

## August 2018

### Global markets mixed in August

Markets were mixed in August. The U.S. had another strong month, with all three major U.S. indices rising. The Nasdaq Composite led the way with a gain of 5.85 percent. The S&P gained 3.26 percent, and the Dow Jones Industrial Average rose 2.56 percent.

These solid results were bolstered by strong fundamentals. According to FactSet, the estimated earnings growth rate for the S&P 500 was 25 percent in the second quarter, which would be the highest quarterly growth rate since the third quarter of 2010. Further, approximately 80 percent of the companies in the S&P 500 beat their earnings per share estimates—the highest percentage recorded since FactSet began tracking earnings surprises in 2008. All three indices were also supported technically, as they stayed above their respective 200-day moving averages.

Unfortunately, international markets did not do as well. Developed markets were down, with a loss of 1.93 percent for the MSCI EAFE Index. But it was emerging markets that suffered the most, with a loss of 2.67 percent in the MSCI Emerging Markets Index. A strengthening dollar and concerns over the risk of an emerging markets financial crisis, driven by the Turkish lira, caused much of the turmoil. The decline worsened about halfway through the month, although a steady recovery returned the index almost to starting levels before a final bout of volatility at month-end. Both indices remained below their 200-day moving averages for the entire month.

Fixed income had a better month. Falling interest rates on the intermediate and long portions of the curve provided a tailwind to performance. The 10-year Treasury note started the month at 3 percent, hit a low of 2.82 percent, and finished the month at 2.85 percent. The Bloomberg Barclays Aggregate Bond Index gained 0.64 percent during the month. High-yield bonds also did well, gaining 0.74 percent. High-yield spreads have traded in a tight range throughout 2018, as investors are still comfortable paying up for higher-yielding securities.

### Consumer data shows strength

Consumer spending figures were strong in August, driving overall growth for the economy. July's personal income and spending report showed solid growth of 0.3 percent and 0.4 percent, respectively. Retail sales data also came in much better than expected, with 0.5-percent growth against expectations for 0.1 percent. The annual Amazon Prime Day likely had an impact on these better-than-expected figures, as nonstore retail sales grew by 0.8 percent.

Growth in the second quarter was also strong, with an upward revision at month-end to 4.2 percent, the highest level in some time. Given this momentum and the overall high level of retail spending—as well as the importance of this kind of spending to the overall economy—we may be able to anticipate another solid quarter of growth ahead.

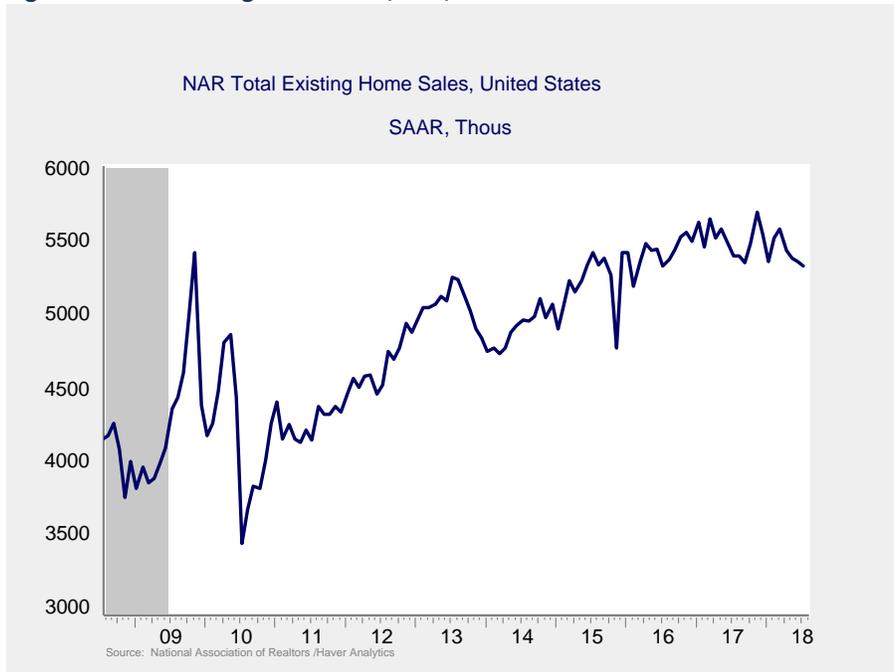
Continued growth has also fed consumer confidence, with the Conference Board Consumer Confidence Index hitting an 18-year high in August. Two of the major drivers of consumer confidence are employment growth and stock market performance. While U.S. equities did their part to boost confidence this month, employment growth also helped. July's headline figure added 157,000 jobs on top of positive revisions for May and June, which added an additional 59,000 jobs. Trends also remained solid, as unemployment returned to 3.9 percent, while wage growth stayed in line with expectations.

With job and income growth driving both confidence and spending, growth continues to remain strong. Nonetheless, while the headline figures are strong and appear to be powering overall growth, there are portions of the economy that bear watching.

## Housing slowdown continues

One of the primary areas of concern is housing growth (or the lack thereof). Both existing and new home sales fell in July, against expectations for a modest increase after a decline in May. While these can be volatile figures from month to month, the overall trend has been negative since we reached cyclical peaks in November 2017 (see Figure 1). On an absolute basis, sales are still at healthy levels compared with prior years. There are no immediate concerns, but the change in trend makes this an area well worth watching.

**Figure 1. Total Existing Home Sales, U.S., 2008–2018**



One of the major causes for the slowdown in sales is low inventory levels, especially for starter homes. Here, there wasn't much good news in August. Economists expected housing starts to rebound in July following a substantial decline in June; instead, they grew by just 0.9 percent. Homebuilder confidence also fell slightly, as rising construction costs are starting to hit builders.

Housing is a very important sector of the economy, so any potential slowdown needs to be closely monitored. The Federal Open Market Committee, which is in charge of setting the federal funds rate, shares that concern. In the minutes from its August meeting, it mentioned housing as a risk for the first time in years.

Despite its concern and driven by the strength of the rest of the economy, markets still expect the Federal Reserve (Fed) to hike rates by 25 basis points at its September meeting, with a December hike also likely. As has been the case throughout this tightening cycle, markets would likely see interest rate hikes as a positive sign for overall economic health—as the Fed would be unlikely to raise rates if it thought the economy was turning over.

## Political risks can shake markets

While the economic news remained encouraging, politics presented a risk. Emerging markets took the worst of it this month. A decline of more than 30 percent in the Turkish lira relative to the dollar and euro stoked fears of a potential contagion across emerging markets. At month-end, however, the damage appeared contained, with only Argentina and Turkey showing signs of major risk. As these countries have the most dollar debt, which becomes more expensive to service when local currencies collapse, they are most exposed. Other emerging market countries have similar but much smaller exposures, which should limit the spread of the damage. Still, future turbulence remains very likely.

The political risks are also rising in the U.S. The upcoming midterm congressional elections in November have the potential to rattle markets, as both parties ramp up their efforts to control the House of Representatives. Plus, recent primary election upsets have raised uncertainty across the board. Again, while this is not a source of significant concern, some additional volatility as we head into the fall would not be surprising.

On a more positive note, politics can also help markets. Reports of a preliminary trade agreement between the U.S. and Mexico have helped calm fears of a global trade war. The continuation of trade talks between the U.S. and Canada is another good sign. Markets took them as steps in the right direction, pushing the S&P 500 and Nasdaq to all-time highs near month-end.

### **Positive outlook for U.S. investors**

Overall, things are good right now for U.S. investors. The economy is humming along, jobs are plentiful, and markets are hitting all-time highs. Risks certainly remain, as a slowdown in housing and political uncertainty could surely spook markets. But even with the international volatility in August, U.S. markets have proven resilient.

We should expect that, at some point, the news won't be as good. While times are good now, that can change. September is, in fact, one of the most volatile months historically, so some turbulence is possible—it may even be likely. Whatever happens, though, a well-diversified portfolio that matches risk and return guidelines remains the best path to follow for achieving long-term financial goals. Enjoy the good times, but be prepared to weather the bad ones.

*All information according to Bloomberg, unless stated otherwise.*

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