Investment Commentary
Second Quarter 2018

In some ways 2018 looks very similar to 2017; in other ways it is very, very different.

Most similar to last year is the broad-based growth of both the economy and corporate earnings here in the U.S. Despite now being more than 110 months into recovery, the labor market in the U.S. continues to reflect growth and has been adding about 150k-200k jobs per month. The unemployment rate recently ticked up for the first time in years but that is entirely due to nearly 500,000 non-workers coming back into the workforce in June 2018, a positive occurrence. Both small business optimism and job openings remain high. Wage growth has been stubbornly below expectations but it is trending higher, albeit slowly. Quarterly corporate earnings are expected to reflect nearly 20% growth YoY when reporting season begins in a week's time. Corporate balance sheets are in solid shape and credit spreads remain stable. The data supports this very favorable fundamental backdrop.

If the tag line for 2017 was "synchronized global growth", this year can maybe be best described as "synchronized global turbulence". Volatility has been much more prevalent and more recent market returns have been muted. The sources of volatility this year have been plentiful: implosion of inverse volatility products, North Korea, Russia, the on-going Washington D.C. drama, and China trade war concerns. We have already had a -10% drawdown this year in the equity market. Such a drawdown feels very significant after such an abnormally low volatility year like 2017. However, this is well in the range of what is considered a normal historical sell-off. The broad equity market here in the U.S. is up low single digits this year while most traditional fixed income strategies have noted low single digit negative returns. Despite solid fundamentals it's been a bumpier ride for sure.

We spend very little time here at CWM focused on near term performance and substantial time focused on the data that defines where we are in the market cycle. We believe that making correct asset allocation decisions will be the biggest driver of overall portfolio success over time. Institutions such as university endowments and sizable foundations evaluate and measure results over three-year periods. We agree that this timeframe is a better assessment of success. A look back at trailing 3yr cumulative returns probably tells the fundamental story of the current cycle best:

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	YTD return*	3yr cumulative returns*
S&P500	+2.7%	+40.6%
Russell 2000	+7.7%	+37.4%
MSCI EAFE (developed markets)	-2.3%	+16.3%
MSCI Emerging Markets	-6.5%	+20.7%
U.S. Corporate fixed income	-3.3%	+9.6%

*(results thru June 30, 2018)

During volatile periods opportunities can often be found. Emerging markets have not only been a poor performer year-to-date due to U.S. dollar strength and trade war worries, this asset class has dramatically lagged the global recovery since 2010. We believe there is going to be a time in the very near future to be adding to emerging markets in portfolios. Valuations are attractive and fundamentals in most emerging markets are solid. We are not there yet, but you will be hearing more from us about emerging markets and the need to be adding to allocations, hopefully at lower prices.

In sum, we believe that recent market returns haven't kept up with the fundamentals. Rhetoric has temporarily trumped good fundamentals. Over time, however, fundamentals ultimately rule out. Always have and always will. I believe that with substantial cash on the sidelines, a still positively sloped yield curve, and widespread availability of credit at the ready, the forward return of the market will migrate back to the underpinnings of very positive economic fundamentals and earnings growth. The fundamental trends we follow diligently and communicate about often are trending higher and supportive of risk assets. As we have said many times before, "bull markets don't just give up, they go down fighting". The data says this bull market has more to go.

Thank you for your continued trust and support. We hope all our clients enjoy some summer vacation with family and friends. Be well and be safe.

Richard J. Barrett
Chief Investment Officer
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