2018 Weekly Portfolio Manager Commentary

December 14, 2018

Trustmark Investment Advisors, Inc.

ECONOMIC HIGHLIGHTS

Final Demand Producer Prices increased at 0.1% for November and 2.5% for the year ended November. Core Producer Prices were up 2.7% for the year ended November. Consumer Prices were flat in November, and up 2.2% year-over-year (both regular and core CPI). Industrial Production was up 0.6% for November, with Capacity Utilization at a healthy 78.5%.

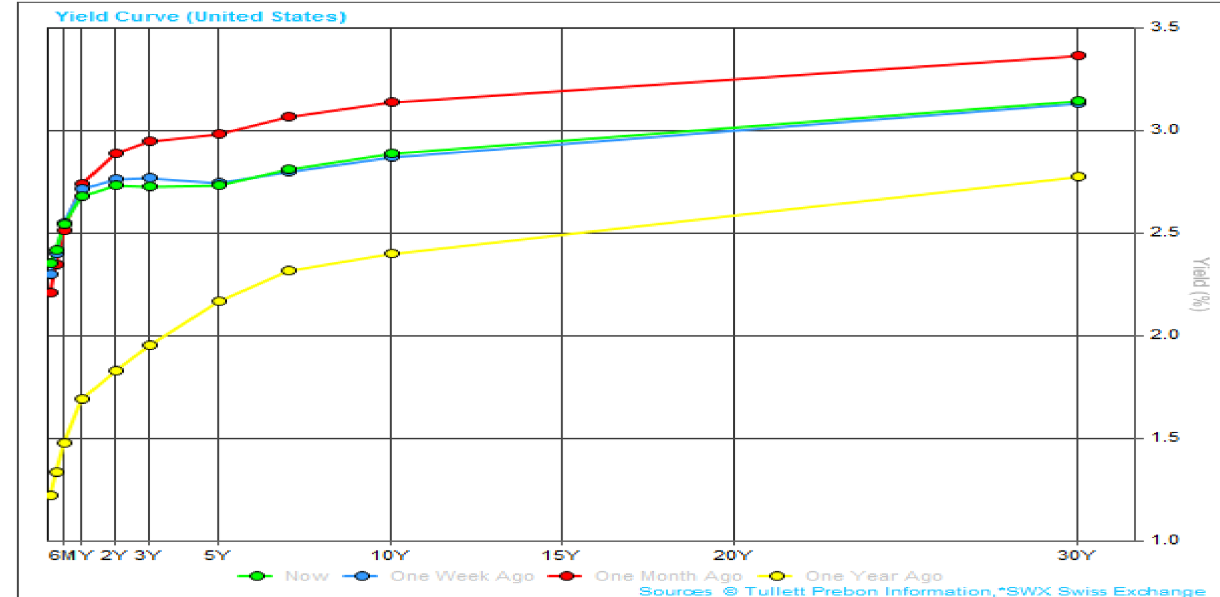
FIXED INCOME

Bond traders are all but certain the Federal Reserve will tighten policy this week. The suspense centers on officials' latest forecasts for interest rates and the economy, which have implications for one of the biggest debates in the Treasury market. The updated projections come as investors are losing confidence that the Fed will keep hiking amid tame inflation and doubts about global growth. Strategists say a key focus is the Fed's outlook for 2019, which could dictate whether the inversion seen in some parts of the yield curve becomes more pervasive. The spread between two- and ten-year yields is already close to going negative for the first time since 2007. From the recent trading actions in the Treasury market, the curve's next leg is likely lower. Fed Chairman Jerome Powell will probably sound more upbeat on the economy than markets anticipate as he justifies raising rates. And should policymakers reaffirm plans to hike three more times in 2019 via the dot plot, that will only add to the flattening trend. Ten-year Treasuries closed trading last week at 2.89%, about 16 basis points above two-year notes. That gap could narrow to the low single digits on a hawkish tone coming out of the Fed meeting Wednesday. The prospect of inversion has drawn the attention of investors and policymakers because it has historically served as a recession signal. Markets in general have undergone substantial changes since the Fed last laid out its projections in September. The S&P 500 Index set a record high that month, but has since erased its 2018 gains. And the first inversion of the yield curve in over a decade happened earlier this month, with the spread from 2 to 5 years becoming negative. Amid the carnage in equities, the spread between December 2018 and December 2019 Eurodollar futures, a measure of how much tightening traders expect next year, has shriveled to 10 basis points. That implies less than one-quarter point hike for all of next year, which is in stark contrast to the Fed's current projection of at least three quarter point hikes. Market players will be paying close attention to Chairman Powell's press conference on Wednesday and whether the message continues to be hawkish going forward.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.41%	3 mo	2.43%	3 mo	2.80%	3 mo	1.73%
6 mo	2.54%	6 mo	2.53%	6 mo	2.87%	6 mo	1.76%
1 yr	2.67%	1 yr	2.66%	1 yr	2.96%	1 yr	1.81%
2 yr	2.73%	2 yr	2.74%	2 yr	3.18%	2 yr	1.92%
5 yr	2.73%	5 yr	2.84%	5 yr	3.45%	5 yr	2.16%
10 yr	2.89%	10 yr	3.26%	10 yr	3.82%	10 yr	2.65%
30 yr	3.14%	30 yr		30 yr	4.23%	30 yr	3.57%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	-1.17%	-0.28%
S&P 500 (Large Cap)	-1.22%	-0.91%
S&P 400 (Mid Cap)	-2.63%	-7.44%
Russell 2000 (Small Cap)	-2.52%	-7.02%
NASDAQ Composite	-0.81%	1.17%
MSCI EAFE (International)	-0.53%	-12.33%
iShares Real Estate	-1.71%	1.98%

It was a decisively bearish week for U.S. stocks – as only 2 of the 12 main sector groups posted positive returns. Financials and Energy led the declining groups – each falling over -3%. Financials entered bear market territory last week having fallen over -20% from their late-January highs for this year. The group has now joined the Energy and Materials sectors who have also posted -20% from the '18 highs – Industrials are not far behind having declined -17% from their January highs.

The S&P 500 closed last week about -11.5% from its all-time high from early-October. According to date from Bespoke, the global equity landscape is in an even more precarious position. Of the 23 major global equity markets the firm tracks, 13 are in bear markets – down an average of -20.4% from 52-week highs. Of the group, none are positive year-to-date and the U.S. shows the shallowest loss of -1.23%.

One positive indicator still holding up amidst the equity market decline has been the S&P 500's cumulative Advance/Decline line. While the index ended last week near its low, the A/D line has been holding up a lot better with what, at this point, looks like two higher highs and two higher lows. Divergences such as this are largely viewed as a positive sign.

Market sentiment hit a multi-year low this week according to the AAII sentiment survey. In the latest survey, bullish sentiment plunged to 20.9% - well below the lows of the year and is at the lowest point since May 2016. Conversely bearish sentiment rose to the highest level in over 5 years to 48.9% - up 18.7% from the prior week. That 18 point increase is the largest uptick and the highest reading since April 2003.

Shares of Johnson & Johnson plummeted nearly -10% on Friday after Reuters reported the company failed to tell the FDA of talc tests showing asbestos from the 1970s, according to documents which show the earliest mentions of tainted JNJ talc date from 1957-58. The documents show that JNJ put asbestos scientists on a list of "antagonistic personalities" and depict successful efforts by JNJ to influence FDA plans for talc regulations. The company issued a response stating its talc is safe and "any suggestion that JNJ knew or hid information about the safety of its talc is false".

Under Armour fell -10% in response to updated guidance. Analysts viewed management's outlook as unexpectedly conservative as growth of just low single digits in North America was a big surprise to some firms.

Bespoke noted in a report on Friday that if the fourth quarter were to end right now, it would be just the 10th time (since 1928) that the S&P 500 closed down -10% in Q4. The report also pointed out Q1 returns are often weak following times when Q4s have been this bad. In prior cases when Q4 has been down at least -10%, the average return in the following Q1 is down -4% with a median return of nearly -8%.

The week ahead is the last full week before two holiday shortened weeks to end the year and will see a small uptick in earnings volume with notable names including – Oracle, Micron, General Mills, FedEx, and Nike. The main focus of the week will be the Economic calendar which will see FOMC meeting and Fed interest rate decision on Wednesday and housing data out earlier in the week. The latest GDP report comes out at the end of the week.

Last week's decline took the index to the lower end of the longer term range we have been noting in these comments since mid-October. The index closed last week at 2599 – still within the 2580-2635 lower bound of the two-month trading range. The upper bound of the trading range acts as resistance upon any rallies and stands at 2815.

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	Unfavorable
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Neutral
Real Estate	Neutral
Commodities	Unfavorable

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

Cash - Neutral weighting now that Fed Funds rate is above 2%. Any exposure is for defensive positioning or liquidity needs.
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 floating rate securities.
Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.
High Yield Bonds - Spreads have tightened considerably and do not warrant exposure to unnecessary credit risk when compared to Treasuries.
International Bonds - Foreign bonds offer good diversification qualities and higher yield opportunities, however, risks have been elevated recently and investment should be made cautiously.
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 continues to be a more favorable style and should be overweighed versus Value.
Mid Cap Stocks - Mid cap exposure remains an attractive market capitalization. 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. However, trade uncertainty and dollar strength provides a headwind for EM in the near term.
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. Volatility will be higher and commodities will be susceptible to short-term price shocks, however, if used in conjunction with other asset classes, risk can be reduced substantially within a diversified portfolio. Used alone though 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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