INVESTMENT STRATEGY UPDATE

ASCENTIAL WEALTH ADVISORS
AN INDEPENDENT PRACTICE

MARKET REPORT

QUARTER 3 • 2018

UNCERTAINTY PREVAILS

Equity markets across the globe have struggled to hold on to intermittent gains in the first half of 2018 as concerns over trade policy, rising interest rates, and politics all made headlines. While fundamentals for economic growth and corporate earnings remain positive, the overall sentiment for markets has been resoundingly unsure.

While the majority of the equity market struggled, technology posted strong returns once again with the NASDAQ up 8.79%. Within the US, Consumer Discretionary, Healthcare and Energy also had positive performance. After outperforming in 2018, emerging markets have pulled back, with the MSCI Emerging Markets down 6.66%, primarily driven by fears of a trade war.

With the US economy on strong footing (historically low unemployment, better than expected GDP growth, and increased business investment) in addition to the benefits of fiscal stimulus, we feel there is reason to remain optimistic. It is likely that the trade war rhetoric is overblown, as it is in no country's best interest, and a compromise is the most likely outcome. Once fundamentals return to the forefront, equity markets should respond favorably.

The Federal Reserve has raised its benchmark rate twice in 2018 to 2.00%, with two more rate increases expected yet this year. As a result, the ten-year US Treasury yield has risen from 2.40% at the end of 2017 to a high of 3.10%, before settling at 2.85% at the end of June. Short term rates have risen faster than long-term rates, with the two-year US treasury yield now at 2.52%, and the 30-year treasury at 2.98%.

Index	*2018 (through 06/30)*
S&P 500	+2.65
DJIA	-0.73
EAFE (Int'l)	-2.75
BC Ttl Bond	-1.62

Dow Jones Relative Risk Benchmarks	
Conservative	+0.04
Moderate	+0.46
Aggressive	+1.30

2018 OUTLOOK

FIXED INCOME — In the US the battle over interest rates continues, with the Federal Reserve pushing rates higher, but demand created by lower global interest rates pressuring yields down. The result thus far has been a flattening of the yield curve, with short term rates increasing faster than long rates. While some have noted this as cause for concern, citing that an inverted yield curve (short term rates higher than long term) has historically preceded periods of recession, we do not believe this will be the case. Downward pressure on rates should subside as global central banks raise rates, the Fed removes its demand from the Treasury market, and Treasury issuance increases to meet the needs of fiscal stimulus. We see strong potential for higher rates and look to proceed with caution by reducing maturities and utilizing another flexible, experienced fixed income manager to replace some of our index holdings.

***Our View —** Reduce maturity, employ active fixed income to remain flexible for changing conditions.*

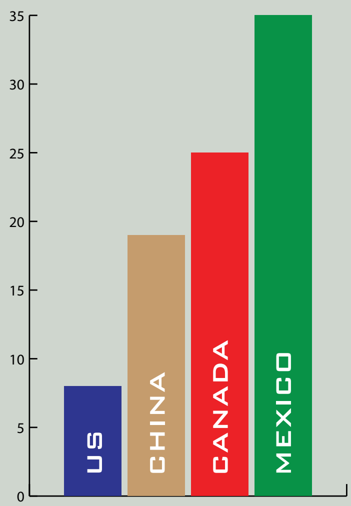
US EQUITIES — Corporate earnings were extremely strong in the first quarter of 2018, with S&P 500 earnings per share posting a 26.8% increase year over year. (JP Morgan, *Guide to Markets,* June 2018) Second quarter earnings are expected to grow 19%, with all eleven sectors expected to report growth. (Raymond James, *Gleanings,* June 2018) This has been overshadowed by tariff talk, and equities have returned to a more normal volatility pattern. Given the positive nature of economic data in the US, we feel it is unlikely that a recession is impending. Furthermore, as a result of higher earnings US stocks appear cheaper than at the end of 2017, and potentially very cheap relative to forward earnings expectations. We see opportunity, particularly within small and mid-sized companies which stand to benefit more from tax cuts and, for the near term, are somewhat less exposed to the negative impacts of tariffs. We also remain positive on banks based on the benefits of higher rates and deregulation, and technology due to broad growth and innovation potential.

***Our View —** Increase weighting to small & mid-sized US companies.*

INTERNATIONAL EQUITIES — Foreign markets have been negatively affected not only by tariff talk but also by fears surrounding the stability of the European Union. This has come to the forefront again with Italy experiencing instability and populist sentiment making news there. Absent these concerns, global growth remains positive. With some resolution to the trade issue, we feel there is untapped opportunity overseas with valuations attractive and growth prospects strong. For the short term, while trade negotiations continue, we feel it would be best to slightly reduce overweight foreign exposure.

***Our View —** Reduce overweight position slightly until trade issues are more settled.*

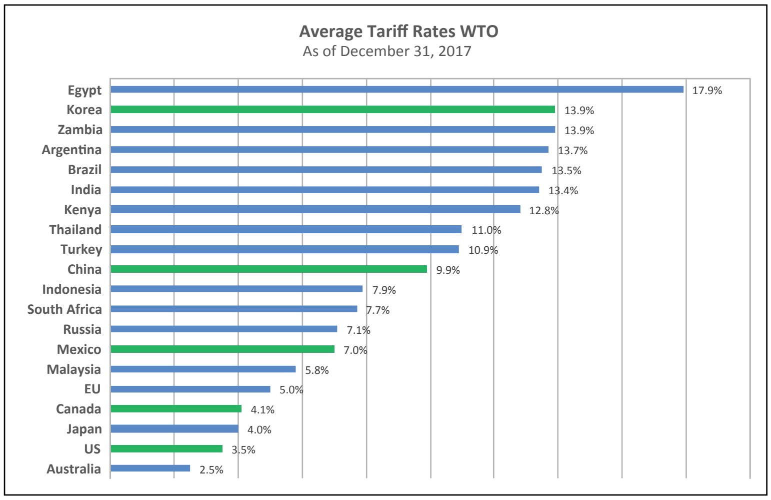
2017 Exports percentage of GDP:



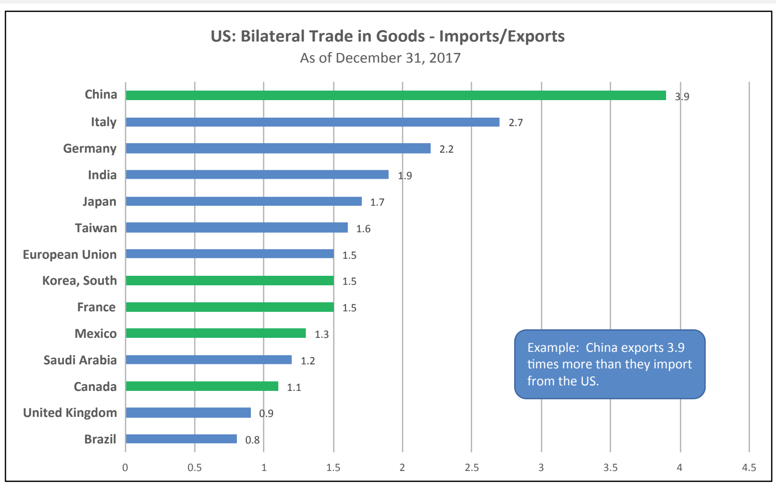
Trade War or Negotiation?

Are current trade discussions between the US and other nations the start of a trade war or merely negotiation? This question has caused tremendous unrest in global equity markets in the first half of 2018. Looking at the relative tariff rates across the World Trade Organization (see chart) it appears the US has a position of power relative to most other countries.

Currently, the US has one of the lowest tariff rates in the world. Additionally, in terms of goods, the US imports more than it exports to many of these countries. These factors offer some bargaining chips, since countries such as China have something to give up with regard to tariff rates, and much to lose due to the amount they are exporting to US markets. This does not mean that these trade negotiations will end swiftly. There could be an extended period of back and forth before an agreement is reached, and that may result in some negative consequences for businesses and investors. In the end, we are hopeful that world leaders are able to find a solution that all can live with.



Source: World Trade Organization (WTO), US Census Bureau, US Bureau of Economic Analysis, US Department of Commerce.



ASCENTIAL
WEALTH ADVISORS
Get there from here

11 East Superior Street, Suite 500
Duluth, MN 55802
218.336.2500 • 888.840.8299

ascentialwealth.com

Disclosures