2018 Weekly Portfolio Manager Commentary

October 19, 2018

Trustmark Investment Advisors, Inc.

ECONOMIC HIGHLIGHTS

U.S. Business Inventories were up 0.5% for August, with the Business Inventories to Sales ratio still in a bullish downtrend. Industrial Production for September was up 0.3%, with Capacity Utilization at a healthy 78.1%. Finally, U.S. Existing Home Sales were down 4.1% from last year, at a 5.15mm unit rate. Rising mortgage rates probably had at least some impact on existing home demand.

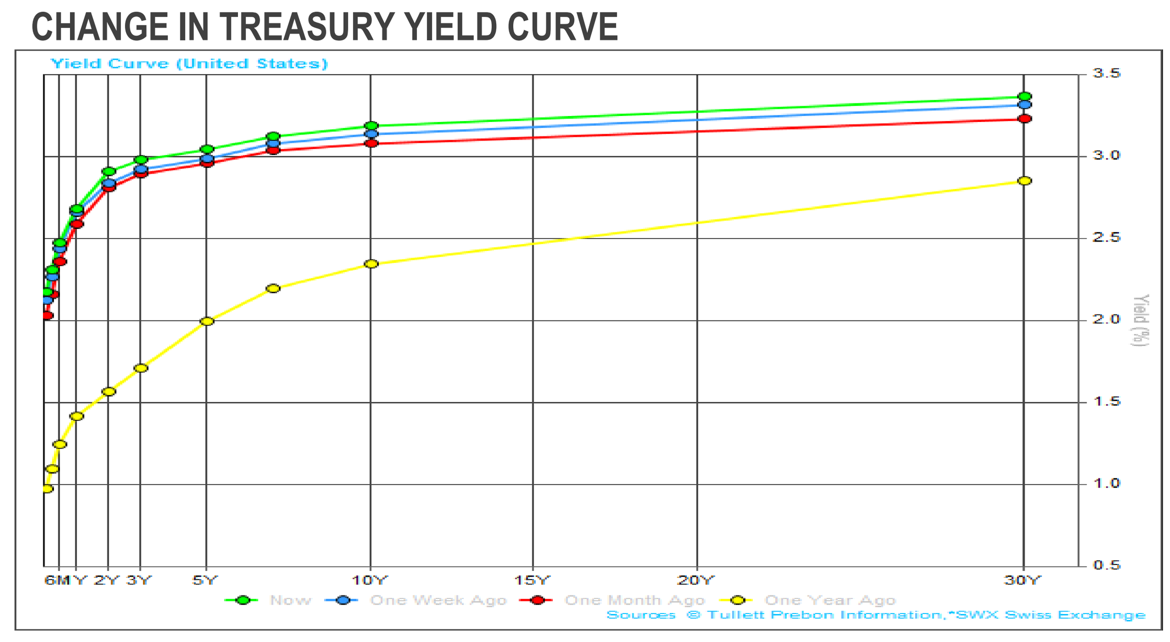
FIXED INCOME

Headwinds from Rome to Riyadh have helped to cap the recent surge in Treasury yields, while the combination of Federal Reserve policy tightening and increasing debt supply appears to be providing a firm floor for U.S. rates. The tug-of-war that has kept the ten-year yield boxed within a 14-basis-point range for the past two weeks looks set to continue as traders weigh the U.S. growth outlook against risks that could spur a flight to haven assets. Minutes from the Fed's last meeting indicated it's willing to keep lifting rates even to the point of restricting growth, providing a boost to yields. At the same time, the market is on edge over Italy's budget standoff, Brexit and other geopolitical events. This week will provide insights on the U.S. growth picture from gross domestic product data, and potentially some clues into Fed thinking, with new vice chairman Richard Clarida delivering his first major speech. There will also be an influx of new Treasury supply at the shorter end of the curve that may give renewed impetus to the current flattening cycle. Italy, which had its credit rating cut by Moody's Investors Service last Friday, is likely to remain in focus as well, along with America's ongoing trade spat with China, while the Saudi situation has the potential to upend oil and other markets. These events are currently creating a backdrop that should keep ten-year yields stuck within a range of about 3% to 3.25% over the next few weeks. The ten-year yield rose about three basis points last week to 3.19%, swinging within a range of just over seven basis points. Rates at the short-end of the curve rose more, helping to flatten the yield curve between two- and ten-year notes for a second consecutive week, and upward pressure was most evident in dollar-based money market instruments. The three-month London interbank offered rate, which serves as the basis for trillions of dollars in loans and floating-rate securities globally, recorded its biggest one-week surge since March, reaching a level unseen since November 2008. Part of the gain stemmed from firming expectations about future Fed rate hikes, although there has also been a widening of the spread over overnight index swaps that move in sync with monetary policy expectations and the approach of year-end funding needs is also having an impact. The increase in Libor could add to strains on some companies and emerging economies and is one of several signs that pressure is growing in dollar funding markets.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.30%	3 mo	2.33%	3 mo	2.57%	3 mo	1.88%
6 mo	2.47%	6 mo	2.46%	6 mo	2.68%	6 mo	1.95%
1 yr	2.66%	1 yr	2.59%	1 yr	2.82%	1 yr	2.02%
2 yr	2.90%	2 yr	2.91%	2 yr	3.14%	2 yr	2.14%
5 yr	3.05%	5 yr	3.13%	5 yr	3.50%	5 yr	2.43%
10 yr	3.19%	10 yr	3.47%	10 yr	3.93%	10 yr	2.97%
30 yr	3.38%	30 yr		30 yr	4.35%	30 yr	3.77%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	0.45%	4.76%
S&P 500 (Large Cap)	0.04%	5.11%
S&P 400 (Mid Cap)	0.06%	-0.32%
Russell 2000 (Small Cap)	-0.29%	1.39%
NASDAQ Composite	-0.64%	8.80%
MSCI EAFE (International)	-0.17%	-7.53%
iShares Real Estate	2.89%	-1.34%

U.S. stocks were essentially flat last week following the prior week's sharp decline. Sector performance decisively swayed toward defensive sector leadership – Consumer Staples were up over 4% while Real Estate, Telecom, and Utilities all gained at least 2%. Cyclical sectors such as Consumer Discretionary and Energy fell around -2% - leading to another week of large dispersions among returns at the sector level.

Bespoke wrote a report last week providing some context to the recent market correction. On October 12 the S&P 500 reached oversold levels at about 3.7 standard deviations below its 50-day moving average. The last time the S&P 500 was more oversold was August 2015. The sell-off was not just relegated to U.S. stocks. Of Bespoke's list of 23 countries in their international index, the group averaged a level 2.38 standard deviations below their 50-day moving averages, and 7 had readings below negative three standard deviations.

When looking at the individual stocks within the S&P 500, the numbers suggest how broad the correction has been. According to data from Bespoke, 73.2% of stocks finished the week at oversold levels – the last time a level that extreme was reached was in January 2016.

Small Cap stocks on average reached bear market territory with the average small cap stock trading down -20% from its 52-week high. By the end of the week prior, the average small cap stock was down just under -24% from its 52-week high. This number is compared to large cap stocks which on average are down -17% from their 52-week high.

Despite the equity market correction, current levels of the AAII Sentiment Survey show that individual investors have largely remained fairly consistent in their feelings toward stocks. The most recent survey results show about 34% of respondents are bullish, while 35% are bearish, which is pretty much in line with where the survey has been over the past few weeks.

L3 Technologies gained nearly 13% on Monday after the company agreed to combine with Harris in an all-stock merger. Harris shares rose about 12% on the news. The combined companies will be the 6th largest defense company in the U.S.

Through the first two weeks of October, the S&P 500 was down -5.04%. According to data from Bespoke, this mark would rank as the seventh worse start to the month for the index on record. Some of the years that were worse were 2008, 1987, 1937, and 1932 – some years that should invoke fear in investors. Since 1983, there have been six prior years where the S&P 500 was down -3% two weeks into the month of October. From day ten through month-end, the S&P 500 saw an average decline of -0.87%, a number largely skewed by 1987's decline of -17.5%. The median return in those years is a gain of 1.87% with positive returns four out of six times.

For the week ahead, earnings season enters into full swing and will largely dominate the corporate calendar. Notable earnings are expected from – Caterpillar, McDonald's, Ford, Microsoft, Twitter, Intel, Alphabet (Google), and Boeing. On the economic front the week will start relatively slow – in the U.S. we will see Chicago Fed, PMI and Home data on Wednesday, and GDP on Friday.

The S&P 500 did nothing to change the support and resistance levels we are watching. Support for the index stands at the 200-day moving average around 2765 then below that at 2700 and 2580. Resistance for the S&P sits at 2870 and the prior all-time highs of 2940. 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.