CLEARBROOK

INVESTMENT COMMITTEE MARKET COMMENTARY

JULY 2, 2018 www.clearbrookglobal.com

U.S. EQUITIES

U.S. equities ended the first half of the year mixed, as continued worries over a global trade war and end of the quarter window dressing took the steam out of Friday's rally attempt.

a) **Dow Jones -1.26%, MTD -0.49%, YTD -0.73** b) **S&P 500 -1.31%, MTD +0.62%, YTD +2.65%**
c) **Russell 2000 -2.46%, MTD +0.72%, YTD +7.66%**

Drivers: I) The **S&P 500 ended Q2 up 2.9%,** but experienced bouts of volatility. The index was buffeted by concerns that the US economy was in the late stage of the growth cycle, but was helped by strong corporate profits and strong employment numbers. Smaller caps led by the **Russell 2000 hit record levels** rising 7.5% in Q2, as technology and internet stocks outperformed. The companies are seen more reliant on the domestic consumer, and less subject to currency and trade worries.

II) Within the **S&P 500, seven out of eleven industry groups** posted **positive returns** for the quarter. Leading the way was Energy (+12.7%), which saw oil prices rise from $64.04 to $74.25 (15.9%), Consumer Discretionary (+7.8%) as consumer spending and retail sales were strong, and Information Technology with earnings growth still hovering above 20%.

III) On the **negative side**, financials (-3.6%) which suffered through 13 straight sessions of declining stock prices, were hurt by a flattening yield curve. Telecom (-2.3%) and Consumer Staples (-2.3%) were lower as investors sold higher yielding stocks due to increasing interest rates. Industrial (-3.7%) were lower due to global trade concerns.

IV) The overall **PCE price index** (which is more volatile than the core) is already beyond target, jumping from **2.0% to 2.3% in June** versus the FOMC median estimate for 2.1% this year. Year-ago comparisons for this reading also look easy and the rising price of oil, now well over $70 and approaching $75, should make an increasing overshoot this summer no surprise either.

V) **Equities in June are higher with Small-Cap, Growth, Consumer Staples and REITs leading equity price performance. The laggards for the month are Large-Cap, Value, Industrials and Financials.**

Capitalization: **Large Caps +0.65%** (YTD +2.85%), Mid-Caps +0.69% (YTD +2.35%) and **Small Caps +0.72%** (YTD +7.66). **Style: Value +0.57%** (YTD +3.72%) and **Growth +0.71%** (YTD +6.72%). **Industry Groups (Leaders):** Consumer Discretionary +3.59% (YTD +11.43%), Info. Tech -0.34% **(**YTD +10.54%), Technology -0.17% (YTD +9.42%), Energy +0.64% (YTD +6.75%), Healthcare +1.61% (YTD +1.72%) and Utilities +2.76% (YTD +0.27%). (**Laggards): REITs +4.41%** (YTD -0.75%), Materials +0.23% (YTD -3.18%), **Financials -1.93%** (YTD -4.13%), **Industrials -3.31%** (YTD -4.46%), Telecom +2.48% (YTD -7.96%) and **Consumer Staples +4.47%** (YTD -8.23%).

EUROPEAN EQUITIES

The MSCI Europe index was lower last week at -0.93%. European markets fell as trade tensions and political concerns weighed on investors due to the potentially divisive two-day European Union summit on migration.

Drivers: I) **In Europe**, the **June economic sentiment** (ESI) reading was 112.3, just 0.2 points short of its unrevised May reading. The June reading was the **weakest since August 2017**. The latest drop extended the run of monthly declines to six. The modest decline reflected weaker household confidence (minus 0.5 after 0.2) as well as softer sentiment in construction (5.6 after 7.1).

II) The June flash harmonized **index of consumer prices was up 2.0%** from a year ago. The narrower core index which excludes energy, food, alcohol and tobacco, saw its yearly rate fall slightly to 1.0%, while without just energy and unprocessed food, inflation similarly stood 0.1% lower at 1.2%. The main drivers behind the headline gain were energy, where the rate rose from 6.1% to 8.0%, and food, alcohol and tobacco (2.8% after 2.5%).

III) **Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index was lower by -0.93% for the week (MTD -0.67%, YTD -3.23%).**

ASIAN EQUITIES

Asian equities were down last week as investors fled risk given the uncertainties surrounding U.S. trade policies and the condition of the Chinese economy. The Dow Jones Asia Index fell by -0.80% for the week, (MTD -2.73%, YTD -7.20%).

Drivers: I) In **China**, the **reserves ratio** currently set at 16% for large banks and 14% for smaller banks, **will be cut by 50 basis points** for eligible banks on July 5. The PBoC estimates that this move will **free up around CNY700 billion for banks to lend**, with officials advising that large banks will be encouraged to use these funds for debt-for-equity swaps with state-owned enterprises. Smaller banks were encouraged to boost their lending to small businesses.

II) In **Japan**, **May industrial production declined 0.2%** on the month after increasing 0.5% in April. On the year, output was up 3.7%. The monthly drop reflected declines in transport equipment, iron, steel and electrical machinery. The declines were partly offset by increases in the output of electronic parts and devices, general purpose, production and business-oriented machinery.

III) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was lower by -0.77% (MTD +0.65%, YTD -1.03%), the Hang Seng Index declined by -1.33% (MTD -4.96%, YTD -3.61%) and the Shanghai Composite fell by -1.47% (MTD -8.01%, YTD -13.90%).**

FIXED INCOME

Treasury yields were lower last week as the Core Personal Consumption Expenditures Index which excludes the volatile food and energy, hit the Feds long term target of 2.0%, in line with expectations.

Performance: I) **The 10-year Treasury yield was lower last week ending at 2.860 down from 2.893%. The 30-year yield was lower last week dropping from 3.037 to 2.991.**

II) **Performance for the week, month-to-date and year-to-date. The Bloomberg Barclays US Aggregate Bond Index rose by +0.34% last week, MTD -0.12% and YTD -1.62%. The Bloomberg Barclays US MBS TR was higher by +0.35% last week, MTD +0.05% and YTD -0.95%. The Bloomberg Barclay's US Corporate HY Index was down by -0.53%, MTD +0.40% and YTD +0.16%.**

COMMODITIES

The DJ Commodity Index was higher by +0.43 last week and is down month to date -3.01% (YTD +1.78%), as oil rallied higher on lower shale production and the drop in rig counts.

Performance: I) The price of **oil surged +7.17% last week** up to $74.25 and is higher month-to-date in June +3.34% (YTD +15.27%). Oil maintained strong gains Friday after data showed the number of active U.S. drilling rigs fell this week. The number of oil rigs declined by four to 858, according to oilfield-services firm Baker Hughes.

II) The **ICE USD Index**, a gauge of the U.S dollar's movement against six other major currencies, **declined -0.05%** from 94.52 to 94.47 for the week (MTD +0.52%, YTD +2.35%). The U.S. dollar was up by 5.0% for the second quarter, as U.S. economic data outpaced European economic reports and the hawkish Fed continued its gradual rate hike plan.

III) **Gold continued to hit new lows for the year,** as a strong USD and rising interest rates caused the precious metal to decline by more than 5.5% during the second quarter. **Gold dropped -1.32%** last week, declining from $1271.1 to $1254.2 (MTD -3.87%, YTD -3.90%).

HEDGE FUNDS

Hedge fund returns for June are primarily lower for the month, with core strategies Equity Hedge, Event Driven, and Distressed lower, while Macro and Relative Value were positive.

Performance:

I) The HFRX Global Hedge Fund Index is lower at -0.38% MTD and -1.05% YTD.
II) Equity Hedge has fallen by -1.14% MTD and is down -0.24% YTD.
III) Event Driven has declined MTD -0.78% and is lower YTD -4.80%.
IV) Distressed Debt is lower by -1.72 MTD and is negative YTD -6.19%
V) Macro/CTA has risen by +0.46% MTD and is down -1.48% YTD.
VI) Relative Value Arbitrage has risen by +0.23% and is higher by +2.04% YTD.

ECONOMIC DATA WATCH AND MARKET OUTLOOK

As we look ahead to **next week's trading session**, investors will question whether **U.S. equities** will continue to be **resilient despite** on-going concerns over the **U.S. and China trade dispute**. In June, the S&P 500 was up about 1% while the Shanghai Index lost 8.0% and is a bear market, losing 20% from its recent highs. China's Yuan also suffered, dropping 3.4% in June, its largest monthly loss since December 1998. **Market pundits are cautiously optimistic** that a **resolution** can be found **through negotiations**, though new US tariffs totaling about $36 billion will go into effect on July 6th and expectations are for retaliation from China. Over the short term, the trade war should have a muted economic effect. According to **economists at UBS**, a **10% tariff across all Chinese imports** is estimated to **raise inflation by 0.25%** and **lower U.S. economic growth by 0.2%.**

In turning to the week's **upcoming economic calendar**, with July 4th splitting the week, the **ISM manufacturing out on Monday** and offering an advance look at June. Street consensus is calling for slight slowing at a still elevated level for the ISM manufacturing index, to 58.3 in June versus 58.7 in a May. But the top-end forecast is calling for acceleration to 60.0 in a reminder that both new orders and backlog orders were both well over 60 in the last report.

Construction spending will be posted **on Monday** and strength in this report would support second-quarter GDP expectations. A rebound in multi-family units helped drive construction spending 1.8% higher in April to fully reverse the prior month's 1.7% decline. Construction spending, often volatile month to month, is **expected to rise** a very constructive **0.6% in May** in what would be a **positive for second-quarter GDP**.

On **Tuesday, unit vehicle sales** will be reported, where the total will offer first hints on whether consumer spending rebounded or not in June. A **17.0 million annualized rate is the consensus** for unit vehicle sales in June, a moderate-to-solid outcome that would compare with 16.9 million in May and hint at another constructive month for the auto component of the retail sales report.

FOMC minutes will be released **Thursday afternoon**. The June meeting produced an incremental 25-basis-point rate hike as expected, but also included an increase in the number of rate hikes FOMC forecasters are expecting for the remainder of the year, from one to two. The quarterly FOMC forecasts also pointed to increasing strength for both employment and inflation. A rebound for the consumer was a highlight of the FOMC statement, though this may seem outdated following the subsequent slowing in consumer spending data for May.

June's employment report on Friday with expectations for another month of very solid strength, and an uptick in year-on-year wage growth. Street consensus is calling for a **190,000 rise**. The unemployment rate, down 0.10% to 3.8%, the highlight of the May report projects June's rate should be unchanged. **Wages** showed some pressure in May and this month's gain for average hourly earnings is expected to be a **modest 0.2%,** enough to lift the year-on-year rate by an expected 0.1% to 2.8%. The workweek is seen unchanged at 34.5 hours with the **labor participation** rate also **unchanged at 62.9%.**