WINFIELD
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Customized Investment Portfolios and Private Wealth Advisory Services

MARKET COMMENTARY

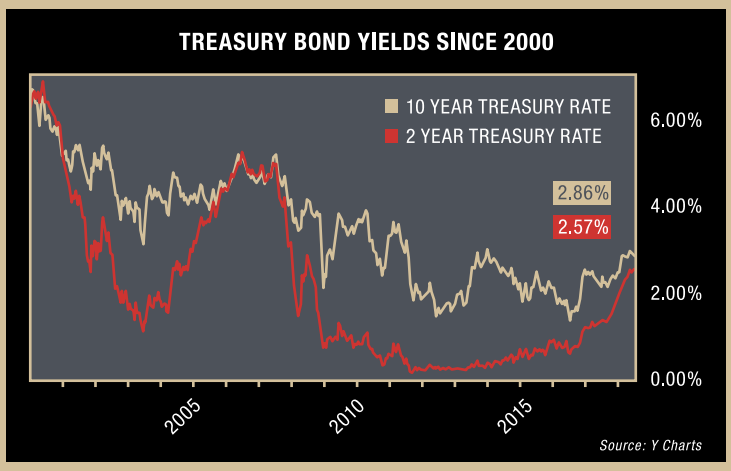
One year ago, we wrote in our July 2017 *Market Commentary* that a "synchronized global recovery" appeared to be underway. No economy seemed susceptible to a recession, and global GDP growth was largely in sync with growth in the United States. Through much of the rest of 2017, the synchronized global recovery theme remained intact as the world benefited from increasing productivity, low commodity prices, and accommodative central bank policies. Equity markets around the world responded with resounding enthusiasm as the S&P 500 rose 21.8%, the MSCI EAFE climbed 25.0%, and the MSCI Emerging Market Index soared 37.3% for all of 2017.

One year later, the economic outlook is more opaque as the synchronized global recovery faces new risks. Divergence in leading economic indicators and financial market performance are already showing cracks in the thesis. Political risks are of particular concern as US protectionism has gone from threats to action. As of the beginning of July, the US had implemented tariffs on over $81 billion of imported goods with the threat of tariffs on an additional $200 billion of Chinese goods in the second half of the year.

While the philosophical change in US trade policy has had limited impact on domestic financial markets to-date, the ensuing turbulence in currencies and interest rates weighed heavily on emerging markets throughout the first half of 2018. Of note, the JP Morgan Emerging Market Bond Index (debt) fell -7.0% during the second quarter of 2018, marking the largest quarterly decline on record in the index's 15-year history. Moreover, the MSCI Emerging Market Index (equities) which rose an astounding 8.8% in January alone, fell from February to June, reversing all its gains to finish down -6.5% for the first six months of 2018. Markets appear to be signaling a divergence in regional economic performance and a potential end to global synchronized growth.

Importantly, the US dollar appreciated against most global currencies during the first half of 2018, exacerbating declines in emerging markets. Without currency translation, emerging market equities were only down -2.7% in local currency terms. Nonetheless, rising US interest rates have been a key reason for dollar appreciation and the resulting emerging market underperformance. Continuation of a global synchronized economic recovery depends on stabilization in currency rates through the second half of the year.

Developed market interest rate differentials are strongly in favor of the United States and are increasing. The Federal Open Market Committee (FOMC) has already raised the fed funds rate twice in 2018. In June, the FOMC increased the fed funds rate 25 basis points (0.25%) from 1.75% to 2.00% and signaled that two additional rate increases are most likely in 2018. By comparison, the European Central Bank's (ECB) overnight lending rate is -0.40%, and the Bank of Japan's (BOJ) is -0.10%. Both the ECB and the BOJ have hinted at no changes in monetary policies well into 2019. Central banks' diverging policies are reflected in the yields of government debt. Ten-year yields of US Treasuries stood at 2.83% on July 6 versus 0.29% in Europe and 0.03% in Japan. The effects of ongoing accommodative monetary policy outside the US are contributing to a stronger dollar and a flattening yield curve in the US.



The graph above illustrates the gap between the US 10-year Treasury bond yield and the US 2-year Treasury bond yield since 2000. Fixed income investors are typically rewarded with higher yields the longer the maturity of the underlying bond. During most periods, the yield of the 10-year Treasury exceeds the yield of the 2-year Treasury. However, two periods indicate a closing and reversing of the gap (2001 and 2008) where the yield curve inverted. An inversion occurs when the 2-year yield rises higher than the 10-year yield. Historically, an inverted yield curve signals that a recession is likely to follow as we experienced in 2001 and 2008-2009. While the 10-2 gap has narrowed in recent months, it has not inverted, providing a cautionary indicator rather than an alarm that a recession is imminent.

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Regional equity market performance has been indicative of diverging earnings growth. In the US, consensus earnings estimates remain positive. Second quarter earnings growth is expected to be up 19% year-over-year with all eleven industry sectors posting positive results. For the first six months of 2018, the S&P 500 rose 2.6% while the tech-heavy NASDAQ Composite increased 9.4%. In Europe and Japan, earnings growth is expected to be more modest in 2018, at 7.3% and 2.7% respectively while emerging market earnings growth is expected to slow from 23.5% in 2017 to 15.6% in 2018. Declining earnings growth in emerging markets largely contributed to the MSCI All Countries World (Ex-US) Index's -5.3% slide in the first half of the year.

US tax reform and the repatriation of overseas cash continue to support US equity valuations. We expect second quarter earnings results to broadly confirm initial enthusiasm and add to investors' confidence in the second half of 2018. Tax savings appear to have been primarily reinvested into labor (adding employees and raising wages) and share buybacks. According to JP Morgan, US corporations spent $750 billion on share repurchases through June 18, a pace which far exceeds the forecast of $840 billion we projected for *the entire year* in our April *Market Commentary*.

We remain cautiously optimistic about the global economy, but make note of the sheer duration of the bull market in equities – nine years without a correction of 15% or more. The change in US trade policy seems to be intensifying, and history has shown protectionism versus free trade can have deleterious effects in the long run. If inflation rises in response to tariffs, the Federal Reserve will push interest rates higher which will in turn slow capital spending and exacerbate the dollar's strength. We have tempered some of our risk assets and will be cognizant of new developments if political positioning transitions into a more significant trade war.

PLANNING AHEAD — ADD A TRUSTED CONTACT

Adding a Trusted Contact provides your advisors (Winfield, attorney, accountant, etc.) and custodians (Schwab, Fidelity, etc.) a resource to contact on your behalf, if necessary. A Trusted Contact is a person you are permitting your advisor or custodian to contact and disclose information about your account to address possible financial exploitation; to confirm your contact information, health status, or the identity of any legal guardian, executor, trustee or holder of power of attorney. Adding a Trusted Contact to your accounts gives advisors and custodians a way to verify your status without involving powers of attorney or other legal documents. Trusted Contacts are unable to view account information, execute transactions or inquire about account activity unless they are already an authorized party or have view-only access to your account. Contact us to learn more about adding a Trusted Contact to your accounts.

MARKET PERFORMANCE

	2Q 2018	2018 YTD
Dow Jones	1.3%	-0.7%
S&P 500	3.4%	2.6%
Nasdaq	6.6%	9.4%
Russell 2000	7.8%	7.7%
MSCI EAFE	-1.2%	-2.7%
Barclays Agg	-0.2%	-1.6%

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- Manage assets with a long-term growth strategy while meeting investment policy requirements

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- Defer taxable earnings in profit sharing plans
- Manage and advise 401(k) plans

BUSINESS PROFESSIONALS

- Customize investment portfolios, manage stock options and consolidate 401(k)/IRA plans to lessen risk of concentrated assets

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