

summaries



the official newsletter of sigma investment counselors

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Market Commentary

Market volatility continued during the second quarter, albeit at a muted level versus the first quarter of the year. The second quarter of 2018 brought positive moves for the major domestic equity averages while international markets gave back outperformance seen in 2017. The continued upward drift in interest rates led to a negative return in the Barclays US Aggregate Bond Index. Returns for the various benchmark indices are shown below.

| | Q2 2018 | YTD |
|--------------------------------------|---------|--------|
| <u>Domestic Equities</u> | | |
| S&P 500 Large Cap | 3.43% | 2.65% |
| S&P 400 Mid Cap | 4.29% | 3.49% |
| S&P 600 Small Cap | 8.77% | 9.39% |
| <u>International Equities</u> | | |
| MSCI EAFE Developed Int'l | -1.24% | -2.75% |
| MSCI Emerging Markets | -7.96% | -6.66% |
| <u>Bonds</u> | | |
| Barclays US Aggregate Bond | -0.16% | 1.62% |

Talk of tariffs and trade wars, inflation and further interest rate increases all contributed to a fair amount of equity market volatility in the second quarter. New in the quarter was the escalation of rhetoric emanating from the White House regarding tariff and trade issues with seemingly all of our global trading partners, including the targeting of Canada and members of the EU, some of the United States' closest allies. The concerns arising from this dialogue resulted in very different performance within the domestic indices. Those companies with less exposure to sales beyond our borders performed better as their sales are less vulnerable to retaliatory tariffs by other countries. This led to the outperformance of small and midcap companies whose sales generally are less at risk to overseas tariffs.

Within the large cap universe, there was a wide disparity between the performance of the various industry sectors. For the first half of the year the energy stocks had strong performance as the price of oil continued to rise. In contrast, industrial stocks dramatically underperformed due to their exposure to overseas markets.

Emerging markets' vulnerability to the trade wars, combined with a stronger dollar resulted in negative performance in the quarter. Similarly, all of the strong rhetoric regarding tariffs with some of our closest partners resulted in a decline in the developed international market indices in the second quarter as well.

Finally, the continued rate increases by the Federal Reserve resulted in negative bond returns since the beginning of the year. Interest rate increases by the Federal Reserve have a direct impact on short-term rates. In response to increasing short-term rates, long-term rates also move up as investors seek to be rewarded for the risk of possible higher interest rates in the future. In a changing interest rate environment, long-term bonds are more volatile than short-term bonds. We continue to believe interest rates on bonds that have longer maturities do not reward investors for the added risks associated with a rising rate environment. Given our ongoing concerns about a rising rate environment, we remain invested in short and intermediate term bonds in client portfolios.

In January, we opportunistically took profits in some of the stocks that performed extremely well in 2017. In our February Sigma Summaries we discussed the strong markets since mid 2016 and how that would affect taxable

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portfolios going forward. By the beginning of 2018, most of the portfolio losses harvested in the market decline of 2008/2009 had been used to offset realized capital gains from the portfolios. This resulted in clients paying lower capital gains taxes over the years than would have otherwise been the case. Further, we noted our rebalancing activities in just the month of January resulted in generating more gains in portfolios than most clients experienced on an annual basis with us in any of the past nine years.

As we said then, the good news/bad news is in most portfolios there are few, if any unrealized losses to harvest to offset gains on a go forward basis. Moreover, while it would be useful to have a loss to take that is not something we endeavor to achieve. All that said, in the past quarter we have sought to opportunistically use the periods of increased market volatility to harvest losses in taxable portfolios as appropriate.

Talks of tariffs and trade wars continue to unsettle markets. As we wrote in our May commentary, being able to separate the news from the noise is becoming ever more important as trade tensions rise. Perhaps it is all spelled out in his book “the Art of the Deal” but the “MO” of President Trump is to start very aggressively in every negotiation,

hold firm in his position and then circle back later with a softer tone. As we begin July, we are seeing signs from the administration of a softer tone in some of the more recent rhetoric regarding tariffs. While many take issue with the President’s tenor, tone and aggressive nature of the commentary, the substance of what is being said has merit. When looking at some of the tariffs US exporters are required to pay vs. US tariffs on imports in the same industries it appears there are several gross inequities and this issue needs to be addressed.

We will have a better understanding of the economic outlook once the public companies begin to report earnings and company managements hold their quarterly investor conference calls. However, as we have said in recent commentaries we remain optimistic about the economy. Equities remain the asset of choice, although we are pleased to see bond valuations beginning to improve.

Thank you for the ongoing trust and confidence you place in Sigma in allowing us to provide our investment counseling and financial planning services to you. We appreciate and welcome our dialogue with clients. As always, we welcome your comments and questions.

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