# 2017 Weekly Portfolio Manager Commentary

**October 20 , 2017**

Trustmark Investment Advisors, Inc.

## ECONOMIC HIGHLIGHTS

U.S. Industrial Production was up 0.3% for September, in line with consensus expectations. Capacity Utilization is now at 76.0%. The Index of Leading Indicators was down 0.2% for September— bit worse than expectations. Housing starts (multi and single family) came in a bit light, at 1.127mm units vs 1.170mm expected. Weakness was primarily in the multi-family space. Existing Home Sales for September were up 0.7%, as expected.

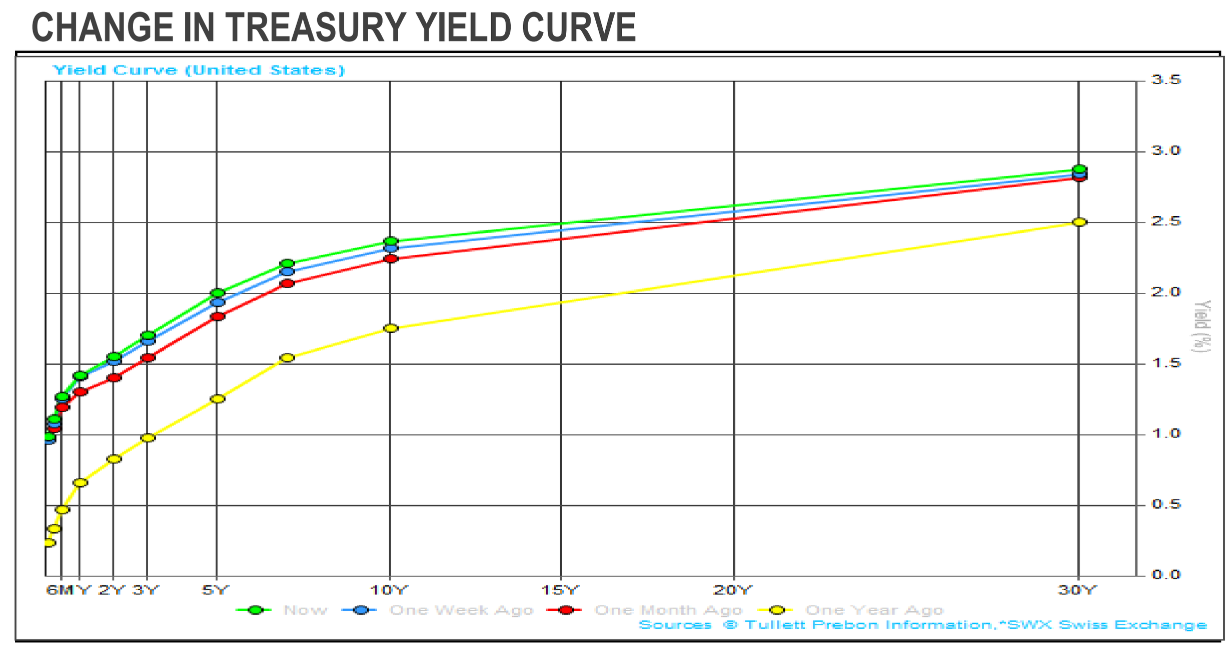
## FIXED INCOME

In the eyes of Wall Street, President Donald Trump couldn't be choosing between two more different candidates for the next Federal Reserve chair. That choice - between Stanford University economist John Taylor and Fed Board Governor Jerome Powell - has the potential to jolt the bond market in a year defined by low volatility and a tug-of-war between bulls and bears that's kept yields stuck in a tight range. Powell, considered the Republican Party's alternative to renominating Janet Yellen, is the leader on betting website PredictIt. For the ten-year Treasury yield, Powell could spark a five basis point drop, while Taylor would cause a ten basis point leap, according to Priya Misra at TD Securities. The yield curve for two to ten years may flatten by twenty basis points in short order with a Taylor nomination, according to Michael Schumacher at Wells Fargo Securities. Currency traders are on edge also: The dollar could gain as much as 3% with a Taylor pick, while sinking a half percent under Powell, said Steven Englander at Rafiki Capital Management. Altogether, bond and currency traders are left scratching their heads as they prepare for the decision between the candidates that Trump's advisors are reportedly steering him toward. An announcement is expected within two weeks. Many analysts expect Powell to maintain many of the policies the Fed has pursued under Yellen's leadership. By contrast, Taylor's eponymous rule calls for a fed funds rate of 3.74%, compared with the current 1.16% effective rate. Complicating things further, the Senate's narrow approval of a budget vehicle for tax cuts, Trump's top legislative priority, has left ten-year yields poised for their highest close since July. The yield curve from two to ten years steepened, the opposite of what's expected with a Taylor win.

**CURRENT GENERIC BONDS YIELDS**

| TREAURIES | | AGENCIES | | CORPORATES | | MUNICIPALS | |
|---|---|---|---|---|---|---|---|
| 3 mo | 1.10% | 3 mo | 1.12% | 3 mo | 1.36% | 3 mo | 0.86% |
| 6 mo | 1.26% | 6 mo | 1.21% | 6 mo | 1.44% | 6 mo | 0.92% |
| 1 yr | 1.41% | 1 yr | 1.38% | 1 yr | 1.53% | 1 yr | 0.99% |
| 2 yr | 1.58% | 2 yr | 1.62% | 2 yr | 1.77% | 2 yr | 1.08% |
| 5 yr | 2.02% | 5 yr | 1.89% | 5 yr | 2.33% | 5 yr | 1.43% |
| 10 yr | 2.38% | 10 yr | 2.76% | 10 yr | 3.02% | 10 yr | 2.06% |
| 30 yr | 2.90% | 30 yr | | 30 yr | 3.79% | 30 yr | 3.07% |

**CHANGE IN TREASURY YIELD CURVE**




## EQUITY

| INDEX RETURNS | LAST WEEK | YTD |
|---|---|---|
| Dow Jones Industrials | 2.04% | 20.33% |
| S&P 500 (Large Cap) | 0.88% | 16.88% |
| S&P 400 (Mid Cap) | 0.87% | 11.79% |
| Russell 2000 (Small Cap) | 0.45% | 12.34% |
| NASDAQ Composite | 0.36% | 24.26% |
| MSCI EAFE (International) | -0.33% | 22.07% |
| iShares Real Estate | -0.92% | 7.91% |

Stocks rose last week, with the S&P 500 reaching yet another new all-time high capping its sixth straight weekly advance. The Dow Jones Industrial Average and S&P MidCap 400 also marked new all-time highs last week.
For the week, HealthCare, Financials, and Utilities were the best performing sectors – while Consumer Staples, Energy, and Real Estate were the only three to post declines.

Shares of IBM rose on Wednesday after the company posted its largest revenue beat in five years. The stock gained nearly 9% as earnings beat on stronger revenues, helped by improved growth in Cognitive Solutions and Strategic Imperatives.

One way to measure market volatility is by looking at the average daily percentage move. By that standard, the Dow Jones Industrial Average is close to having its least volatile year on record. Bespoke wrote on this subject last week noting that so far in 2017, the Dow has seen an average daily move of 0.305% - the only other year on record where the average daily move was smaller was 1964 at 0.303%.

Last week also marked the 10-year anniversary of the last bull market's peak culminating in the bear market low of March 2009. Interestingly, if one had bought the S&P 500 on the day of the peak in October 2007 right before the credit crisis and the 50% decline in the S&P 500, you would have still doubled your money on a total return basis by now.

Sentiment readings for the stock market have been increasingly growing more and more bullish lately, but are still well below the peak readings for 2017. The AAII Sentiment Survey last week showed 40% of survey respondents are bullish, which marks the fifth highest weekly reading this year. This indicator is contrarian in structure, in that the higher the number of bullish respondents, the lower the prospects for future market gains.

For the week ahead, earnings season picks up steam and we get our first look at Third Quarter GDP on Friday. Notable earnings scheduled for this week include: Hasbro, VF Corp, Caterpillar, Lockheed Martin, 3M, AT&T, Amgen, Bristol-Myers, Amazon, Microsoft, and Colgate-Palmolive. Continue to watch for news from Washington as tax overhaul legislation continues to be debated and changed.

Support levels for the S&P 500 continue to climb as the index pushes out to new all-time highs. The numbers we are watching are 2500, 2490, 2415, and 2400.

## 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.*