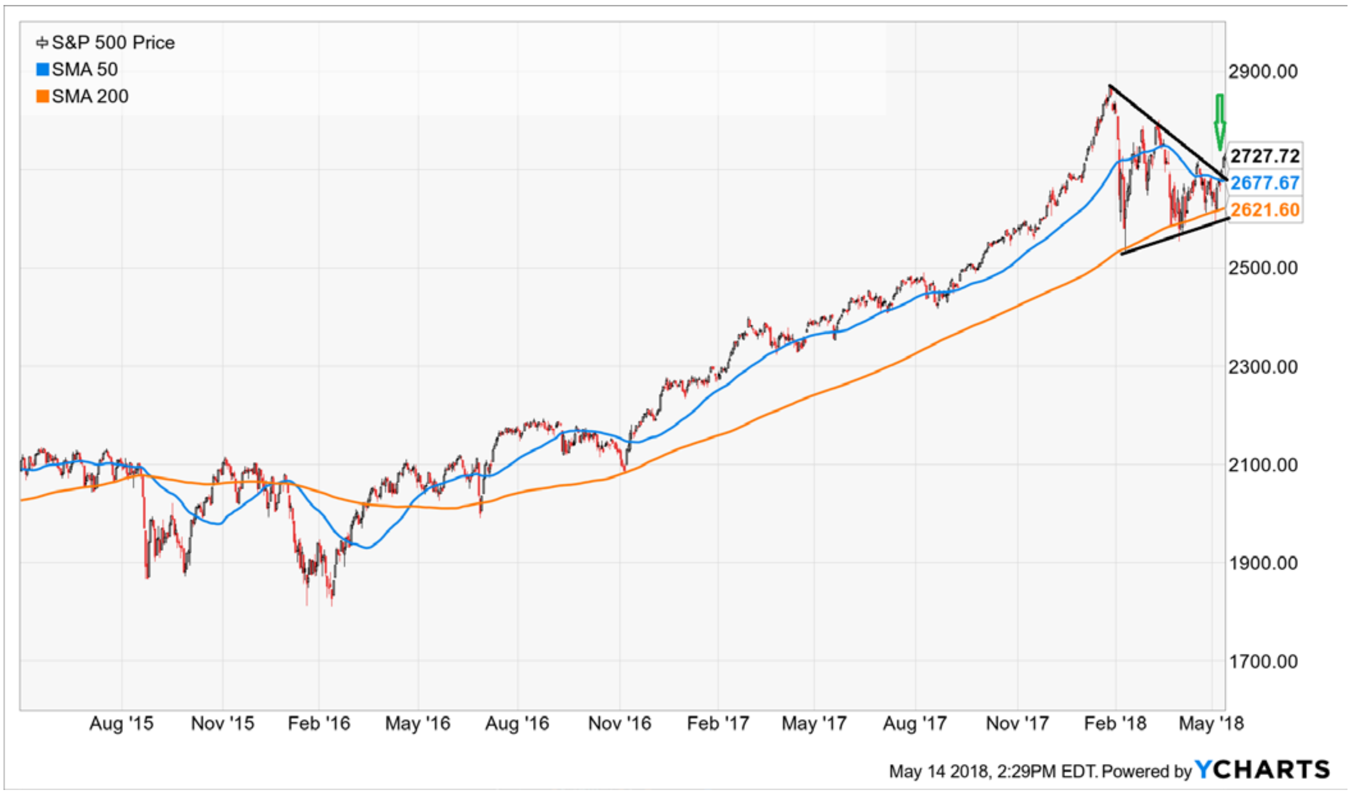
Market Update

May 14, 2018

Markets Break out of Range on the Heels of Earnings Season

U.S. Equities markets seemed trapped in a range bound pattern since the beginning of March. Equities had been experiencing large swings. The bottom of the range was the 200-day moving average and the top of the range the 50-day moving average. As the markets would touch and slightly break through each average, the next move would reverse action and go the other direction. This caused the 50-day moving average to continue to come down and the 200-day moving average to continue to move up. The sideways pattern was building concerns that the next conclusive directional move could be down below the 200-day moving average, a sign that equities could go much lower. To confirm a positive move, the markets needed to break through the 50-day moving average resistance level while generating higher shorter-term highs. Good earnings would provide the catalyst for this to happen. On May 4th the markets started responding and have been able to put together several trading days of gains on the heels of a robust earnings season. The green arrow in the 3year S&P 500 chart below shows the recent break out above the 50-day moving average (blue line) and the converging channel (thick black lines).



Information in the chart above was taken from sources we believe to be reliable; however; we do not guarantee its accuracy or completeness.

This short-term break-out pattern does not mean that the markets do not have things that can derail the new direction. However, it is a sign, especially to institutional portfolio managers, that the markets may act more favorably in the shorter term.

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The chart below shows the percent change since November 2016 for the S&P500, TLT (our proxy for long dated Treasuries), GLD (our proxy for Gold) and the Dow Jones REIT index which tracks general performance of Real Estate Investment Trusts. Equities, REITs and Gold have moved up in price since my last market update and the price of longer term bonds have gone down, as interest rates continue their slow move upward.

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Domestic equity markets shrugged off the President's announcement that the U.S. is leaving the current Iran nuclear deal, which caused oil to rise for the 5th consecutive week. There was a slight loss in momentum in underlying inflation in April. This loss of momentum helped reduce concerns that the Federal Reserve is moving too fast with rate increases.

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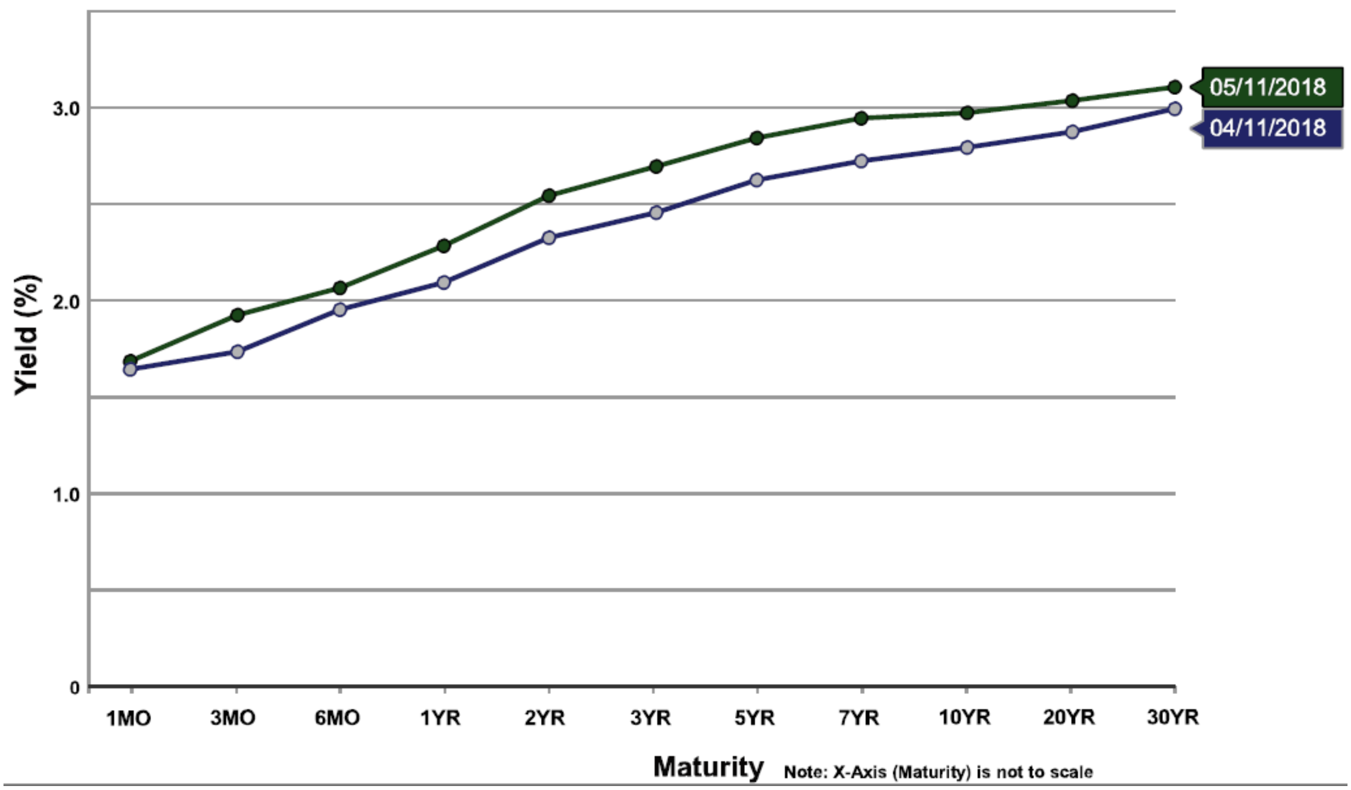

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https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-Yield-Data-Visualization.aspx

The Treasuries yield curve experienced another slight shift to the left and some additional flattening in the intermediate to longer dated range. As the Federal Reserve moves cautiously towards its neutral interest rate range of around 2.9%, we anticipate the yield curve will continue to shift upward toward the left, with the potential of more flattening at the longer end of the curve.

Our view remains that the fundamental back drop of the economy should provide the markets with a platform for continued growth. Earnings season came in very strong. Commentary and future forecast from the companies also indicated that many corporations feel that there is still plenty of growth potential left for 2018. However, there are signs of a later stage economic environment as evidenced by wage increases, inflation and rising interest rates. The biggest concern for the next 12 months is still the Federal Reserve increasing rates too quickly, to combat inflation, which can often stifle growth. Our outlook is more cautious for this year, although we do feel there is more opportunity for growth. Overall, we prefer domestic equities over international equites although some international markets may become more attractive as the U.S. economic cycle continues to mature. Most all our portfolios hold a percentage of their assets in international investments, which should benefit from improved economic indications globally. We are currently bearish on fixed income and interest rates and believe that the future will bring a higher rate environment. One way we are looking at combating the decline in fixed income prices is by shifting some of our fixed income holdings to floating rate securities. These tend to hold value better in rising rate environments. Also, we are starting to look at ways to directly combat inflation such as investing in Treasury Inflation Protected Securities (TIPS). These securities have important tax ramifications and are typically most appropriately used in retirement accounts where the current tax effects are reduced and often eliminated. It is important to maintain discipline regarding strategic asset allocation. Tactically, the shift to holding some floating rate bonds or bond funds and TIPS should help reduce some of the pressure on the bond allocations in our portfolios.

If you have questions or would like to discuss this further with regard to your personal portfolio, please contact me at 310-433-5378.

James M. Liotta, CFP®, CPWA®, AIF®, NSSA®, MBA
President
Prominence Capital GP, LLC.
jliotta@prominencecapital.com
www.prominencecapital.com

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