2018 Weekly Portfolio Manager Commentary

July 27, 2018

Trustmark
Investment Advisors, Inc.

ECONOMIC HIGHLIGHTS

New U.S. Single-Family Home Sales came in at 631,000 annualized units for June, versus 668,000 expected. Durable Goods Orders were up 1.0% for June, with demand fairly well diversified. U.S. Real GDP growth was 4.1% for the second quarter of 2018, approximately in line with expectations. The GDP Price Index was up 3.0%.

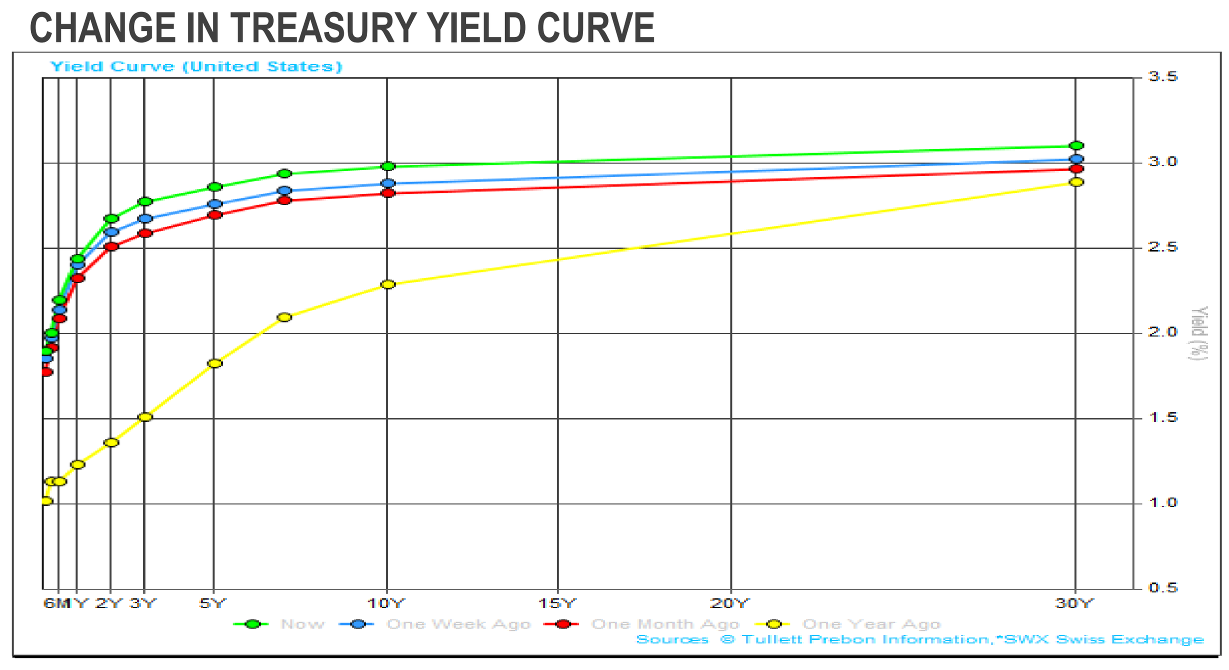
FIXED INCOME

For Treasuries traders, this week isn't going to offer much of a summer lull. Far from it. Central bankers in both the U.S. and Japan are set to gather, while the Treasury will detail its latest plans for funding America's burgeoning budget deficit. A fresh read on the nation's labor market rounds out the week. These are all events with implications for one of the biggest topics in fixed-income -- the shape of the yield curve. Put it all together and there's a risk Treasuries emerge at least briefly from the malaise that's kept ten-year yields in a tight range since they failed to extend a break above 3% in May. The Treasury's choice of maturities as it ramps up issuance may strengthen the flattening trend, as could a Federal Reserve reaffirmation that it plans to hike rates gradually. But any hint that the Bank of Japan is adjusting its ultra-loose monetary policy could spark the reverse. "There is definitely a good chance for volatility this week, which also includes month-end," said Peter Tchir, Head of Macro Strategy at Academy Securities, Inc. "Especially as the Street might be lightly staffed, so there won't be the liquidity we are used to. And if the data continues to come in strong, yields could be pressured higher." Last week, the 2- to 10-year Treasuries yield gap had its largest two-day steepening since February on reports of a possible BOJ policy tweak. Japan's central bank will release a statement on Tuesday, the day before a Fed decision that's expected to produce no change in its current stance. The 2- to 10-year spread still wound up narrowing last week, and is close to the flattest since 2007. Jim Caron, a Senior Fixed-Income Portfolio Manager at Morgan Stanley Investment Management, expects flattening to continue, aided in part by the Treasury's Wednesday announcement of its quarterly debt sales. Dealers say coupon-bearing debt auctions will probably rise for the third straight quarter, and many predict Treasury will keep a bias toward shorter maturities, which may help narrow the gap between short- and long-term yields. The curve from two to ten years hasn't been inverted since 2007. Several Fed officials, including the Minneapolis Fed's Neel Kashkari, have warned about the need to avoid inverting the curve by hiking rates. The economic data don't indicate much of a slowdown. Figures last week showed gross domestic product expanded in the second quarter at the fastest pace since 2014. Reports this week should underscore that the labor market is tight and inflation remains above the Fed's 2% goal.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.98%	3 mo	2.03%	3 mo	2.39%	3 mo	1.30%
6 mo	2.18%	6 mo	2.18%	6 mo	2.51%	6 mo	1.36%
1 yr	2.40%	1 yr	2.31%	1 yr	2.61%	1 yr	1.43%
2 yr	2.67%	2 yr	2.65%	2 yr	2.90%	2 yr	1.60%
5 yr	2.84%	5 yr	2.91%	5 yr	3.29%	5 yr	2.04%
10 yr	2.95%	10 yr	3.26%	10 yr	3.70%	10 yr	2.68%
30 yr	3.08%	30 yr		30 yr	4.10%	30 yr	3.69%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	1.57%	4.22%
S&P 500 (Large Cap)	0.61%	6.55%
S&P 400 (Mid Cap)	-1.15%	4.79%
Russell 2000 (Small Cap)	-1.96%	9.05%
NASDAQ Composite	-1.05%	12.72%
MSCI EAFE (International)	1.07%	-0.19%
iShares Real Estate	-0.62%	0.25%

U.S. equities continued their recent advance with strong gains last week. Participation was broad in the S&P 500 with 10 of the 11 major sector groups posting positive returns – led by Industrials, Energy, and Materials.

As the month of July comes to a close, the S&P 500 is on pace for its fourth straight month of gains. This streak comes on the heels of declines in February and March of -3.89% and -2.69%, respectively. 2018 also marks the third straight year where the S&P 500 has seen gains over this four month stretch. According to Bespoke, going back to 1928 the S&P 500 saw gains in April, May, June, and July only 12 times and while returns in those cases for August are tepid, the average return for the rest of the year in the prior 11 cases is 10.8% with positive returns 100% of the time.

Even though U.S. stocks have shown recent strength, the AAII bullish sentiment reading fell last week into the mid-30s, down significantly from the near 60 reading seen back in January. Interestingly, bearish sentiment also dropped by a similar amount to below 25%. That means neutral sentiment saw a large jump. Commenting on these numbers, Bespoke noted this type of action is not indicative of what one would typically see at either near-term or long-term market peaks. Those cases are usually exemplified by large bullish readings.

Shares of Facebook fell sharply on Thursday after the company reported Q2 results. The company's sell-off was the biggest ever one-day decline in market values terms by a U.S. company in history. The company said it expects revenue growth rates to decline by high single digits from prior quarters for the last two quarters of this year. Daily active users came in slightly short of analyst estimates, but European users fell by 3 million users, or around 1%.

Amazon posted strong results on Friday breaking from the other FANG members who have released weaker than expected earnings and guidance reports. The company said revenue for the quarter was $52.89 billion, and reported income of $2.9 billion, almost 70% more than what analyst were expecting. Prime members continued to show growth with the company announcing it had more new members sign up than any other day in its history during the recent prime day.

Trade tensions eased a bit last week after President Trump's meeting with European Commission's Jean-Claude Juncker. The two parties agreed to work together toward zero tariffs on non-auto industrial goods. Juncker said as long as talks are ongoing, the U.S. and E.U. will hold off on further tariffs.

The S&P 500 decisively advanced above the 2800 level we have been noting in these comments for quite some time. That puts the all-time highs of 2872 as the next real level of resistance. The 2800 threshold now becomes support along with 2765 and 2700 below that. The index closed last week at 2836.

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.