce our overweight to international stocks. Even with this change, we still feel there is compelling value outside the US and we will continue to hold meaningful diversified foreign exposure.

HCM believes that the best portfolio is the one that manages risk well. Building portfolios that meet this goal requires taking many different forks.

Weekly Focus – Think About It

"Two roads diverged in a wood and I –
I took the one less traveled by,
and that has made all the difference."

-Robert Frost

Market Activity

Performance last week for the four major asset classes were:

- U.S. Stocks – Russell 3000 (IWV) – Gain of .13%
- Developed Foreign Markets (EFA) – Loss of .48%
- Emerging Markets (EEM) – Loss of 1.81%
- Fixed Income (AGG) – Gain of .12%

(Note: performance is based on the change in net asset value)

Last Week's Headlines

-The European Central Bank announced the proposed end to its bond purchase program by the end of 2018 and gave the indication it wouldn't raise rates before the second half of 2019.

-China announced disappointing economic data, showing credit creation had slowed and it raised concerns about growth going forward.

-President Trump and North Korean lead Kim Jong Un met in Singapore in an attempt to reach an agreement on denuclearization of North Korea. Details of the agreement that was reached were insufficient to have any meaningful effect on markets.

Eye on the Week Ahead

-A quiet week for economic data will give way to Central Bankers from the US, Eurozone and Japan as they may provide some context to recent monetary policy decisions.

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