2018 Weekly Portfolio Manager Commentary — *October 12, 2018*

Trustmark Investment Advisors, Inc.

ECONOMIC HIGHLIGHTS

U.S. Final Demand Producer Prices were up 0.2% year-over-year. Core PPI was up 2.5% year-over-year. Consumer Prices were up 0.1% for September and up 2.3% year-over-year.

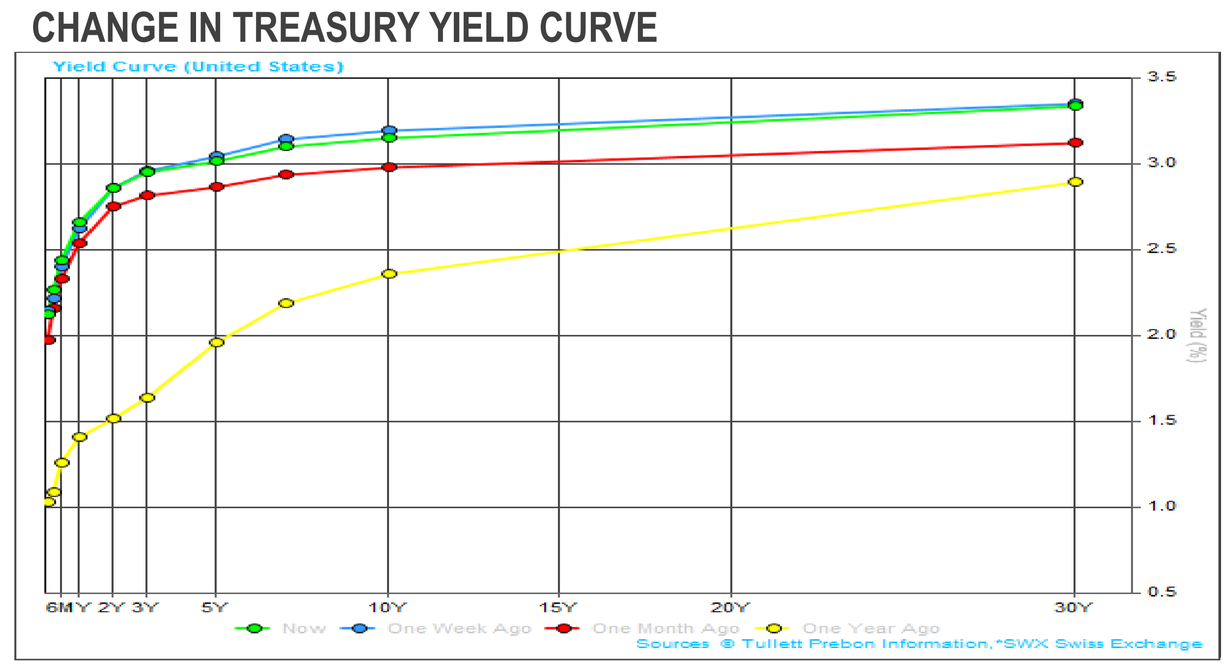
FIXED INCOME

This month's bond-market slump hasn't jolted the majority of Wall Street strategists from one core view; the Treasury yield curve will keep flattening well into next year. Strategists at most of the Federal Reserve Bank of New York's primary dealers expect the spread between two- and ten-year yields to narrow through the first half of 2019, according to yield forecasts compiled by Bloomberg. From about the current spread of 30 basis points, the average prediction is for the gap to shrink to 21 basis points by year-end, and to about 11 basis points by the middle of 2019. Still, it may be a bumpy ride, with forecasts for mid-2019 ranging from a 30 basis point inversion to a positive slope of a half-percent. The key to the majority view is the expectation that the Fed will keep tightening, while subdued growth and contained inflation cap longer-maturity yields. Further flattening could make things uncomfortable for those playing the other side of this prediction. It may also be problematic for policy makers because some investors see the march toward inversion as signaling an impending recession. "The flattening continues, and it's really a grind," said Shahid Ladha, head of Group-of-10 strategy for the Americas at BNP Paribas. "It's painful for the Fed. It's also painful for the market." The climb in yields gained momentum at the start of this month, pushing the benchmark ten-year rate to the highest since 2011 and sparking the biggest jolt of curve steepening since February. This reversal led some strategists to suggest that the flattening of the curve had run its course. The curve narrowed in August to levels last seen in 2007, which is also the last time it was inverted. "The bond market is sending us flashing yellow signs, saying,'Hey, it may not be all roses looking ahead," Minneapolis Fed President Neel Kashkari, who isn't a voting member of the Fed this year, said earlier this month. Twenty of the 23 primary dealers contributed yield forecasts to the survey. At least five see the curve from 2 to 10 years inverting by the end of September next year, with some saying that will happen as early as the first quarter. But several banks disagree. Deutsche Bank AG, for example, expects a spread of 50 basis points at mid-year. Jefferies LLC sees that level by the end of September 2019 amid reduced pension-fund demand and European Central Bank accommodation, along with increased longer-maturity issuance as deficits deepen. "You are going to get more sources of longer-term supply, just as sources of demand will wane," said Ward McCarthy, chief economist at Jefferies.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.26%	3 mo	2.31%	3 mo	2.52%	3 mo	1.79%
6 mo	2.43%	6 mo	2.42%	6 mo	2.64%	6 mo	1.85%
1 yr	2.65%	1 yr	2.53%	1 yr	2.77%	1 yr	1.93%
2 yr	2.85%	2 yr	2.84%	2 yr	3.08%	2 yr	2.05%
5 yr	3.02%	5 yr	3.09%	5 yr	3.45%	5 yr	2.39%
10 yr	3.16%	10 yr	3.43%	10 yr	3.87%	10 yr	2.94%
30 yr	3.34%	30 yr		30 yr	4.29%	30 yr	3.97%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	-4.17%	4.29%
S&P 500 (Large Cap)	-4.07%	5.06%
S&P 400 (Mid Cap)	-4.91%	-0.39%
Russell 2000 (Small Cap)	-5.22%	1.69%
NASDAQ Composite	-3.74%	9.50%
MSCI EAFE (International)	-3.85%	-7.37%
iShares Real Estate	-2.85%	-4.06%

It was a wild week for U.S. stocks – as the Dow Jones Industrial Average fell nearly 1,400 points on Wednesday and Thursday. Financials, Materials, and Telecommunication all fell around -6% on the week – all 12 of the major sector groups declined. The Mid Cap Index wiped out all their year-to-date gains and Small Caps are nearly back to breakeven and were hit the hardest last week. International and Emerging Market Indexes are pushing down -10% and -15%, respectively.

The Nasdaq dipped below its 50-day and 200-day moving average last week. Bespoke wrote in a report that the move broke a streak of 108 trading days above its 50-day moving average. The index has only gone over 100 days above the moving average 8 other times in its history. In prior cases, when the index finally breaks below the line after spending at least 100 days above it, the near-term performance of the Nasdaq has actually been very negative.

Bespoke also analyzed sector performance during rising interest rate environments. The general rule is that cyclical sectors tend to outperform when rates rise, and defensive sectors tend to underperform. Financials have generally benefitted from rising yields because banks typically see more net income benefit from higher yields on assets. It is worth watching the ratio of the Financials and Consumer Staples sectors which historically tracks along closely with movements in the 10-year Treasury yield. Bottom line, higher rates mean good times, which favor cyclicals, while sectors with steady, slow-growing cash flows behave more like bonds.

As the November 6 Mid-Term Election quickly approaches, Bespoke noted that the S&P 500 has averaged a gain of 3.06% during October of mid-term years versus a gain of 0.34% in all other Octobers. For the entire Fourth Quarter, the S&P 500 has averaged a gain of 7.51% in mid-term years versus 2.86% in all other Q4's. The last time the S&P was down in an October of a mid-term election year was back in 1990. With a month-to-date loss of a little over -5.5% the index has its work cut out for it to reach these historical averages.

The Growth outperformance relative to Value has sharply reversed in recent days. The ratio of the S&P 500 growth and value ETFs is now over two standard deviations oversold. The threshold is not predictive of future returns, as past instances are mixed. The one thing that is for sure is that this trend has been in place in earnest for almost two years, so a continuation of this reversal is worth watching.

For the week ahead, third quarter earnings season begins to ramp up which will dominate most of the news on the corporate calendar. The schedule will be somewhat weighted toward banks and asset managers with results expected from noteworthy companies such as – Bank of America, Schwab, Goldman Sachs, Johnson & Johnson, Ebay, Netflix, American Express, Paypal, IBM, and Procter & Gamble. The economic calendar is pretty light with the only noteworthy items being production data and some housing data.

The S&P 500's decline last week took out all the support levels we have been noting in these comments. Resistance for the index stands at the 200-day moving average around 2770 and then at 2800. Support for the index stands at 2700 and then below that at 2580. The S&P closed last week at 2767.

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 summery 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 overweighed 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.