

ECONOMIC HIGHLIGHTS

The PMI Manufacturing Index and the ISM Manufacturing Index came in at 55.4 and 60.2 for June 2018. Factory Orders were up 0.4% for May. The PMI Services Index and the ISM Non-Manufacturing Index came in at 56.5 and 59.1 for June 2018. All the readings continue to be nicely expansionary. The U.S. Unemployment Rate came in at 4.0% vs. 3.8% for June.

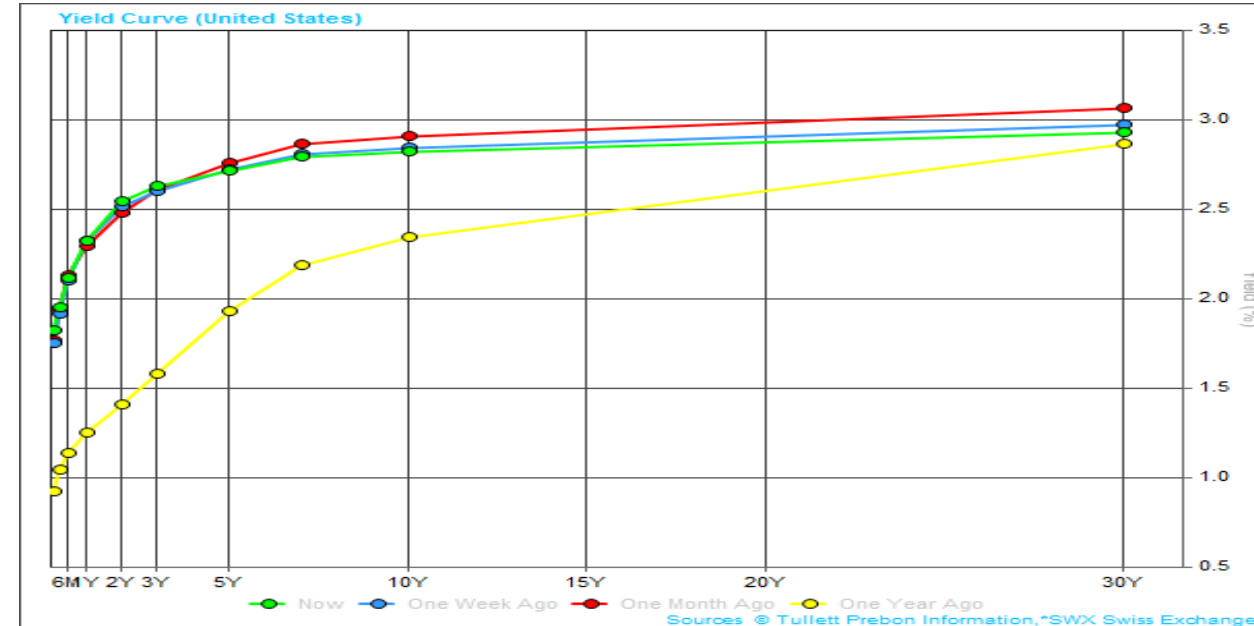
FIXED INCOME

Treasury yields are slipping further away from the pivotal 3% level, and an escalating trade war between the U.S. and China has traders bracing for the world's largest bond market to keep rallying. A four-week advance in ten-year notes, the longest of 2018, has driven yields down to 2.82%, from an almost seven-year high of 3.13% in mid-May. Amid a tit-for-tat tariff standoff, investors may still look to government debt as a haven in the days ahead as they assess the economic ripple effects of the levies and hedge against the risk that the protectionist measures will roil markets. Some on Wall Street are anticipating that this week could bring a test of 2.75% for ten-year yields, which is the low for the past three months. Barring a spike higher in U.S. consumer price data that will be released on Thursday, Treasuries are poised to draw buyers. "At some point, cooler heads will prevail, but that doesn't seem to be the direction," said Gene Tannuzzo, a money manager at Columbia Threadneedle in New York. "If you want a market that can actually provide you some insurance, some ability to go lower in yields, then Treasuries are the best risk-reward safe haven there." Ten-year yields dropped as low as 2.8053% last week, even as the U.S. is set to sell \$22 billion of the maturity on Wednesday. The spread between 2- and 10-year maturities continued to flatten as it briefly fell below 27 basis points last week, the smallest since 2007. And there may be more tariffs ahead as President Donald Trump has threatened to apply further measures on additional Chinese goods, although much of that tension may be reflected in current prices. Bond bulls may also face a potential hurdle this week in the release of June's consumer price figures. Inflation is projected to rise 2.9% from a year earlier, the quickest pace since 2012. However, should Thursday's reading show a significant leap above expectations, that could boost yields and possibly even disrupt the flattening trend if it has investors betting the Fed isn't moving aggressively enough, according to Morgan Stanley's Matthew Hornbach. This week's data will come too soon to capture the impact of tariffs, but inflation readings will become "incrementally more important" as a measure of their economic effect, according to Tannuzzo. He also mentioned that although tariffs may initially produce inflationary pressures, they could also start to dent growth in the U.S. and abroad.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.94%	3 mo	1.98%	3 mo	2.40%	3 mo	1.34%
6 mo	2.11%	6 mo	2.06%	6 mo	2.50%	6 mo	1.40%
1 yr	2.30%	1 yr	2.16%	1 yr	2.60%	1 yr	1.47%
2 yr	2.54%	2 yr	2.54%	2 yr	2.87%	2 yr	1.62%
5 yr	2.72%	5 yr	2.78%	5 yr	3.27%	5 yr	2.04%
10 yr	2.82%	10 yr	3.13%	10 yr	3.70%	10 yr	2.64%
30 yr	2.93%	30 yr		30 yr	4.09%	30 yr	3.62%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	0.82%	0.09%
S&P 500 (Large Cap)	1.56%	4.25%
S&P 400 (Mid Cap)	1.95%	5.50%
Russell 2000 (Small Cap)	3.12%	11.03%
NASDAQ Composite	2.40%	12.00%
MSCI EAFE (International)	0.96%	-1.91%
iShares Real Estate	1.82%	3.12%

The S&P 500 rallied sharply on Thursday and Friday to end the holiday-shortened week with positive returns. That reversed a string of two consecutive losing weeks heading into the July 4th holiday. The participation in the rally was broad with 10 of the 11 major sector groups posting gains – led by Health Care and Telecommunications which both rallied over +3%. Small Cap stocks continued their recent relative outperformance compared to large cap stocks, with the Russell 2000 booking its best week since early March.

Trade was the dominant theme last week with Friday's implementation by the U.S. of tariffs on \$34 billion in Chinese exports and an immediate \$34 billion in retaliatory Chinese tariffs. One example in the commodity space where prices are already discounting the tariffs is Soybeans which ended last week at \$8.94 a bushel – sharply lower from its highs of March near \$11 a bushel.

Shares of Facebook fell on Thursday after the Washington Post reported the SEC is now involved, along with the FBI and Department of Justice, in the investigation into the user data scandal surrounding the company's relationship with Cambridge Analytica.

Thursday afternoon, the Fed released the minutes of the June 12-13 FOMC meeting. The minutes reiterated the Fed's upbeat view of the U.S. economy and its heightened confidence that inflation will run near the 2% target on a sustained basis. At the same time, the minutes reflected ongoing concerns about the risks from trade tensions, which some argued could have negative impacts on business sentiment and investment spending.

Biogen jumped 21% on Friday after the company demonstrated statistically significant slowing in clinical decline and reduction of amyloid beta in the brain – increasing confidence in the company's lead Alzheimer's drug.

Bespoke published an interesting report which put the recent sideways movement of the S&P 500 into perspective. The six-month sideways period has put current returns much closer to their long-term average. Over the last year, the S&P 500 is up 14% on a total return basis, which is nearly 3% ahead of the 11.7% historical average of all twelve month periods. Longer term though, returns have fallen slightly below average on a 10-year and on a 20-year rolling basis. The S&P 500 is up 10.2% over the past 10 years versus its average of 10.4% - and is up only 6.5% over the past 20 years compared to its 20-year average of 11.1%.

Now that 2018 is halfway over, one notable theme this year has been the increase in volatility compared to the historic quiet of last year. Only 3.2% of days in 2017 had moves greater than 1% in either direction versus 29% in the first half of 2018. Also, the average absolute daily change in the first half of this year was 0.74%, more than double the 0.30% average from 2017 – according to data from Bespoke.

The earnings calendar picks up a bit this week as banks start to report quarterly results. Notable reports are expected from JPMorgan, Citigroup, Wells Fargo, and PepsiCo. On the economic front, PPI and CPI are both due out on Wednesday along with Import/Export price index on Friday.

The S&P 500 inched closer to the 2800 level we have been noting as important resistance in these comments for the past several months. That level remains intact along with support at 2725, 2680, and 2580. The index ended last week at 2759.

ASSET ALLOCATION

CURRENT SENTIMENT

Cash	Neutral
Short Fixed Income	Neutral
Intermediate Fixed Income	Neutral
Inflation-Adjusted Fixed Income	Unfavorable
High Yield Fixed Income	Neutral
International Fixed Income	Neutral
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Favorable
Real Estate	Favorable
Commodities	Unfavorable

Below is a summary of our current stance on most asset classes:

Cash - Holding as little as possible given the miniscule yields in money market instruments. Any exposure is for defensive positioning.

Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the outlook for higher interest rates.

Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in spread products.

Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.

High Yield Bonds - Spreads have tightened; however, still remain attractive versus Treasuries.

International Bonds - Emerging market bonds offer good diversification qualities while providing higher yield opportunities relative to domestic fixed income.

Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.

Large Cap Stocks - A favorable weighting is recommended. Growth has reemerged as a more favorable style and should be overweighted versus Value.

Mid Cap Stocks - Mid cap exposure along with a value tilt is preferred. Mid cap stocks continue to provide the "sweet spot" of market capitalization - large enough to provide stability, but small enough to be more nimble.

Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. However, a recent divergence of relative strength between small caps and large caps warrants a neutral exposure.

International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight to neutral weight is recommended.

Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. Recent relative performance versus developed markets support the stronger fundamental backdrop and positions have been added.

Real Estate - Pricing has stabilized and long-term valuations appear attractive. Real Estate has performed well of late and should continue to be a strong alternative to other asset classes.

Commodities - Global demand should support higher prices if the global recovery remains on track. Although, volatility will be higher and commodities will be susceptible to short-term price shocks, if used in conjunction with other asset classes, risk can be reduced substantially to a diversified portfolio. However, used alone is not recommended as the short-term outlook is not favorable.

Sources of statistical information are Bloomberg and Ned Davis Research.

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