FULLEN FINANCIAL GROUP

Quarterly Market Summary – Q2 2018

Market Results as of the Second Quarter of 2018
Selected Index Results for Q2 – 2018

Index(1)	**%Growth For FY 2017**	**%Growth For FY 2018**	**%Growth For Q2 2018**
DJIA	25.08%	-1.81%	-0.94%
Leman Aggregate Bond Index (U.S. multi-sector bond)	1.18%	-2.75%	-1.25%
S&P 500 (large cap)	19.42%	1.67%	2.43%
S&P 400 (mid cap)	14.45%	2.69%	3.49%
Russell 2000 (small cap)	13.14%	7.00%	7.10%
MSCI EAFE Index (developed international)	21.79%	-4.75%	-3.35%
iShares MSCI Emerging Market Index	34.59%	-8.04%	-9.42%
iShares Dow Jones US Home Construction	59.10%	-12.74%	-1.24%
MSCI US REIT Index	0.11%	-0.84%	10.05%
Amex Oil Index	5.33%	13.51%	3.60%
Barclays Global Agg ex-US Corp Bond Index	14.44%	-4.30%	-4.87%

These results do not include reinvesting dividends.

Economic Bifurcation and Dollar Strength Equal U.S. Outperformance

Some variance in economic indications between the U.S. and the rest of the world was a key factor in driving global equity markets in the second quarter. GDP expectations for the U.S. (positive) versus developed foreign economies (negative), and emerging markets (flat), seem to now be trending in different directions. Weaker economic numbers from China likely exacerbated the noted economic variance that emerged in Q2, perhaps as China’s economic actors fretted over trade concerns. The varied economic landscape represents some diversion from the unified global growth witnessed in previous quarters. Meanwhile, negative price correlations between the U.S. dollar and non-U.S. equity markets were also on display as the greenback turned sharply higher during the period. The currency move in particular sapped wind from the sails of emerging markets. These key economic and currency elements paced most of Q2’s global equity market activity. Market participants apparently shook off potentially negative trade impacts on the U.S. economy (or at least delineated a relative winner) and pointed investment allocations toward U.S. shores.

For the period, the S&P 500 Index rose 2.43% while the MSCI EAFE Index closed 3.35% lower and the MSCI Emerging Markets Index fell 9.42%. Notable in U.S. markets was the rise in small-cap stocks as the Russell 2000 Index gained 7.1%. The latter was boosted by the favorable economic backdrop enjoyed by these largely U.S.-focused companies.

S&P 500 Index Sector Returns – Q2 2018
Source: Bloomberg

Sector	Cyclical or Defensive	Total Return	Sector	Cyclical or Defensive	Total Return
Consumer Discr.	Cyclical	8.2%	Info Tech	Cyclical	7.1%
Consumer Stples	Defensive	-1.5%	Materials	Cyclical	2.6%
Energy	Cyclical	13.5%	Real Estate	Cyclical	6.1%
Financials	Cyclical	-3.2%	Telecom	Defensive	-0.3%
Health Care	Defensive	3.1%	Utilities	Defensive	3.7%
Industrials	Cyclical	-3.2%			

In U.S. equity groups, the Energy sector led the market with a 13.5% gain. The group was sparked by a 15.8% rise in oil during Q2. This despite news that OPEC was planning to increase production quotas. Consumer Discretionary stocks rose 8.2% on the strength of U.S. jobs market improvements, lower taxes, and a lift in Retail Sales. In a continuation of robust price performance, the U.S. Technology sector again fared well (+7.1%) behind ongoing momentum and notable earnings generation. Meanwhile, the Real Estate sector made a material recovery in Q2 (+6.1%) as U.S. interest rates reached a mid-quarter peak before falling in the back half of the period. Given the reversal of the rate rise, REITs stocks broke back above breakeven for the year. Prominent to the downside were U.S. Industrials (-3.2%) and Financials (-3.2%). Industrials were driven by concerns over the U.S. governments trade action, while Financials gave back some late 2017 gains as interest rates fell and long-term/short-term yield spreads continued to narrow. Yield spreads are a concern due to their potential drag on the trajectory of financial institution net interest income.

U.S. bond market performance was improved slightly over Q1, but remained negative for the year with a 2.75% drawdown. Foreign bond indices did not fare well, as indicated by a 4.87% fall in the Bloomberg Barclays Global Aggregate Ex-US Corporate Bond Index. While yields in key developed nations were mixed, nationalist election results in Italy, in part, left some European markets a bit unsettled and a stronger dollar helped cause negative returns in emerging market debt.

In the U.S. treasury market, the yield curve continued to flatten and long/short spreads narrowed. While the 10-yr T yield rose 12 bps in the period, the 30-yr T yield was only 2 bps higher. Long yields indeed finished the quarter fairly subdued after a mid-quarter yield spike attracted buyers. The Bloomberg Barclays Treasury Bond Index closed the period 0.1% higher. We believe relative value in the U.S. Treasury market continues to be available, given the ultra-low developed foreign yields, and the resulting Treasury demand is helping to hold down long-term interest rates.

Yield spreads continued to widen in both in U.S. investment-grade and high-yield credit markets. The condition weighed most heavily on investment-grade returns, while the Bloomberg Barclays U.S. High Yield Index managed a 1% return for the period. Cyclical highs in debt on company balance sheets may help account for the widening of spreads in Q2, despite default rates that remain subdued. According to Moody's, May's reading for U.S. speculative grade defaults was 3.7%, down from 3.8% in April. Given the supportive credit environment and relative ease in raising corporate funding, Moody's is forecasting the U.S. default rate to reach a low of 2.6% later this year. The low corporate default rate, however, may belie the elevated concern over rising debt levels in the U.S.

Key Events in the Quarter

Jun. 1: Giuseppe Conti was sworn in as Prime Minister of Italy; installing a coalition government platform with definitive anti-EU leanings.

Jun. 1: President Trump lifted a tariff suspension on imports from Mexico, Canada, and the European Union and began imposing a 25% tariff on steel and 10% on aluminum.

Jun. 13: The U.S. Federal Reserve closed a two-day FOMC policy meeting by raising its benchmark rate 25 basis points to 1.75% - 2.00%.

Jun. 14: The European Central Bank confirmed a plan to taper then end net bond purchases by December-end 2018. However, the ECB will continue to reinvest principal payments from maturing securities for an extended period of time.

Jun. 24: The Peoples Bank of China cut its required deposit reserve ratio by 50 bps to 15.50%.

Global Economic Data Still Strong; But Recently Below Forecasts

Global economic growth remains well-above the post-crisis trend, yet the trajectory of improvement has fallen below recent consensus expectations. Indeed, emerging concerns over global trade and the tendency for economies to undergo early-year bouts of weakness may have muted recent tailwinds. Couple that with rising U.S. dollar impacts on emerging economies, plus a notable slowdown in China, and you get high-frequency data that has come in below expectations. The synchronized global growth previously witnessed has begun to show some cracks.

Recent global manufacturing and services data points have begun to show economic bifurcation, which is causing forecasters to reassess the likely trajectory of non-U.S. growth. The economic boost, authored by the recent U.S. tax plan, we believe has been a differentiator in the global GDP landscape. Without similar measures and with just monetary policy to do the heavy lifting, it seems other developed economies may be reverting more quickly to their sustainable rates of growth. Indeed, policymakers in Europe now are beginning to talk of softening fiscal policy strictures on its Eurozone members.

Further signs of economic divergence are on display when reviewing recent economic numbers relative to forecasts (Citigroup Economic Surprise Indices) and the trajectory of GDP forecasts themselves. Here we see a U.S. economy that is perhaps more formidable in its foundation. Evidence of such was key in allowing for more attractive U.S. equity returns to emerge in Q2. The consensus theory that existed prior to Q2 (other global economies were just a step behind the U.S. in terms of their cyclical evolution) came under some duress during the period. However, although U.S. economic performance is currently strong, history has shown that such outperformance by a nation or region relative to the global economy is rarely sustainable.

China remains a key influence on global economic activity, generating as much as a third of global growth, and we believe the country is the sentiment barometer for how emerging markets are assessed. Given the trade tensions and slowing credit activity in China, concerns over the future pace of growth are material and well-founded, in our estimation. We have long-maintained that China's attempt to deleverage its economy, or reduce the growth of credit, will act as a negative drag on global economic activity (including the U.S.). Too few market participants, in our view, are properly rationalizing the likely impact on the globe's sustainable growth rate and emerging market sentiment. Adding to the China concern are the taxes recently levied by the U.S. government on Chinese goods and the threat of up to $250 billion in tariffs. Both China's deleveraging and brewing trade battles are likely to be headwinds for China's economy and the world's. Indeed, recent economic data out of China, although carefully managed, has been a bit less robust than expected. Consensus GDP forecasts are now coming in below previously targeted 6.5% growth rates. We believe the slowing of China's economic engine may increasingly become a drag on global equities and other non-cash investments.

Real GDP Growth (Year over Year%)

Country	**2017**	**2018E**	**2019E**
U.S.	2.3%	2.8%	2.5%
Eurozone	2.3%	2.4%	2.0%
U.K.	1.4%	1.5%	1.5%
Japan	1.7%	1.4%	1.0%
BRICS	5.7%	5.7%	5.6%

Source: Bloomberg

E = Bloomberg consensus estimate

Outlook - Slowing Ex-U.S. Growth a Concern

While we remain modestly positive on global equities, the economic slowing newly evident in non-U.S. economies may be a lasting drag on markets outside the U.S. Although U.S.-based investors can boast more sustainable growth and still easy monetary policy, already high valuations are likely to give U.S. stocks only a modest runway. The expected total return for the S&P 500 Index looks to be on target through 6/30, although experts now expect non-U.S. equity returns to fall under that. Previous expectations were for MSCI EAFE and MSCI Emerging Market returns to come in the 7% to 9% return range, but just beyond the half-way point both EAFE and EM indices are notably in the red. A modest retreat in Eurozone and emerging market economic conditions and a stronger U.S. dollar have been key anchors on non-U.S. equity prospects. And we are not expecting a catalyst that could author material EAFE or EM improvement in the back half of 2018. As a result, expectations have lowered for 2018 MSCI EAFE and MSCI Emerging Market Returns to 3%-5%.

Meanwhile, due in part to the effects of fiscal policy, the U.S. economy, U.S. corporate earnings and U.S. equity markets are getting most of the positive attention, offset by the heavy dose of trade talk emanating from Washington D.C. Still, U.S. market participants seem willing to shrug off the trade concerns as, so far, the visible economic impacts have been few. Most of the trade focus has been on China, and U.S. exports to that country are relatively small. Broader trade talk, or deeper tariff action re: China could change the landscape and eventually elicit more of a negative reaction from U.S. markets. High technology equity valuations are particularly vulnerable, which generate outsized profits outside the U.S.

So, while we acknowledge the growth in earnings and the favorable business cycle position, equity valuations still leave us with a note of caution.

In fixed-income, total return expectations in the bond market (Bloomberg Barclays U.S. Aggregate Bond Index) for 2018, now appear to be in the –1% to +1% range; down from the previous +2.5% forecast.

Interest rate movements in most developed fixed-income markets should remain relatively subdued. In fact, our 2.75% to 3.00% year-end target for the 10-year Treasury yield looks well placed today. After spiking to 3.11% mid Q2, the benchmark has settled back to well within our target range. Our mantra continues to be lower interest rates for longer in developed markets and we assign a low probability for a sustained, material rise in inflation that would upset the yield environment.

Risks

Investors should be aware of the risks associated with all portfolio strategies and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance.

Conclusions

As odd as it may seem in the apparently endless stream of good investment news, our position is one of caution and measured expectations. As mentioned earlier, there is convincing evidence that over the next few years, investment returns will be lower and volatility higher. The possibility of a correction is certainly there. A moderately rising interest rate environment is hoped for even though it will include some negatives such as lower fixed income yields (compared to what we have experienced over the last couple of decades). Adding to the anxiety associated with a lower yield environment will be higher volatility; unfortunately, investors that choose to sit-out to avoid volatility will likely lose what investment yields are available, even if reduced. While there will be periods of negative returns, history tells us that equity and fixed income yields should still be positive (over time) and are highly likely the best alternative for the vast majority of investors (even at reduced levels).

If we enter a period of higher volatility, maintaining investment discipline within a lower overall yield environment will be more difficult emotionally. However, we need to remember that market timing as an investment strategy has never worked consistently (and results in lower longer-term yields). Trying to time markets in a lower yield environment has a high probability of creating permanent loses. Compounding the problem, a less favorable investment environment will increase the “sales pitches” of companies with products and strategies purporting phony and distorted claims that appeal to our emotions. Avoid the temptation to act in an undisciplined and consequently damaging way– no matter how slick the advertisements trying to sell a strategy (or product) will claim. If a lower yield environment develops, no person or company is going to find a way around it – everyone is investing in the same lower yield environment. If someone appears to have found a way around it, be very wary – they are either not showing you all their “cards” or taking very high investment risk.

Fullen Financial is always available to help sort out false claims so don’t be concerned about asking us.

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As always – stay with a consistent and disciplined investment strategy – it is the only course of action with any track record of success (in any investment market). There is no reason to believe that with the changing economic dynamics that the disciplined approach to investments will be less effective than in the past at delivering the best possible relative returns.

At the most fundamental level, match your investment time horizon to your spending timeline – if you have short term cash needs then those funds should be in short term investments. If you have long-term spending needs (like 10 or more years into retirement) then this cash should be in long-term equity investments. These are simple asset/liability matching principles practiced by the most sophisticated investment managers every day (but far too complex to explain in sound bites and not conducive to selling products). Additionally, don't try to solve short-term financial problems with long-term equity exposure. If you try to chase returns, you may get lucky sometimes but, if pursued long enough, it always ends in extreme frustration and often with serious financial losses. The reality is that no one has ever consistently predicted investment markets and they never will - and there is always a consequence to continued unsound financial behavior.

As always, if your personal or family situation has changed (or is likely to) a discussion with us as to how this may impact your financial plan and your overall asset allocation is warranted. Or, if you simply feel a need to discuss any aspect of your portfolio and/or financial plan, or you haven't had a planning update within the last 12 months, please contact us to review your financial plan and investments.

Your financial plan is the most important financial document that you possess! Keep it updated and use it.

Please note that you are entitled to receive Fullen Financial's Form ADV whenever you would like to. This document outlines many details of who Fullen Financial is, their investment methodologies and their advisor's education and experience. You may do so by contacting Lisa Bushman at lisa@fullenfinancial.com and requesting such. Alternatively, you can go to the www.fullenfinancial.com website and under Client Center, click on Obtain Form ADV.