IdahoTrustBank

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust Bank

The global financial markets have struggled so far this year. Volatility levels have increased from exceptionally low levels experienced last year. Uncertainties surrounding the global political landscape have clearly begun to impact the investment environment. Most central banks around the world are maintaining an accommodative policy outlook. However, the U.S. central bank has been boosting interest rates as the domestic economy continues to expand.

Interest Rates

At the mid-June meeting, the Federal Reserve Bank (Fed) raised interest rates for the second time in 2018 (marking the 7th increase in the past 10 years). The target range of the Fed funds is now 1.75% – 2.00%. The domestic economy experienced a notable improvement towards the end of last year and the Fed members currently project that they will increase rates one or possibly two more times in 2018. Presently, inflation appears manageable, although it has ticked up a bit in the past six months. If inflation pressures move higher, it is possible that the Fed will become more aggressive about raising interest rates. However, at this stage we do not think this is a likely outcome and the recent pickup in inflation levels is not likely to get much stronger.

The Fed appears to want to act before there are actual signs of inflation. The

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central bank has made an effort to convey the idea that economic activity levels will determine the path and timing of future interest rate increases. During the previous tightening cycle of the Federal Reserve, it raised interest rates by 0.25% at 17 straight meetings. This time, the Fed has made it clear that there will be no predetermined path and they will be more sensitive to incoming economic data.

First Half Recap

Of the major U.S. indices, the Nasdaq Composite, which contains a large portion of technology companies, had the strongest returns in the first half of the year. The Dow Jones Industrial Average which contains a broader composition of companies, registered modest losses, as investors fretted over the economic impact of trade tariffs. International stock indices experienced similar struggles and emerging market equities have fared the worst, experiencing a decline of 6.7%.

2018 Market Returns

(Year to Date)

as of: June 29,2018:

Broad Market Returns	
S&P 500	2.65%
Dow Jones Industrial Average	-0.73%
Nasdaq	9.38%
Russell 2000 - small cap	7.67%
MSCI EAFE	-2.75%
MSCI Emerging Markets	-6.66%
US Bond Index	-1.62%
Treasuries	-1.08%
Corporate Bonds	-3.27%
Municipal Bonds	-0.25%
Foreign Bond Index	-1.20%
Commodities	0.01%
Domestic Stock Sectors	
Information Technology	10.87%
Financials	-4.09%
Health Care	1.83%
Energy	6.81%
Consumer Discretionary	11.50%
Consumer Staples	-8.55%
Industrials	-4.69%
Utilities	0.32%
Materials	-3.08%
Telecommunication Services	-8.35%
Real Estate (REITs)	0.81%

Small-cap stocks have benefited from international trade disputes, as investors focused on these companies that conduct a majority of their business domestically. The Russell 2000 Index rose 7.7% in the first half of the year. For the first time since the fourth quarter of 2016, value equities led the small-cap rally. In the U.S., strong earnings growth has been a crucial underpinning of the markets' performance. Also a resilient tech sector, led by U.S. and Chinese giants,

has had an increasing influence on markets domestically and in Asia.

The S&P 500 trades at about 16.1 times projected earnings over the next 12 months, a reduction from the over 18 times the index sold for at the start of the year. Despite the reduction, this valuation metric is still high by historical standards but is well below its forward multiple at the dot-com bubble's peak (of 26 times) in 2000. Valuations are more modest elsewhere around the globe. In Germany, the DAX trades at less than half its peak multiple in 2000. The forward earnings multiple for the Nikkei is around its 5 year average.

Exhibit 3: 10 stocks have contributed more than 100% of S&P 500's YTD return
as of June 28, 2018

Ticker	Company	Cons. 2019E sales growth	Total return	Mkt cap weight	% of SPX Return
AMZN	Amazon.com Inc.	23 %	45 %	2.1 %	**36 %**
MSFT	Microsoft Corp.	10	16	2.9	**18**
AAPL	Apple Inc.	4	10	3.8	**15**
NFLX	Netflix Inc.	24	106	0.4	**15**
FB	Facebook Inc.	27	11	1.9	**8**
GOOGL	Alphabet Inc.	18	7	2.8	**7**
MA	Mastercard Inc.	12	31	0.6	**7**
V	Visa Inc.	11	17	0.9	**6**
ADBE	Adobe Systems Inc.	19	37	0.4	**5**
NVDA	NVIDIA Corp.	14	25	0.5	**5**
Top 10 contributors		**16 %**	**20 %**	**16 %**	**122 %**
S&P 500		**5**	**3**	**100**	**100**

Source: FactSet, Goldman Sachs Global Investment Research

Strong performance from Technology companies has been an important contributor to the overall market returns (see chart above). During the first six months of this year, the U.S Tech sector rose 10.9%. The Consumer Staples sector was the biggest loser over the same time frame, declining 8.6%, as rising interest rates negatively impacted these stocks. The Energy sector experienced a healthy rebound from the struggles it had in the beginning of the year. For the first half of the year, the group has advanced 6.8% (recording a 13.5% increase in the second quarter).

Conclusion

Given the relatively healthy state of the domestic economy, the pace of Fed interest rate increases will certainly have an impact on the financial markets. Another important variable will be the changing political and fiscal policy environment, which has created many uncertainties; from spending priorities to the impact of tariffs. Uncertainty surrounding these issues could add to the volatility this year, but the underlying foundation of economic health remains strong. We also think another important variable will be inflation expectations. If inflation rates begin to accelerate, the Fed will become more aggressive in tightening monetary policy.

S&P 500 Index

3 Month	5.80%
Year-to-Date	2.65%
1 Year	14.36%
3 Year	11.69%
5 Year	13.31%

MSCI EAFE Net Index

3 Month	-1.22%
Year-to-Date	-2.75%
1 Year	6.84%
3 Year	4.64%
5 Year	6.19%

Barclays Aggregate Bond Index

3 Month	-0.21%
Year-to-Date	-1.62%
1 Year	-0.40%
3 Year	1.79%
5 Year	2.25%

As of 6.29.2018

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