Economic & Market Commentary

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Market Update – July 2018

Global stocks charged ahead gaining 2.8% in July as all stock asset classes posted gains. U.S. large value stocks led the way with a 4.2% gain. Despite a positive month across the board, international stocks remain in the red year-to-date. Bonds were essentially flat during July, although inflation-protected bonds fell 0.5% in response to changes in inflationary pressures.

Economy

- The first estimate of second quarter real GDP growth came in at an annualized rate of 4.1%. This increase of almost 2% from first quarter's figure marks the fastest growth rate posted since the 3rd quarter of 2014.
- Inflation, measured by the Consumer Price Index for all goods, ticked up slightly to 2.8% year-over-year. Energy prices decreased during the month but gained 12.0% over the past year.
- Unemployment remains near business cycle lows at 3.9%.

Stocks

- The S&P 500 (+3.7%) generated strong gains to start the second half of the year. U.S. small cap stocks (+1.7%) also managed solid gains during July.
- International developed (+2.5%) and emerging market (+2.2%) stock asset classes reversed portions of their losses from earlier in 2018. International large value stocks (+2.9%) outdid all other developed market stocks last month.

Bonds

- Reacting to an insignificant nudge upwards across the yield curve, short-term bonds (+0.1%) and intermediate-term bonds (+0.0%) were effectively flat.
- Inflation-protected bonds (-0.5%) fell slightly during July but have still generated a 1.2% gain over the last 12 months.
- International bonds (-0.1%) were also relatively flat for the month.

Alternatives

- Global REITs (+0.9%) and reinsurance (+0.7%) each made gains during July. However, commodities (-2.1%) and managed futures (-0.6%) each fell in part due to volatile energy markets.

Sources: Bureau of Economic Analysis (BEA), Federal Reserve, Morningstar Direct, Standard and Poor's, The Economist

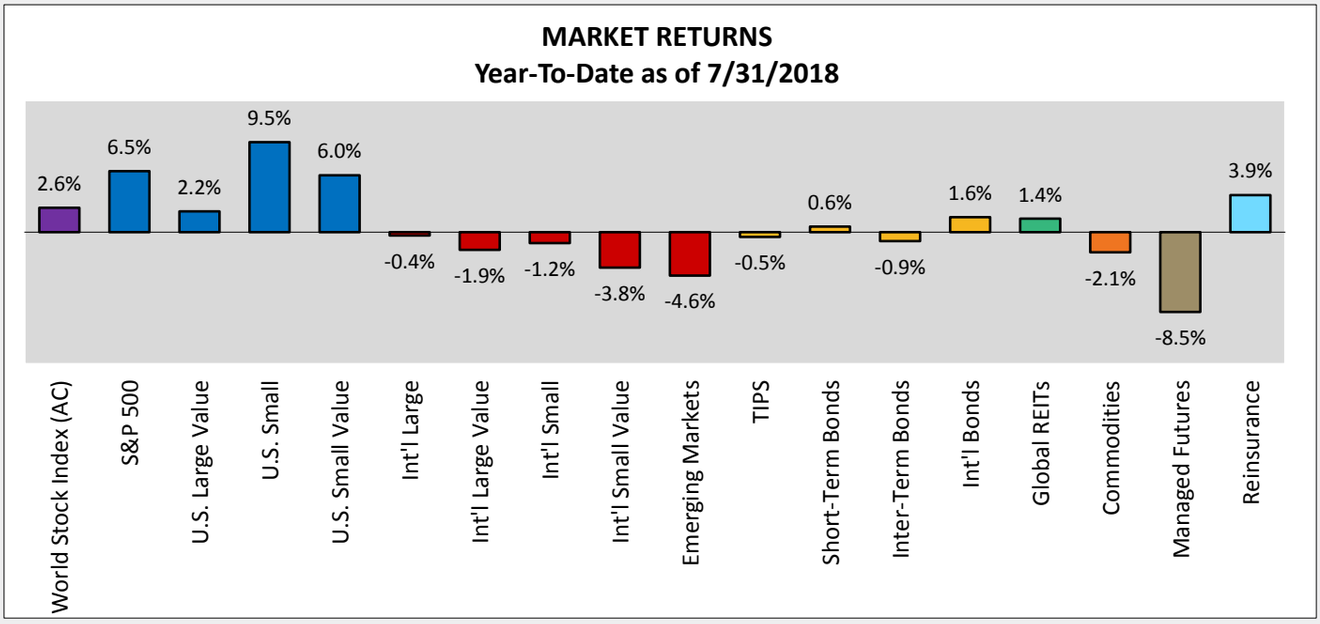
The Big Mac and the Power of Your Dollar

Foreign exchange rates often go unnoticed in day-to-day life, but they can play a sizable role in decision making at central banks around the globe and influence choices in large corporations, as well as impacting the returns on your investments. On a lighter note, exchange rates impact how expensive it is to take your next vacation out of the country. Just like stocks, currencies can be expensive (or inexpensive) relative to others. To determine whether a currency is overvalued, undervalued, or appropriately priced, we can perform an economic analysis utilizing factors including current account deficits/surpluses, interest rates, inflation, and debt levels to name a few. Or we can just compare the price of Big Macs in different countries!

The Big Mac Index was developed by *The Economist* in 1986 as a simple methodology to value currencies around the world. This beginner's guide to currency valuation is actually based on the theory of purchasing-power parity which states that, in the long run, exchange rates should gravitate towards a rate that would price the same basket of goods equally in two different countries. But enough with the academic jargon – let's get to the meat of this.

As of the July 2018 publishing of the Index, a Big Mac costs $6.05 in Australia but only $5.51 in the United States. This implies an exchange rate of approximately 1.1 AUD/1.0 USD. However, the actual exchange rate sits at 1.34 AUD/1.0 USD. This implies that the Australian dollar is 18.1% undervalued versus the U.S. dollar. Based on this appetizing analysis, we would expect the Australian dollar to appreciate relative to the U.S. dollar in the long run. But before you book your next trip (surely with a Big Mac comparative analysis as the central focus), there is an additional adjustment to consider. A Big Mac should cost more in a wealthier country (with a higher GDP per capita) relative to a poorer country due to labor costs. So don't forget to adjust your next Big Mac for GDP!

Of course, we do not expect to hear mention of the Big Mac Index in any of this quarter's earnings calls or even as Federal Reserve Chairman Jerome Powell addresses the U.S. economy in his next press conference, as this streamlined metric is simply a fun way to compare currencies around the globe. But it just may help in choosing a cost-effective spot for your next escape.



MARKET RETURNS - Longer Term Annualized as of 7/31/2018

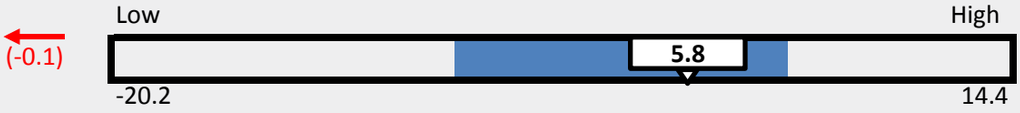
	1 Month	YTD	1 Year	3 Years	5 Years	10 Years	15 Years
STOCKS							
S&P 500	3.7%	6.5%	16.2%	12.5%	13.1%	10.7%	9.4%
U.S. Large Value	4.2%	2.2%	10.4%	11.0%	10.7%	9.3%	9.0%
U.S. Small	1.7%	9.5%	18.7%	12.0%	11.3%	10.4%	10.2%
U.S. Small Value	1.9%	6.0%	13.0%	12.0%	10.5%	10.5%	10.4%
Int'l Large	2.5%	-0.4%	6.4%	5.0%	5.9%	3.4%	7.3%
Int'l Large Value	2.9%	-1.9%	3.8%	3.7%	4.8%	2.8%	6.8%
Int'l Small	0.7%	-1.2%	8.8%	9.7%	10.3%	7.1%	10.8%
Int'l Small Value	1.0%	-3.8%	5.2%	8.8%	9.8%	6.9%	11.1%
Emerging Mkts	2.2%	-4.6%	4.4%	8.9%	5.3%	2.9%	10.4%
World Stock Index (AC)	2.8%	2.6%	11.2%	9.1%	9.1%	6.7%	8.6%
BONDS							
TIPS	-0.5%	-0.5%	1.2%	1.7%	1.4%	3.0%	4.3%
Short-Term Bonds	0.1%	0.6%	0.7%	0.4%	0.3%	0.5%	1.4%
Interm-Term Bonds	0.0%	-0.9%	-1.0%	1.0%	1.5%	3.1%	3.4%
International Bonds	-0.1%	1.6%	3.2%	3.4%	4.3%	4.4%	4.3%
ALTERNATIVES							
Global REITs	0.9%	1.4%	4.3%	5.9%	7.5%	6.6%	8.9%
Commodities	-2.1%	-2.1%	2.7%	-1.6%	-7.1%	-8.1%	-0.8%
Managed Futures	-0.6%	-8.5%	-6.1%	-3.0%	2.8%	2.7%	5.7%
Reinsurance	0.7%	3.9%	1.9%	4.6%	5.3%	6.9%	7.4%

Source: Morningstar Direct. Indices used in above graphs: S&P 500 Index, U.S. Large Value-MSCI U.S. Prime Market Value Index, U.S. Small-Russell 2000 Index, U.S. Small Value-MSCI U.S. Small Value Index, Int'l Large-MSCI EAFE Index, Int'l Large Value-MSCI EAFE Value Index, Int'l Small-S&P EPAC Small Index, Int'l Small Value-S&P EPAC Small Value Index, Emerging Mkts-MSCI Emerging Markets Index, World Stock Index-MSCI All Country World IMI Index, TIPS-Barclays Gbl Infl Linked US TIPS Index, Short-Term Bonds-Ibbotson 1 Yr Treasury Const Mty Index, Interm-Term Bonds-Barclays Interm-Term Govt/Credit Index, International Bonds-JPM GBI Global Ex US Hdg, Global REITs-S&P Global REIT Index, Commodities-Bloomberg Commodity Index, Managed Futures-Credit Suisse Mgd Futures Liquid Index, Reinsurance-SwissRe Global Cat Bond Index.

Past performance is historical and does not guarantee or indicate future results. Index returns assume reinvestment of all distributions and unlike mutual funds, do not reflect fees or expenses. It is not possible to invest directly in an index. This report is not intended to provide personalized investment advice. Some information has been produced by unaffiliated third parties, and while it is deemed reliable, the advisor does not guarantee its accuracy or completeness.

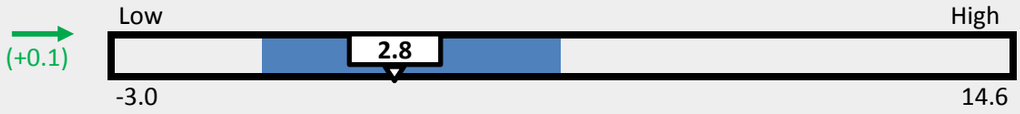
Economic Indicators

Leading Economic Index Year over Year Change (%)

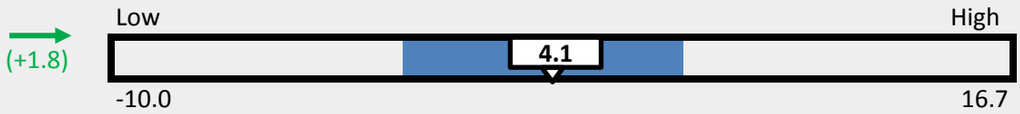


Unemployment (%)

Inflation CPI (YOY %)

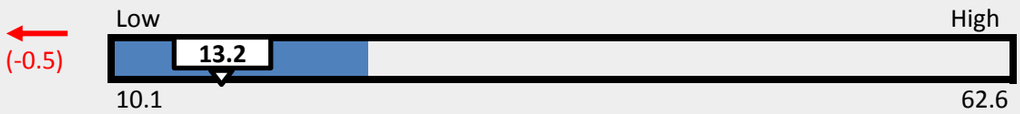


Real GDP Growth (%)

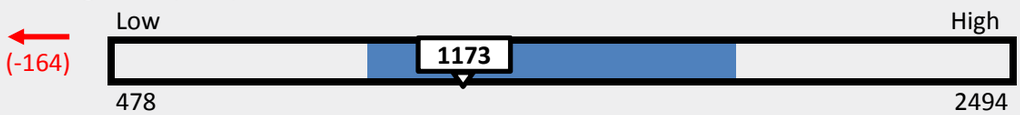


Consumer Confidence

VIX - Market Volatility



Housing Starts (000s)



10-year Treasury Yield (%)

Typical range (within 1 standard deviation of the median)

Current Value

Historical Range

Change in value since last month

**See appendix for sources and data ra*

Appendix

Leading Economic Index Year over Year Change (%)

The Leading Economic Index is composed of 10 indicators used to forecast the direction of the economy. A fall in the index over three consecutive months is seen as a sign of a recession. The value shown represents the 12-month change in the index level. *(Data Source: The Conference Board. Monthly data since 1/1/1959)*

Unemployment

The unemployment rate measures the percentage of workers that are out of work in the U.S. labor force. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

Inflation CPI (YOY)

The Consumer Price Index (CPI) measures the change in the price level for a broad basket of goods in the U.S. economy. The value shown represents the percent change in the index from a year ago. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

Real GDP Growth

Real GDP Growth represents the change in the market value of all output in the U.S. economy. It is an annualized quarterly measure. *(Data Source: U.S. Bureau of Economic Analysis. Quarterly data since 4/1/1947)*

Consumer Confidence

The Consumer Confidence Index measures the level of optimism among U.S. consumers on the economy and their overall financial situation. *(Data Source: The Conference Board. Monthly data since 1/31/1991)*

VIX

The CBOE Volatility Index (VIX) measures the volatility of the S&P 500 index. An increase in the index level represents a spike in market volatility. Conversely, a decrease in the index represents a move towards stability. *(Data Source: Chicago Board Options Exchange. Daily data since 1/2/1990)*

Housing Starts

The number of housing starts (new construction) in the U.S. each year. *(Data Source: U.S. Bureau of the Census. Monthly data since 1/1/1959)*

10-year Treasury

The annualized return that would be realized for holding a 10-year Treasury bond to maturity. The 10-year Treasury yield is the primary benchmark for measuring interest rate movements. *(Data Source: U.S. Board of Governors of the Federal Reserve System. Daily data since 1/2/1962)*

Disclosure

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