Trumbower Financial Advisors, LLC
2nd Quarter 2018
Investment Market Commentary

Tipping the Scales to Level the Playing Field

Major US equity indices advanced, albeit erratically, up the field while the rest of the world huddled on the bench. Small companies brought home the Q2 trophy as the Russell 2000 Index (+7.75%) crossed the goal line into record territory. Mid-Caps finished in second place (S&P 400 +4.29%) while Large Caps held their own (S&P 500+3.43%). The NASDAQ kicked up 6.62%. Its all-star FAANGs scored from 8% (Google) to 32.5% (Netflix).

Developed International stocks limped around the sidelines (MSCI EAFE -2.34%) and Emerging Markets (MSCI EM -7.96%) floundered amid deteriorating field conditions. The Shanghai Composite is down -20% from its January high and officially called bear. The MSCI Emerging Markets Index is not far behind, down -18% from its peak earlier this year. Recharged US dollars coupled with an oil price revival took the shine off lesser developed country stocks despite otherwise relatively healthy fundamentals.

The Bloomberg Commodity Index gained 0.4% during the 2nd quarter. Brent crude rallied more than 13%. OPEC and its allies announced plans to ramp up production by 1 million barrels per day starting in July but this did not alleviate concerns about shrinking Venezuelan and Libyan output, Canadian production outages not to mention the prospects for renewed US sanctions on Iranian imports. Soybean prices, traumatized by trade war posturing, slipped -18% to a nine-year low. Roughly half of U.S. soybean exports are shipped to China – the world's largest consumer of the cash crop.

Treasury yields on the short-end of the curve moved in sync with the Fed's 0.25% rate hike in June. The 10-year note briefly topped 3.1% in mid-May but retreated to settle in at 2.84% on June 30th. The spread between the 2 and 10-year is a mere 0.32% - the narrowest in more than a decade. Tighter spreads diminish bank profits and this expectation drove down the S&P Financial Sector ETF more than -3.5% during the quarter. Flattening

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Selected Benchmark and Category Average Returns

Large Cap Equity

Benchmark Indx & Category Average*	(Total Return) 2nd Q 2018	12 Mos.
S&P 500 Growth	5.25	20.63
Large Cap Gr Avg	5.39	21.49
S&P 500 Value	1.40	7.58
Large Cap Val Avg	1.34	8.35
S&P 500 Index	3.43	14.37
Large Cap Blnd Avg	2.42	12.19

Mid Cap Equity

Benchmark Indx & Category Average*	(Total Return) 2nd Q 2018	12 Mos.
S&P MC 400 Growth	3.31	15.69
Mid Cap Gr Avg	4.31	19.29
S&P MC 400 Value	5.35	11.17
Mid Cap Val Avg	2.12	7.85
S & P 400 Index	4.29	13.50
Mid Cap Blnd Avg	2.77	9.39

Small Cap Equity

Benchmark Indx & Category Average*	(Total Return) 2nd Q 2018	12 Mos.
Russell 2000 Growth	7.23	21.86
Small Cap Gr Avg	8.86	21.89
Russell 2000 Value	8.30	13.10
Small Cap Val Avg	6.24	11.93
Russell 2000	7.75	17.57
Small Cap Blnd Avg	6.02	13.82

International Equity

Benchmark Indx & Category Average*	(Total Return) 2nd Q 2018	12 Mos.
MSCI EAFE	-2.34	4.01
Intl Equity Avg	-2.11	6.32

* **Category average** calculated using *Morningstar Direct*. Fund universe screened to include funds that meet the following criteria:

- **A.** M-Star Category consistent with designated asset class and management style.
- **B.** M-Star Style Box consistent with designated management style.
- **C.** Fund's Objective consistent with asset class.
- **D.** Excludes Index Funds.

We have not independently verified *Morningstar* data.

2nd Quarter Equity Market Results

	2nd Qtr. % Chg.	12-mo. % Chg.
S&P 500	3.43	14.37
S&P 400	4.29	13.50
Nasdaq	6.61	23.60
Russ 2000	7.75	17.57
MSCI EAFE	-2.34	4.01
MSCI Emg Mkt	-7.96	8.20

Level Playing Field

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may also signal investors' concerns that an era of economic expansion is soon to end. If the curve continues to flatten it faces inversion - often (but not always) a precursor to recession.

The labor market is strong with unemployment at 4%; the lowest level in 18 years. As we write this commentary, Fed funds futures indicate a 48% chance of 2 additional rate hikes in the 2nd half of 2018. Who knows if longer-term bond yields will join the game. Inflation is running at a 6-year high but still restrained. If the dollar remains in demand yields may get stuck hanging upside down.

The WSJ Dollar Index rallied 5.1% during the 2nd quarter with many analysts and hedge funds betting the trend will continue. China's yuan fell -3.4% against the dollar during June and ended down -5% for the quarter. Many blame the looming trade war for the yuan's worst monthly decline in nearly 20 years. Investors appear to have sought refuge from trade tensions bidding dollar yields down and the greenback up. This makes almost everything more expensive to foreigners perhaps challenging global recovery. A strong dollar and retaliatory tariffs could make US companies less competitive overseas and possibly less profitable.

The trade spat has yet to lighten consumer wallets but US steel producers have already increased prices – with detrimental impact on US businesses that use the raw material. A 25% levy on vehicle imports is a bargaining chip on the table that has put US auto manufacturers on the defensive - formally warning that the proposed tariffs will cost US jobs. For the most part the tech sector was not tarnished by trade turmoil. In fact, technology companies have been credited with nearly all of the first half broad US market advance.

The scales tipped dramatically in the other direction during the last week of June. News of plans to interfere in sales to and capital investment from China involving technology sent the NASDAQ down -2% in one day. The Administration has since softened its stance and tech investors were rewarded with a recovery, but high-flying US technology giants remain vulnerable. Two thirds of Qualcomm's revenues are earned from China. Its stock is down -12% year to date. Micron Technology dropped -5.5% when a Chinese court banned sales of its chips in an effort to bolster nascent domestic production. 18% of Apple's revenue came from China last year and every iPhone sold is assembled in a Chinese factory.

Trade skirmishes raged on into Q3. *July 1st*. Canada officially levied tariffs on more than $12 billion of American goods. 25% on U.S. steel and iron. 10% on everything from motorboats to air fresheners to orange juice. *July 5th*. Part two of Mexico's retaliatory measures took effect including a 20% tax on pork. Last year roughly 25% of U.S. pork exports were sent to Mexico. Shipments from Europe are already replacing US orders. *July 6th*. $34 billion in new tariffs announced by both the U.S. and China.

According to The World Trade Organization (WTO), before the recent volley tariffs on goods exported to China averaged almost 10%. Exports to Mexico bore an average tax of 7% and 5% has been imposed by the European Union. The average tariff placed on US imports was a comparatively modest 3.5%. There are also other ways in which some countries operate outside WTO guidelines to stack the deck in favor of domestic companies. Granted, WTO parameters are designed to support industrial development within less affluent regions. Does the world's second largest and often fastest growing economy still deserve global trade affirmative action? May's report shows that a $22.7 billion surplus in the balance of U.S. services trade was dwarfed by a $65.8 billion deficit on goods. It is hard to argue that global trade is a fair game. Many fear, however, that slapping on tariffs could backfire and hope we can negotiate more constructive ways to level the playing field.

S&P 500 plans to shuffle up its sectors. The index provider will trade big-name technology and consumer discretionary players into a new communications-services sector at the end of September. Names like Facebook and Alphabet will leave tech to join existing telecoms (Verizon, AT&T and Century Link) along with former consumer discretionary media giants Netflix and Comcast in the new group. Communications-services will then represent more than 10% of the S&P 500. Funds and index ETFs that track these sectors will be trading billions to realign portfolios. Investors drawn to telecom for its 5.6% yield will find themselves holding a high concentration of Growth stocks with a greatly diminished dividend yield. Investors looking to make a pure Growth bet will have to spread their wealth outside tech. Other implications? Remains to be seen.