# 2018 Weekly Portfolio Manager Commentary

***November 9, 2018***

Trustmark Investment Advisors, Inc.

## ECONOMIC HIGHLIGHTS

The PMI and ISM Services Indexes came in at 54.8 and 60.3, respectively—both nicely expansionary. Final demand Producer Prices came in at 0.6% for October, and +2.9% year-over-year. This was far ahead of the monthly consensus of +0.2%.

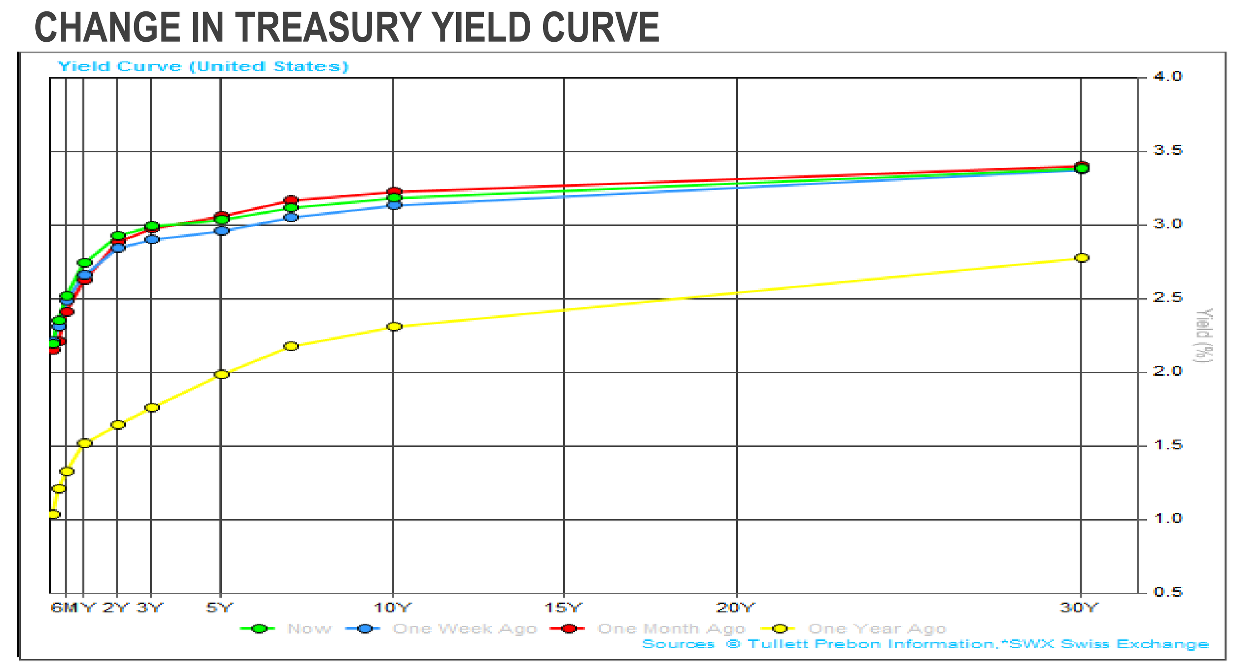
## FIXED INCOME

A debate is breaking out in the Treasury market before Wednesday's release of U.S. consumer-price data as tumbling crude oil leads investors to ratchet back inflation expectations. There seem to be two schools of thought on inflation depending upon who on Wall Street you follow. One camp sees price pressures building into 2019, fueling demand for inflation protection, in part as investors anticipate more U.S. tariffs on Chinese goods. Bond traders are more skeptical. The five-year breakeven rate, which represents investors' view on the annual inflation rate over the next five years, has dropped to 1.9%, close to the lowest since January, from a 2018 high of 2.19%. Given that the lowest jobless rate since 1969 has yet to cause a jump in inflation, the market's take is likely spot-on, according to BMO Capital Markets. "It's a rational response to the fact we're notably through sustainable unemployment levels and you're not seeing broad pickups of inflation," says BMO rates strategist Jon Hill. "We're seeing this as an indication of building concerns about global growth several quarters out." The biggest question for bond investors is whether policymakers agree with their tempered outlook for consumer prices, or foresee accelerating inflation that could require additional rate hikes. Traders will get a read on that when Federal Reserve Chairman Jerome Powell speaks on the economy Wednesday evening in Dallas, following the Labor Department inflation data due that morning. Benchmark ten-year yields pulled back from close to a seven-year high as stocks and oil sank at the end of last week, closing at 3.18% on Friday. The spread between two- and ten-year Treasury yields flattened by the most since August as markets turned their focus back to the Fed's tightening path in the wake of the U.S. midterm elections. Traders are pricing in nearly two quarter-point rate hikes in 2019, after an expected rate hike in December. The CPI figures are the next key for the inflation debate. Consumer prices likely rose by 2.5% in October from a year earlier, according to a Bloomberg survey of economists.

**CURRENT GENERIC BONDS YIELDS**

| TREASURIES | | AGENCIES | | CORPORATES | | MUNICIPALS | |
|---|---|---|---|---|---|---|---|
| 3 mo | 2.35% | 3 mo | 2.38% | 3 mo | 2.68% | 3 mo | 1.91% |
| 6 mo | 2.51% | 6 mo | 2.52% | 6 mo | 2.81% | 6 mo | 1.97% |
| 1 yr | 2.73% | 1 yr | 2.68% | 1 yr | 2.93% | 1 yr | 2.04% |
| 2 yr | 2.92% | 2 yr | 2.92% | 2 yr | 3.25% | 2 yr | 2.17% |
| 5 yr | 3.04% | 5 yr | 3.13% | 5 yr | 3.59% | 5 yr | 2.45% |
| 10 yr | 3.18% | 10 yr | 3.48% | 10 yr | 4.00% | 10 yr | 2.95% |
| 30 yr | 3.38% | 30 yr | | 30 yr | 4.41% | 30 yr | 3.69% |

**CHANGE IN TREASURY YIELD CURVE**




## EQUITY

| INDEX RETURNS | LAST WEEK | YTD |
|---|---|---|
| Dow Jones Industrials | 3.00% | 7.17% |
| S&P 500 (Large Cap) | 2.21% | 5.73% |
| S&P 400 (Mid Cap) | 1.13% | 0.34% |
| Russell 2000 (Small Cap) | 0.12% | 1.95% |
| NASDAQ Composite | 0.74% | 8.27% |
| MSCI EAFE (International) | 0.09% | -8.01% |
| iShares Real Estate | 3.34% | 1.96% |

U.S. stocks ended the week higher, marking the second week of gains following the October 29 correction low. Ten of the twelve major sector groups finished the week higher with Health Care gaining over 4% followed by Consumer Staples, Materials, and Consumer Discretionary. Telecommunications and Communication Services were the only two sectors to decline.

October was not only a horrible month for U.S. equities, but it was also a nasty month for international equities and most other asset classes. Outside of Brazil, Consumer Staples, Utilities, and some commodities, just about everything else was down for the month, according to data from Bespoke.

Despite October's drop, over the last few months we have once again seen positive sentiment toward equities increase. While the percentage of consumers expecting higher stock prices is at a high but not a terribly extreme reading of 44.5%, those expecting lower stock prices fell to 19.1%. That marks the lowest reading since February 2007.

There were several bullish reports released following Tuesday's midterm elections. Axios noted the S&P 500 has always been higher a year after the midterms, no matter the outcome. The New York Times discussed this dynamic, noting that since 1946, in years with midterm elections, the S&P has gained a median of 18.4% in the nine-month period from September 30 through June 30.

Bespoke data shows that in the post –World War II period, from Election Day through year end, the S&P 500 has averaged a gain of 3.26% with gains two-thirds of the time.

Also notable is a report from Bespoke showing that dating back to 1901, there have been five sessions where we had a GOP President along with a mixed Congress. Under that scenario, average returns are notably more subdued than most other periods with the Dow Jones Industrials averaged a gain of just 2.37% during the two-year session.

According to data from FactSet, with 90% of the companies in the S&P 500 reporting actual results, 78% of S&P 500 companies have reported a positive EPS surprise and 61% have reported a positive sales surprise. The blended earnings growth rate for the S&P 500 is 25.2%. If 25.2% ends up being the actual growth rate for the quarter, it will mark the highest earnings growth since Q3 2010.

For the week ahead we begin to see the end of Q3 earnings as the volume of reporting companies will be roughly half from the prior week. Notable reporters include among others – Macy's, Cisco, Home Depot, Wal-Mart, and Nvidia. There will be a noticeable uptick in investor meetings and brokerage conferences – so expect lots of upgrades and downgrades to be announced. The economic calendar will be relatively quiet domestically with CPI on Wednesday and Retail Sales on Thursday.

U.S. stocks continued their bounce from their October lows ending the week higher. The gain for the S&P 500 was not enough to push prices through the 2800 resistance level we noted last week, so that will remain as first resistance. Further advances will also encounter resistance at 2815 and then at 2870. Support for the index is at 2700 and then the 2580-2595 range. The S&P ended last week at 2781.

## 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.*