2018 Weekly Portfolio Manager Commentary

October 26, 2018

Trustmark Investment Advisors, Inc.

ECONOMIC HIGHLIGHTS

U.S. New Single-Family Home Sales were awful, at 553,000 units versus 625,000 units expected. The large difference was likely due to higher mortgage rates combined with limited supply. Durable Goods Orders came in at +0.8% for September, most of which was transportation equipment. U.S. Real GDP growth was 3.5% on an annualized basis for the third quarter of 2018. The GDP Price Index was up at an annualized rate of 1.7%.

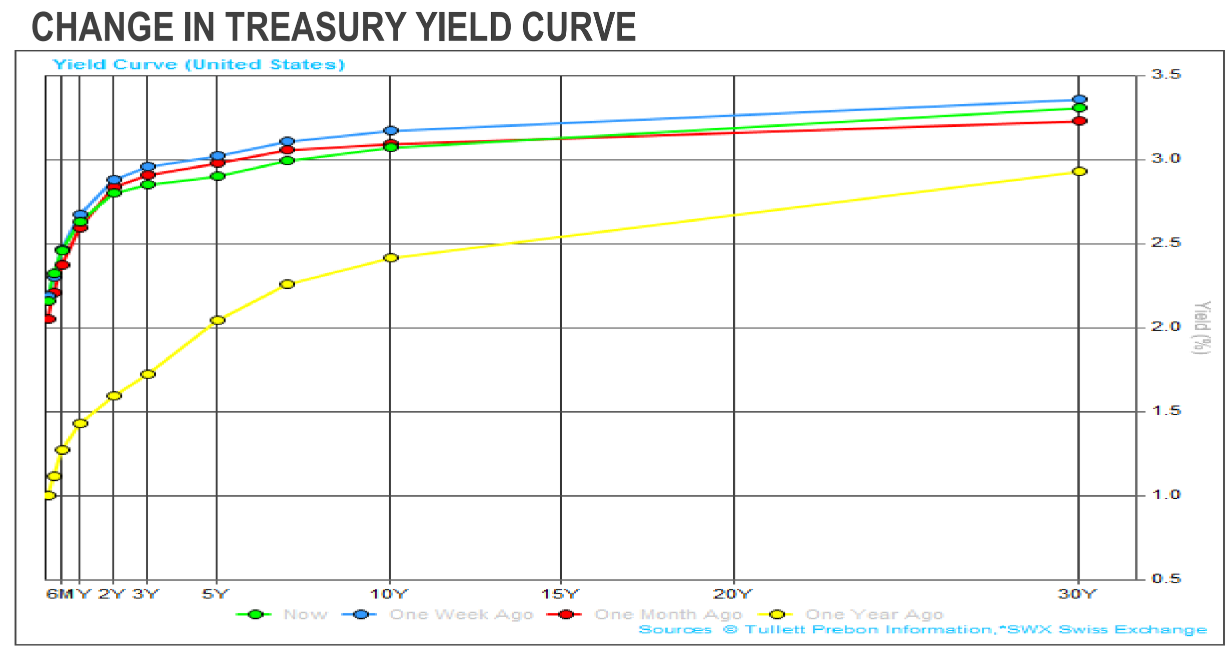
FIXED INCOME

The bond market is losing confidence in the Federal Reserve's policy tightening projections after a punishing stretch for U.S. stocks. Traders pared wagers on 2019 rate hikes last week as disappointing corporate earnings helped drag the S&P 500 Index down 10% from its record high at one point Friday. Markets are now factoring in fewer than two quarter-point hikes for next year, compared with the three increases that policymakers project. Tanking inflation expectations suggest some investors already deem Fed policy too restrictive. Should the carnage in equities continue, some on Wall Street believe the debate over a December Fed move may intensify. Eurodollar options activity suggests the same, with traders starting to ponder the possibility of a Fed pause at year-end. While others on Wall Street expect the central bank to proceed with its ninth hike of this cycle, signs that liquidity is getting more scarce could get policymakers' attention. "I can see another week like last week taking December hike odds down to 50% because of the tightening in financial conditions," said Priya Misra, head of global rates strategy at TD Securities. "Do they want to pause and see if the economy can handle this tightening? That will be the question." Ten-year Treasuries are coming off their biggest rally since May. Yields sank 12 basis points last week to 3.08%, after setting a seven-year high of 3.26% earlier this month. There is risk ahead for bond bulls in October's employment report which will be released on Friday. Confirmation of labor-market strength or evidence of quickening wage growth could reignite tightening bets. Average hourly earnings likely rose 3.2% from a year earlier, according to a Bloomberg survey of economists, up from a 2.8% increase in September. It would be the largest acceleration in wages since 2009. "Something that takes average hourly earnings to cycle highs would be enough for the market to say, 'This is why the Fed needs to keep hiking,'" Misra said. "Unless there's a massive drop in wages, the Fed's path to least resistance will be to hike." So far, Fed officials are still signaling a gradual path of rate increases, and despite the wobble in December hike odds, others still see it as a lock to happen. A continued crunch tighter in financial conditions could eventually merit a Fed pause, but it's probably too early for that discussion.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	2.32%	3 mo	2.35%	3 mo	2.60%	3 mo	1.91%
6 mo	2.46%	6 mo	2.47%	6 mo	2.70%	6 mo	1.96%
1 yr	2.61%	1 yr	2.61%	1 yr	2.83%	1 yr	2.02%
2 yr	2.81%	2 yr	2.79%	2 yr	3.14%	2 yr	2.13%
5 yr	2.91%	5 yr	2.99%	5 yr	3.49%	5 yr	2.41%
10 yr	3.08%	10 yr	3.37%	10 yr	3.92%	10 yr	2.93%
30 yr	3.31%	30 yr		30 yr	4.37%	30 yr	3.73%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	-2.97%	1.65%
S&P 500 (Large Cap)	-3.93%	0.98%
S&P 400 (Mid Cap)	-4.10%	-4.40%
Russell 2000 (Small Cap)	-3.76%	-2.42%
NASDAQ Composite	-3.78%	4.69%
MSCI EAFE (International)	-3.62%	-10.88%
iShares Real Estate	-1.11%	-2.43%

The recent sell-off continued last week, with U.S. stocks making new correction-lows. The S&P 500 dropped a little over -4% last week alone, pushing its year-to-date return to around +0.50%. Last week's sell-off was broad in scope with Small Cap and Mid Cap stocks posting similar weekly declines. FactSet noted that more than 40% of the S&P 500 stocks are now down more than 20% from their 52-week highs.

All twelve of the major sector groups declined, with defensive sectors holding up relatively better than their cyclical counterparts. Consumer Staples, Real Estate, and Utilities all fell around -2% compared to Energy which fell over -7% and Financials and Industrials which both declined nearly -6%.

Results from Amazon and Alphabet were a drag on the overall market Friday. Amazon fell nearly -8% after posting another big margin-driven operating income beat, but revenues were light and the company guided Q4 revenues 5% below analyst estimates. Alphabet fell about -2% after missing on revenues for the first time since Q1 2016.

The latest AAII Sentiment Survey shows optimism among individual investors has fallen to an unusually low level. The latest survey showed Bullish sentiment at 28%, well below its historical average of 38%. Bearish sentiment jumped to 41% rising to a six-month high and well above its historical average of 30%. Historically, when bullish sentiment readings reach more than one standard deviation below their historical averages it has mostly been followed by higher than average 6 and 12 month returns for the S&P 500.

Bespoke wrote in a report that the average daily change for the S&P 500 month-to-date stands at -0.51% - the worst since February 2009. Overall this is the 7th worst average intraday decline for the S&P 500 since September of 1985, when intraday data began.

With the current decline in the S&P 500 reaching -9% from the early October highs, rallies have been practically nonexistent. For the life of this correction, the S&P 500 has traded lower intraday relative to its prior day's close over 70% of the time. In other words, nearly three-quarters of the days in this correction have at no point exceeded the prior day's close – it has been one down day after another.

Ned Davis data showed that as of October 24, the S&P 500 traded lower in 13 of the prior 15 trading sessions and by the end of the week that tally rose to 14 of the prior 17. The same study also showed that in prior cases of the index trading lower in 13 of 15 sessions, the market was down more than it was up 5, 10, and 21 days later.

Earnings season thus far has been a bit of a mixed bag – according to data from Bespoke entering last week 72% of the reporting companies have beat bottom line earnings estimates, which is a good number. Contrast that with the fact that only 58% of companies have beat top-line revenue estimates, which would be the weakest reading in six quarters.

The declines last week took out the 2700 support level we have been watching for some time on the S&P 500. That level now becomes resistance and we will move our next support to the 2580-2595 range. The index closed last week at 2658.

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.