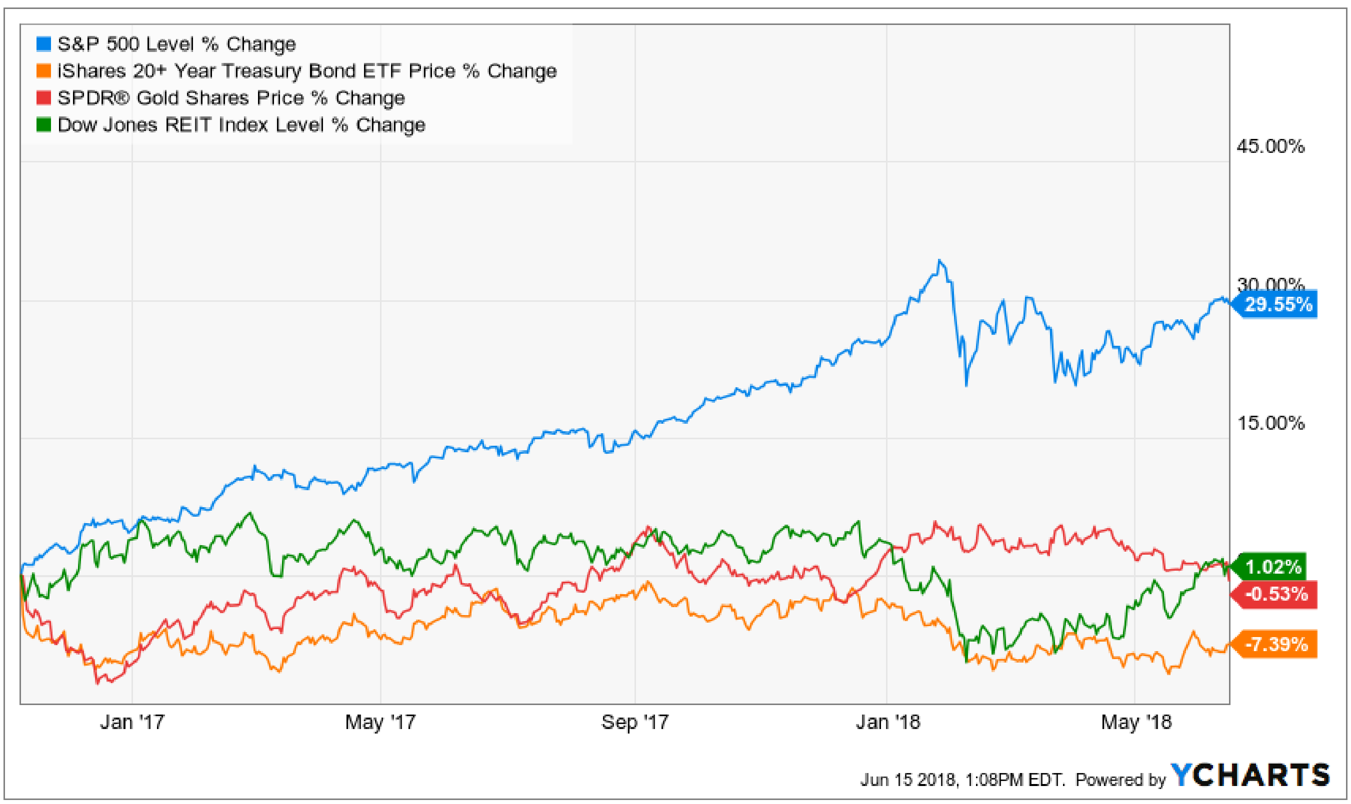
Market Update

June 15, 2018

The Federal Reserve is the Most Important to Watch

The Federal Reserve decided to increase the Federal Funds lending rate it charges by another quarter of a point this Wednesday. This pushed the funds target rate up to a range of 1.75% to 2%. Equity markets mildly sold off on this news, as the prospects of higher rates, has a potential slowing effect on the economy. Interestingly, the markets started the week cautious and did not move much after the U.S. and North Korean summit. The market seemed more concerned about what was coming up regarding the interest rate decision by the Federal reserve. In the chart below, we see the S&P 500 (blue line) continuing to make progress higher from the lows of the year. TLT the iShares 20+ Year Treasury ETF (orange line), which is our proxy for long term fixed income, has gained in price since my last update, but appears to be trading sideways with a downward bias. This is indicative of a rising rate environment. GLD (red line), our proxy for gold, has trended down and lost a bit of its luster, suggesting that investors are not running from equities or fixed income due to economic and geopolitical concerns. Lastly, we see a divergence from the recent trend in the Dow Jones REIT Index (green Line), as Real Estate Investment Trusts seem to have picked up investor interest, as the prices came down and yield on the sector moved up. This along with good economic indicators has given investors some reason to buy back into REITs.



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PROMINENCE CAPITAL

Market Update

June 15, 2018

Last month, I started the market update with a review of the technical break out the market was experiencing. This was important because we saw an upward change in the trading range between the 50day moving average and 200 day moving average. This breakout has continued, as the chart below suggests.

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The US. Treasury yield curve below, has flattened out and shifted down a slight bit since last month. A shift down of longer-term rates made up much of the change in the yield curve. Above trend economic growth and inflation convinced the Federal Reserve to move its lending rate up by a quarter percent this week. Growth in the second quarter is currently tracking a blistering 4.0% annualized pace, helped along by a strong rebound in household spending, firm business investment, and surprising strength in net exports. What's more, growth is expected to continue at a 3.0% annualized pace on average, for the remainder of the year, with fiscal stimulus contributing about half a point.

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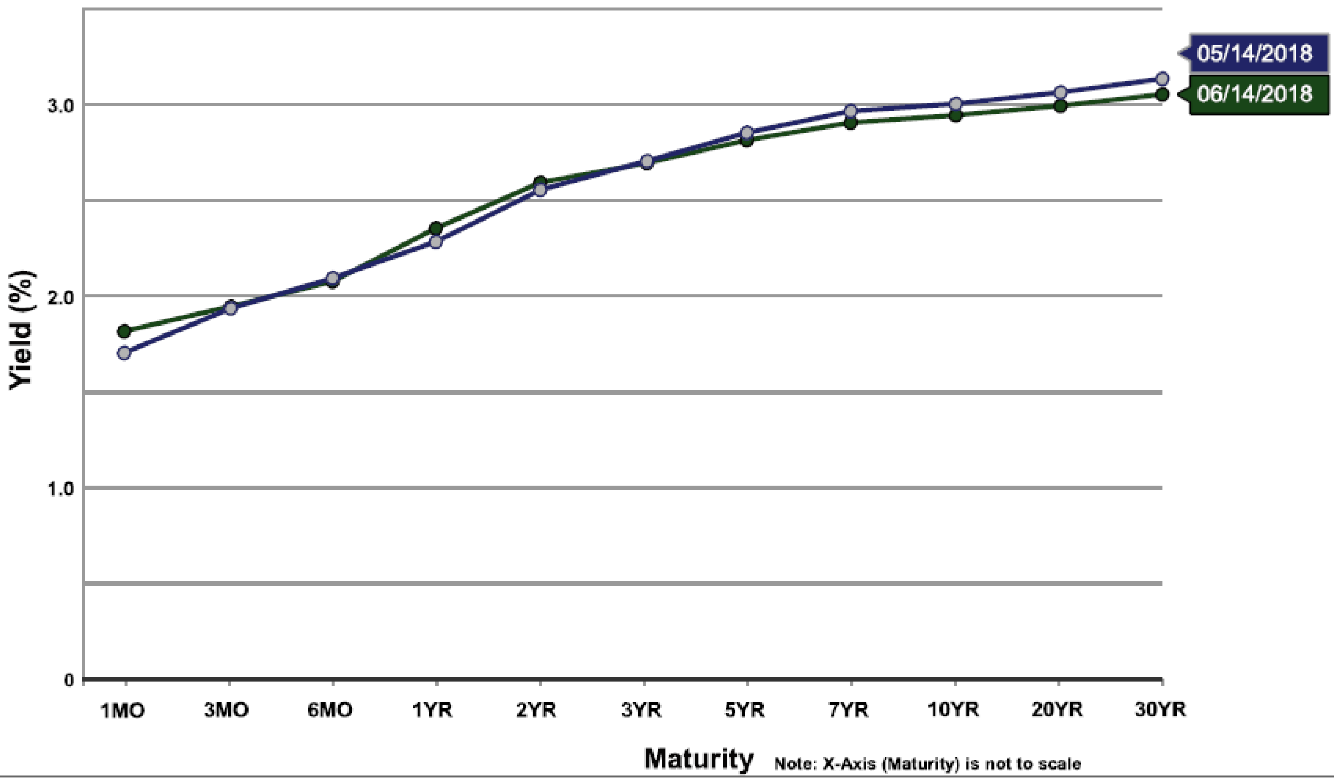

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https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-Yield-Data-Visualization.aspx

Our view remains that the fundamental back drop of the economy should provide the markets with a platform for continued growth. However, we still feel that there are signs of a later stage economic environment, as evidenced by wage increases, inflation and rising interest rates. The biggest concern for the economy in the next 12 months is still the Federal Reserve increasing rates too quickly, to combat inflation, which can often stifle growth. Preliminarily, our outlook is more cautious for the remainder of 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.

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