INVESTMENT COMMITTEE MARKET COMMENTARY

DECEMBER 18, 2017 www.clearbrookglobal.com

U.S. EQUITIES

U.S. equity market indexes hit fresh record highs on Friday, driven by rising expectations for large corporate and personal tax cuts. The Fed raised interest rates as expected by 0.25%.

a) **Dow Jones +1.34%, MTD +1.64%, YTD +27.75%** b) **S&P 500 +0.95%, MTD +1.14%, YTD +21.86%**
c) **Russell 2000 +0.61%, MTD -0.82%, YTD +14.17%**

Drivers: I) The **Republicans' tax overhaul** appears to be **heading for approval** in Congress next week, after GOP senators who were previously holdouts on the bill said they would vote for the sweeping measure that would **cut corporate and individual rates**. Released late Friday afternoon, the bill would retain seven individual tax brackets; lower the corporate rate to 21% from 35%; and double the child tax credit to $2,000.

II) The **Federal Reserve** last Wednesday lifted a key U.S. interest rate, but the central bank was also cautious due to persistently low inflation and a pending change in leadership. The central bank as expected **raised the federal funds rate by 0.25%** to between 1.25% and 1.5%, the fourth increase in a year. The central bank made no change to its forecast for inflation and interest rates in 2018, sticking to earlier **plans for three rate hikes in 2018.**

III) **Retail sales rose a sharp 0.8% in November** which was well above the consensus and 0.3% over the Street's high estimate. The data included upward revisions to October which now stands at a 0.5%. **November's standout was a 2.5% jump in nonstore sales**, pointing to unusual **strength for e-commerce** which makes up about 90% of the nonstore component. Electronics are the early holiday favorites reporting a 2.1% jump.

IV) **November's consumer price report** was another disappointment with the core reading, **falling 0.1% to 1.7%**. Apparel and once again medical care and housing all dragged on inflation in November. The core in fact has been going in the wrong direction all year and has been under 1.8% for six out of the last seven months.

V) **Equity prices in December are higher with Large-Cap, Growth, Consumer Discretionary and Staples leading equity price performance. The laggards for the month are Small-Cap, Value, Materials and Utilities.**

Capitalization: **Large Caps +1.03%** (YTD +21.59%), Mid-Caps +0.05% (YTD +17.49%) and **Small Caps -0.82%** (YTD +14.17). **Style: Value -0.91%** (YTD +10.73%) and **Growth -0.52%** (YTD +18.10%). **Industry Groups (Leaders):** Info. Tech +1.09% **(**YTD +38.95%), Tech +1.50% (YTD +35.75%), Healthcare +0.70% (YTD +23.38%), Industrials +0.64% (YTD +22.11%), **Con. Discretionary +1.78% (**YTD +22.04%), Financials +1.63% (YTD +21.66%), **Materials -0.36%** (YTD +21.08%), **Utilities -1.88%** (YTD +17.01%), **Con. Staples +2.23%** (YTD +12.94%) and REITs +0.27% (YTD +11.54%). **(Laggards):** Energy +0.08% (YTD -5.69%) and Telecom -0.12% (YTD -5.95%).

EUROPEAN EQUITIES

The MSCI Europe index was lower last week falling by -0.09%. Markets fell due to uncertainty over US tax reform, end of year profit-taking and fear about a U.S. government shutdown which could impair a march to new records for stock markets.

Drivers: I) As widely expected, **the ECB left its refi rate at zero percent** while the rates on the deposit and marginal lending facilities remain at minus 0.40% and 0.25% respectively. The central bank is also **cutting in half** the current pace of **net monthly QE purchases** to €30 billion from January through at least September. Interest rates will not be raised until well after the completion of QE.

II) **Eurozone private sector activity** expanded at the **fastest pace in nearly seven years** in December according to the flash surveys for composite PMIs for the Eurozone, Germany and France. The Eurozone composite output index climbed to an 82-month high of 58.0 in December from 57.5 in November. Germany's composite PMI grew at the fastest pace in over six years with the flash PMI composite index rising to an 80-month high of 58.7.
III) **Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index was lower by -0.09% for the week (MTD -0.78%, YTD +22.67%).**

ASIAN EQUITIES

Asian markets were mostly higher, but as the week ended, uncertainty about the outlook for the Republican tax reform plan weighed on investor sentiment. The Dow Jones Asia Index rose by +0.85% for the week, (MTD -0.21%, YTD +22.51%).

Drivers: I) In **Japan**, the closely watched **Bank of Japan Tankan** indicated that confidence among **Japanese large manufacturers increased for the fifth straight quarter** to an **11-year high** as strong exports and rising corporate profits underpin activity. The large manufacturers' sentiment index rose to 25 from 22 in the third quarter. This was the highest score since the end of 2006. At the same time, the large non-manufacturers' sentiment indicator held steady at 23 in the fourth quarter.

II) In **China**, **November retail sales advanced 10.2%** on the year, up from 10.0% in October. Stronger retail sales growth was largely driven by communication equipment, sales of which surged 33.9% on the year after growth of just 2.1% in October. Sales growth also accelerated for clothing, furniture, household non-durables, home appliances and oil and oil products.

III) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was lower by -1.13% (MTD -0.76% YTD, +20.03%), the Hang Seng Index rose by +0.67% (MTD -1.19%, YTD +30.16%) and the Shanghai Composite was down by -0.73% (MTD -1.54%, YTD +5.24%).**

FIXED INCOME

Treasury yields were lower last week as the flattening of the yield curve continued as the 2-year yield, reflecting falling demand, rose 4 basis points to 1.84% and the 10-year, reflecting rising demand, fell 3 points to 2.35%.

Performance: I) **The 10-year Treasury yield was lower last week ending at 2.355 down from 2.375%. The 30-year yield fell last week declining from 2.767% to 2.689%.**

II) **Performance for the week, month-to-date and year-to-date. The Bloomberg Barclays US Aggregate Bond Index climbed +0.29% last week, MTD +0.55% and YTD +3.64%. The Bloomberg Barclays US MBS TR was up +0.11% last week, MTD +0.33% and YTD +2.48%. The Bloomberg Barclay's US Corporate HY Index rose by +0.03%, MTD +0.09% and YTD +7.27%.**

COMMODITIES

The DJ Commodity Index was higher by +0.04 last week and is down month to date -1.79% (YTD -0.46%), as energy and metals rose when the USD remained steady despite the Fed Funds rate hike.

Performance: I) **Oil prices jumped a bit last week by +0.03%** up to $57.36 and is lower month to date for December -0.07% (YTD +6.44%). Oil was higher as recent crude supply and production data fueled volatile trading in the energy market, with U.S. and global benchmark prices recouping most of what they lost a day earlier due to **solid economic data.**

II) The **ICE USD Index**, a gauge of the U.S dollar's movement against six other major currencies, **rose +0.03%** from 93.90 to 93.93 for the week (MTD +0.95%, YTD -8.25%). The U.S. dollar ended the week on a strong note, increasing against all of its counterparts **on strong economic data including retail sales** in the run-up to Christmas.

III) Gold finished higher for the week after the Federal Reserve announced its decision this week to raise interest rates, as expected, and did not change its forecast for inflation and interest rates in 2018. Gold was up by +0.45% last week, rising from $1250.5 to $1256.1 (MTD -1.61% YTD +9.04%).

HEDGE FUNDS

Hedge fund returns in December are mixed, as core strategies Equity Hedge, Event Driven and Macro are all lower. Distressed and Relative Value are up for the month.

Performance:

I) The HFRX Global Hedge Fund Index is lower at -0.28% MTD and +4.93% YTD.
II) Equity Hedge is down -0.67% MTD but is up +8.12% YTD.
III) Event Driven has declined MTD -0.33% and is higher YTD +5.71%.
IV) Distressed Debt is higher by +0.01% MTD and is positive YTD +2.20%
V) Macro/CTA has fallen by -0.47% MTD and is up +1.19% YTD.
VI) Relative Value Arbitrage has advanced by +0.35% and is higher by +3.47% YTD.

ECONOMIC DATA WATCH AND MARKET OUTLOOK

In a look forward to **next week**, investors amid a **year end Christmas rally** are **leery of a potential government shut down**. Even though Street strategists are playing down the possibility, the threat of a government closure may push some investors to the sidelines. House Republicans unveiled a short-term spending bill this week to keep the government running through Jan. 19. The proposal includes controversial offsets that Democrats have already rejected, but **Washington insiders believe a deal will be made**.

Market sentiment will likely be **positive following the release** of the final version of a **tax bill** that is expected to be voted on next week. The plan **cuts the corporate tax rate to 21%** from 35% and lowers the rate for most households. Wall Street believes tax reform will be the key catalyst to drive stocks higher going forward. The Street estimates that the passage of **GOP tax bill could add about $10/share in S&P 500 EPS** with an additional around $4/share in cash flow during the initial twelve months of full tax reform implementation.

In turning to next week's economic calendar, the approval of tax cuts will be front and center, but this will also be an important week regarding the fourth-quarter economy. Data will include a full run down of the housing sector and whether it can extend its emerging momentum, starting Monday with the housing market index from the nation's home builders followed on Tuesday by housing starts and permits.

Home builders have been reporting rising confidence going into year end with the housing market index moving 4 points higher in October to 68 followed by a 2-point gain in November to 70, the best reading since March. Strength in this report has not translated this year to equivalent strength in actual housing data though **new home sales** have in fact **been coming alive in recent months**. Forecasters see December's index holding at 70.

Existing home sales will be Wednesday's highlight followed on Friday by new home sales. **New home sales have been climbing sharply** while existing home sales showed strength of their own in October, up 2.0% to a 5.480 million annualized rate. Gains were posted for single-family resales, up 2.1% to a 4.870 million rate, and condos, up 1.7% to a 610,000 rate. The **pending home sales index**, which tracks initial signings for resales, jumped strongly in the last report and have forecasters **looking for significant strength** in this report for November, **at a consensus rate of 5.520 million.**

Friday will also see the release of two other central indicators on the economy: durable goods orders for the latest on the factory sector and personal income and outlays for updates on both the health of the consumer and, very importantly, the pace of inflation.

There is **strong optimism for durable goods** and **consumer spending,** but much less so for core PCE inflation. **Boeing orders** from Dubai's air show are **expected to help lift durable goods orders** in November where the consensus calls for a **2.0% gain** that would resume, after October's 0.8% drop, what had been a late-year burst of strength for the factory sector. Excluding transportation equipment, orders are expected to show less strength, but at a still very solid 0.6% increase while core capital goods orders are expected to bounce back from an October decline with a 0.3% gain.