MONTHLY UPDATE AND COMMENTARY
JULY 2018

Hello to all,

The tug of war continues between a solid U.S. economy with strong corporate earnings and the “wall of worry” that has increased in height with the actual implementation of tariffs, emerging markets strain, the ever-flattening yield curve, Fed tightening, and the threat of ECB tapering. Against this backdrop the markets have continued to churn, although we have seen a decided tilt to the upside in the last few days, capped by the goldilocks jobs report on Friday which showed continued job growth without wage inflation.

We are about to enter Q2 earnings season and expectations are high for another 20%-plus quarter. Where companies guide for the balance of the year will be the focus. A rising dollar has not helped the cause, and analysts will be drilling down to assess the effect of the trade war on future revenue expectations. Overall, we believe the effect will be minimal but a change in business confidence could affect capex and force downward revisions. We will pay close attention to ISM manufacturing and nonmanufacturing surveys which have been strong all year but could show weakness in the second half if the trade conflict intensifies.

Valuations remain reasonable on a historic basis, having improved significantly from January’s frothy forward PE that was approaching 19x. Our positioning has not changed materially, although we are evaluating an increase in exposure to energy and we have been eyeing a reduction in technology exposure closely. Industrials most affected by the trade war continue to be the laggards and have hovered in correction territory since early March. Financials have underperformed due to the flat curve and should see strong earnings in Q2, but money flow has dried up and time may be running out for that trade to play out. Small caps are close to fairly valued and will probably overshoot to the upside as positive money flow tends to drive prices up more quickly than earnings.

Overall, markets should retest the January highs and push through into August until midterm election stress takes over as a primary concern. This assumes a respite in the trade tango, a moderation in the dollar’s recent climb, and strong earnings and guidance in Q2. Please call or email me with any questions or comments.

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