THE PRIVATE CLIENT GROUP

WEALTH MANAGEMENT

Economic & Market Review

~SECOND QUARTER 2018 NEWSLETTER~

EXECUTIVE SUMMARY

U.S. stock markets, buoyed by robust corporate profits and a positive economic outlook, rallied in the second quarter even as other investing markets struggled. The U.S. dollar made a comeback against a broad range of currencies, paring back returns from international investments. Rising fears over trade wars and political turmoil in Europe also dampened enthusiasm for investments outside the U.S.

U.S. stock market returns were driven by a narrow range of growth stocks in the consumer and technology sectors and by energy stocks, which rebounded as energy prices spiked. Smaller companies, considered more resilient to the geopolitical risks outside the U.S., sharply outperformed larger companies. Small-cap-value stocks, driven by double-digit returns from energy companies staged a comeback, though still lag their pricey small-cap-growth brethren. Another notable area of strength was real estate stocks, which had been rebuffed by investors earlier in the year due to their exposure to rising interest rates.

International stocks had a lackluster quarter, particularly emerging markets stocks which were most impacted by a stronger U.S. dollar and rising interest rates. Despite recent stock market performance, emerging markets continue to dominate global economic growth. By some measures, the U.S. dollar is now overvalued versus most other currencies. A reversal of recent currency trends would be positive for international investments.

Rising interest rates continued to batter the fixed income markets, but credit metrics were fairly stable over the quarter. The yield curve flattened as the Fed once again raised short-term interest rates. The U.S. 10-year Treasury, the closely watched bellwether for economic growth and inflation, breached the 3% threshold. Long-term rates rose only modestly, suggesting expectations for long-term growth are restrained. High yield and municipal bonds outperformed for the quarter. Despite lackluster returns, asset flows have tended to favor high-quality, defensive fixed income investments, indicating that investors are wary.

Fiscal stimulus from tax cuts and government spending has sparked an uptick in economic growth, corporate profits, and inflation in the U.S. At the same time, the Federal Reserve has taken steps to pull back on the unprecedented level of monetary stimulus supporting the economy and the stock market since the credit crisis. The long-term impact of these measures is uncertain. Inflation has reached the Fed's 2% target despite limited wage pressure. The possibility of U.S. dollar weakness and supply disruptions resulting from escalating trade tensions are adding to the upward pressure on inflation expectations.

Asset class diversification, including allocations to inflation-sensitive stocks and real assets, remains a sound tool to protect investment portfolios from volatility and the erosion of purchasing power over time.

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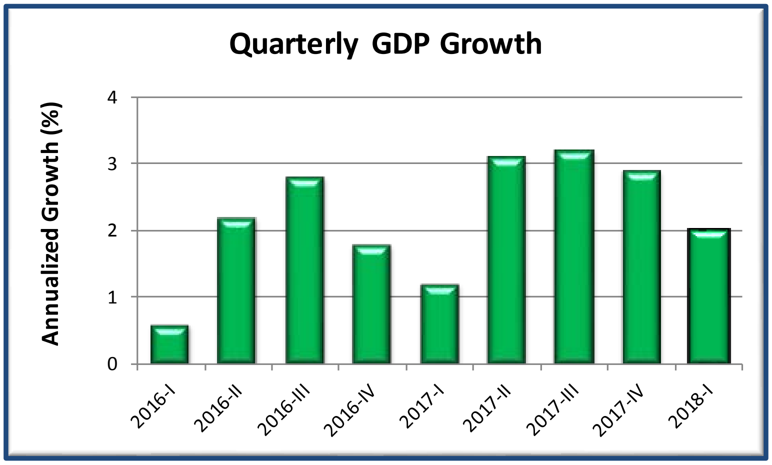
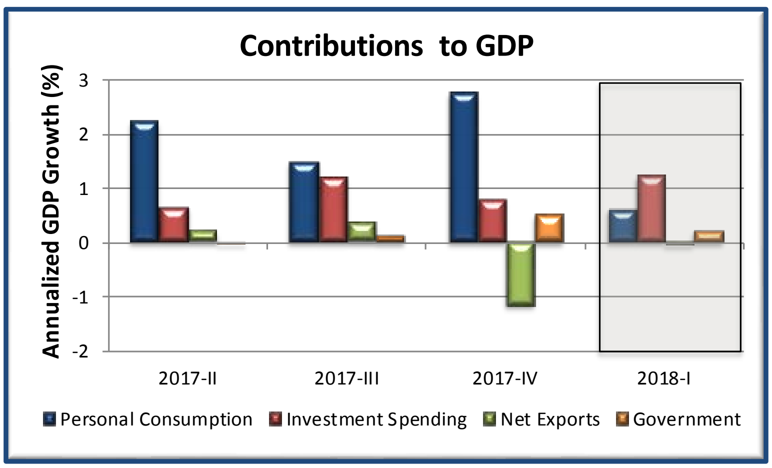
ECONOMIC REVIEW AND OUTLOOK

Key Economic Fundamentals



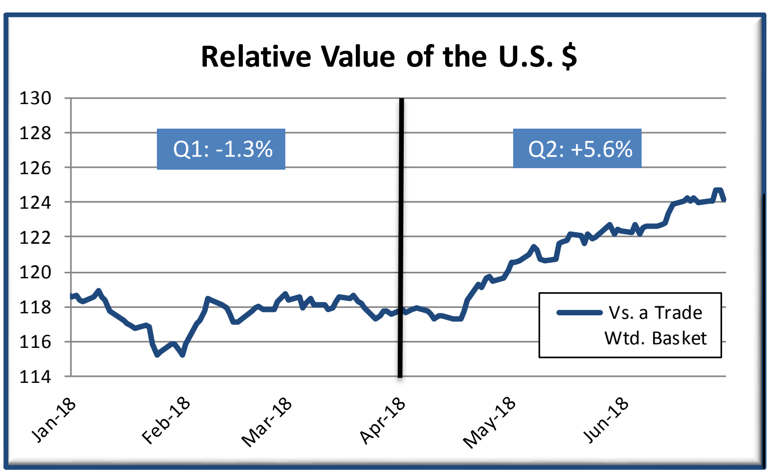
Data Source: U.S. Department of Commerce

In the Commerce Department's third estimate, Q1 U.S. economic growth was revised downward to an annualized pace of 2%. As of this writing, the Atlanta Fed's "GDPNow" estimate for second quarter growth is 4.5%. Most economists' predictions range from 3.2% to 4.6%. For 2018 and 2019, the IMF predicts economic growth of 2.9% and 2.7%, respectively.



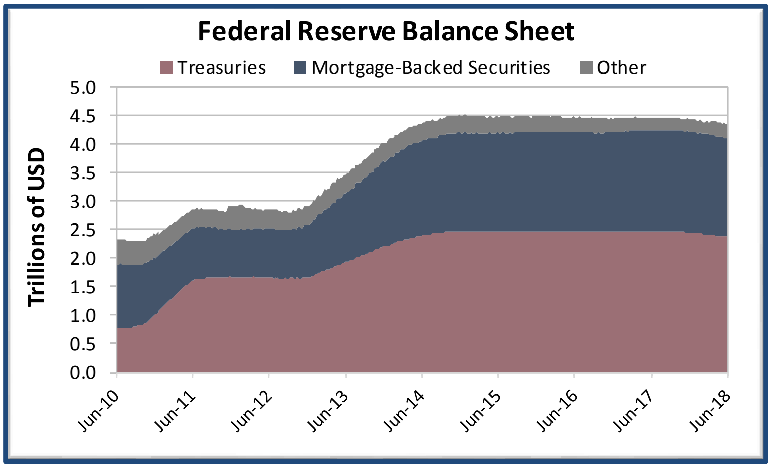
Data Source: U.S. Department of Commerce

After a very strong showing in the fourth quarter of 2017, consumer spending in the first quarter of 2018 came in at its weakest level in five years. Investment spending spearheaded GDP growth in Q1, a phenomenon rarely seen, while government spending and net exports both had de minimis impacts.



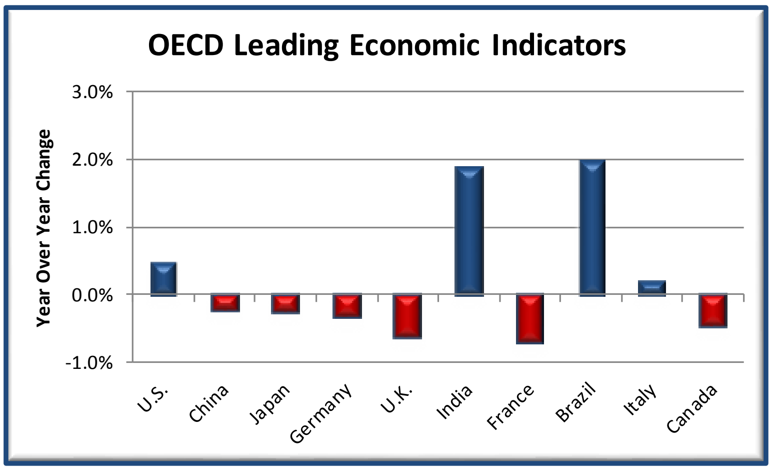
Data Source: U.S. Federal Reserve

Dollar weakness was a major theme last year that continued into the first quarter of 2018. That trend reversed sharply in Q2, as the dollar appreciated 5.6% versus a trade-weighted basket of foreign currencies. Dollar strength was a major contributing factor to negative returns on international investments. The effect was most pronounced on EM stocks.



Data Source: U.S. Federal Reserve

The Fed's quantitative tightening efforts have resulted in a 5% reduction in its balance sheet from the January 2015 apex. The Fed is now allowing $40B per month to "runoff." The target will jump to $50B in October, and will remain at that pace thereafter. This process is expected to take 4-6 years. The target balance sheet size is expected to be $2.5T-$3.0T.



Data Source: Organization for Economic Cooperation and Development

Leading economic indicators show a modestly negative trend for many of the world's largest economies. This metric, designed to identify business cycle inflection points before they occur, portends modest deterioration in China, Japan, Germany, the U.K., France, and Canada. Meanwhile, India continues to show great strength while Brazil's recovery continues to gain momentum.

Global Growth Rates[1] (%)

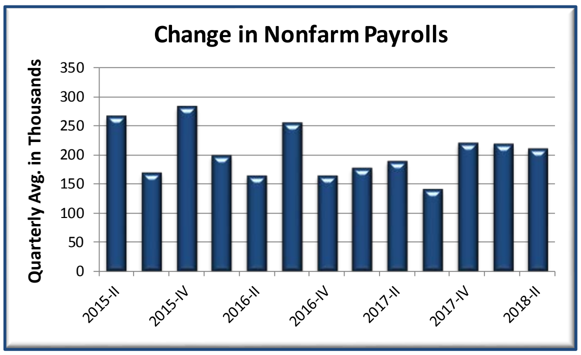
	Q1 2018	Q2 2018	Q3 2018	2017	2018	2019
Advanced	**1.6**	**3.1**	**2.3**	**2.3**	**2.4**	**2.1**
Euro[2]	1.5	2.5	2.5	2.6	2.4	2.3
U.S.[2]	2.0	4.0	2.5	2.3	2.8	2.3
Japan[2]	-0.6	2.0	1.5	1.7	1.1	1.4
U.K.[2]	0.9	2.0	2.0	1.7	1.5	1.9
Canada[2]	1.3	2.3	1.7	3.0	1.9	1.7
Emerging	**5.6**	**4.5**	**4.4**	**5.1**	**4.9**	**4.9**
China	6.9	6.6	6.3	6.9	6.7	6.4
India	7.3	7.2	7.1	6.7	7.1	7.3
Russia	2.6	4.8	0.5	1.5	1.7	1.6
Brazil	1.8	0.0	1.8	1.0	1.2	3.0
World	**3.1**	**3.6**	**3.1**	**3.4**	**3.3**	**3.2**

Data Source: J.P. Morgan
[1]Q1 2018 and 2017 are actual, all others are forecasts
[2]Quarterly numbers are sequential annualized, others are year-over-year

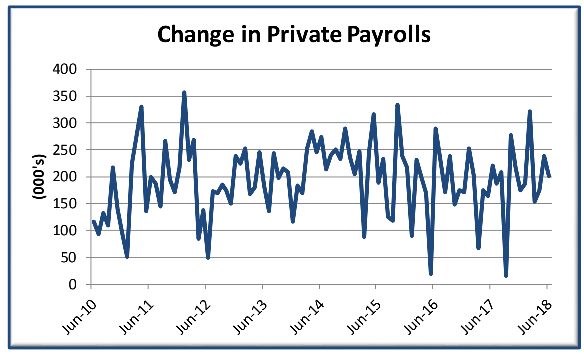
Expectations for future growth in most large economies have risen marginally in recent quarters, despite escalating trade tensions. Economists' outlook for the Euro Area has turned significantly more positive as of late. India and China continue to power global growth; some estimate these two nations were responsible for nearly half of the growth in global GDP in 2017.

Employment

Amid the second-longest economic expansion in history, labor market strength continues apace. Payrolls grew at an average clip above 200K for three quarters in a row, a feat that has only occurred twice since 2001. Private payrolls have grown for 100 months straight, surpassing the next longest streak by 41 weeks! While the unemployment rate ticked up from 3.8% to 4.0% in June, this was a result of 600K new people entering the labor force. Job openings are just below record highs. However, the skill set of workers seeking employment is not well-aligned with employers' needs - a potential long-term concern. Jobless claims remain historically low and the record duration below the important 300K level continues to extend with each week's release. Wage growth is trending higher, albeit slowly. This bodes well for consumer spending, but could result in a more aggressive Fed if wage growth accelerates.



Data Source: U.S. Department of Labor



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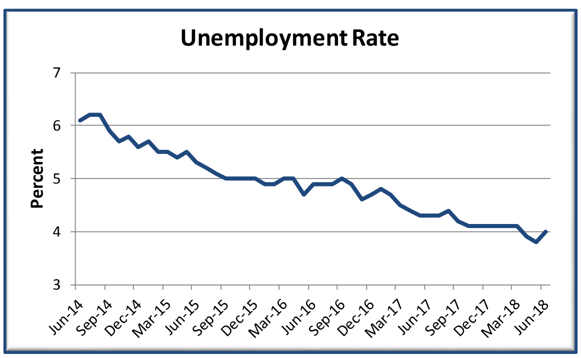

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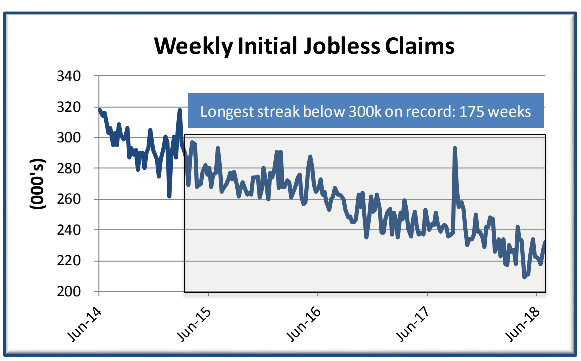
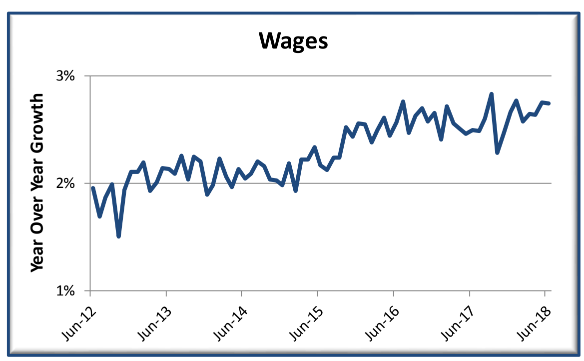


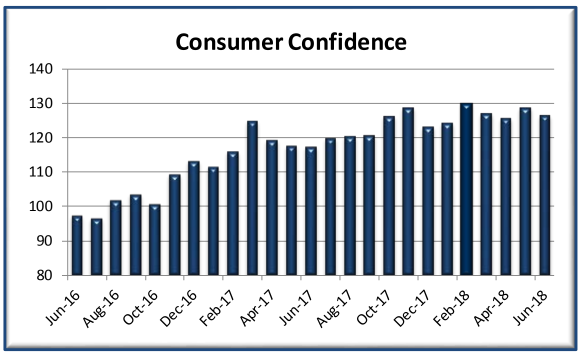
Data Source: U.S. Department of Labor



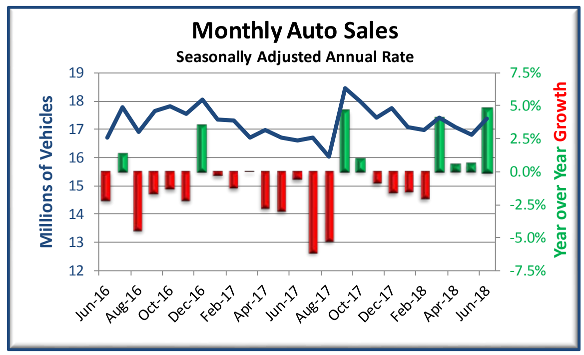
Data Source: U.S. Department of Labor

Consumer

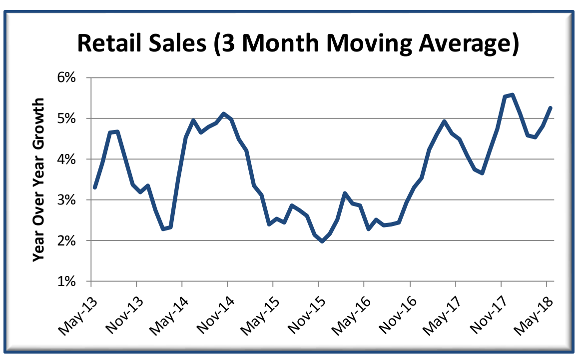
U.S. consumers are benefitting from a strong labor market, a domestic equity market near all-time highs, increasing home values, and lower income taxes. Consumer confidence remains near a 16-year high. Despite losing momentum earlier in the year, retail sales have rebounded more recently, in part due to a strength in the auto sector. The most recent monthly retail sales figure came in 6.6% higher than last year. While this was the largest year-over-year increase in five years, a significant contributor to the strong reading was higher energy prices. Fuel costs could prove to be a pain point for the consumer down the road if prices remain elevated. At present, households are in a strong financial position. Household net worth continues to reach record highs, surpassing $100 trillion, 83% above the low point touched during the credit crisis. While most metrics indicate a very healthy consumer, the low Personal Saving Rate remains a concern. The metric has hovered between 2.4% and 3.8% for the past year and currently stands at 3.2%. These are paltry levels last seen just prior to the Great Recession. Individuals are not "saving for a rainy day" and are thus more vulnerable should future economic turbulence materialize anytime soon.



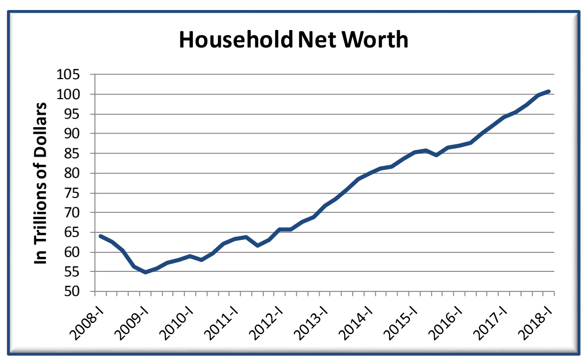
Data Source: The Conference Board



Data Sources: Bloomberg



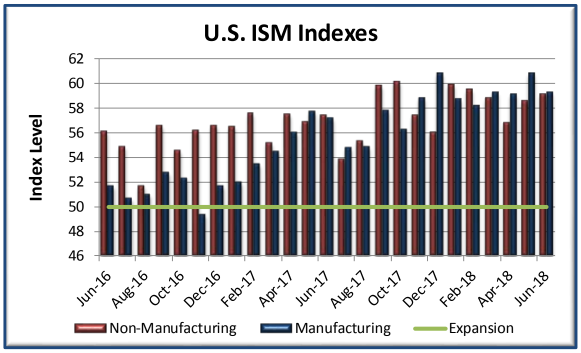
Data Sources: U.S. Census Bureau



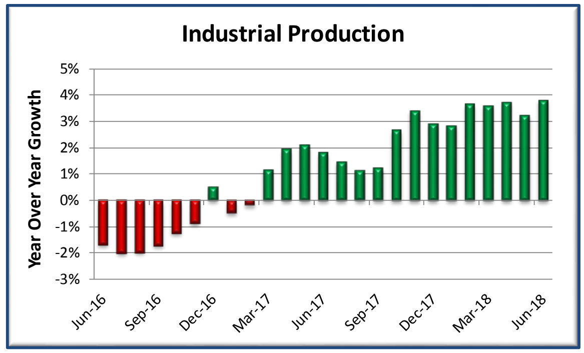
Data Sources: U.S. Federal Reserve

Business Activity

Both the service and manufacturing segments of the economy exhibited strong growth in the second quarter of 2018. ISM figures for both sectors remain well above 50, the crossover level that demarcates growth versus contraction. Industrial production growth has also been positive for sixteen months and has accelerated as of late. Businesses reported larger than anticipated demand in Q2, particularly from purchasers outside of the United States. Relatedly, suppliers are experiencing bottlenecks in delivering products to customers due to diminishing transportation capacity. This phenomenon is most apparent in trucking. This should be monitored closely, as transportation shortages can lead to an upward pressure on prices.



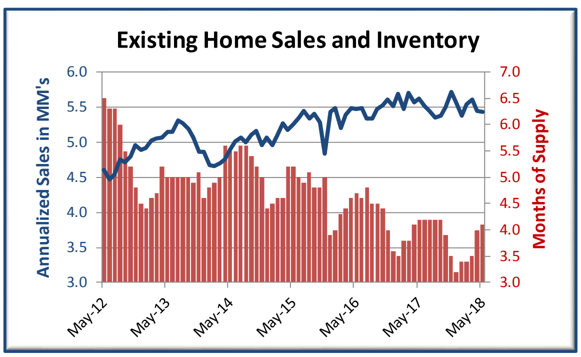
Data Source: Institute for Supply Management



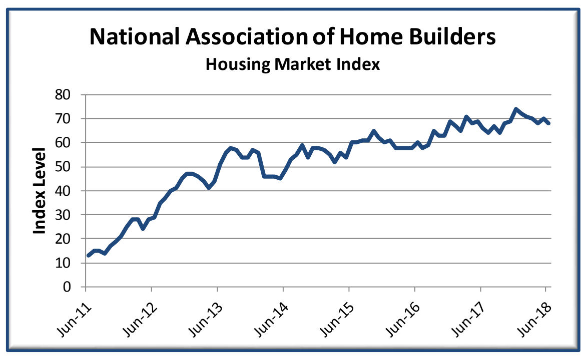
Data Source: U.S. Federal Reserve

Real Estate

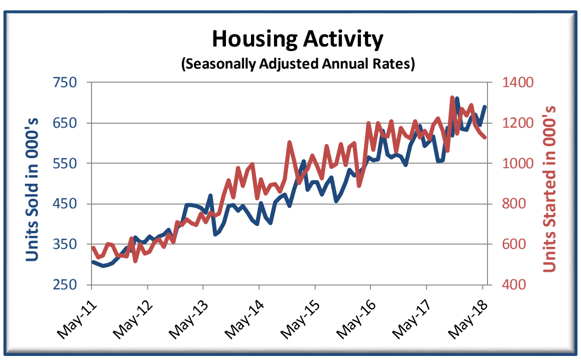
Metrics measuring the health of the housing market generally paint a positive picture. Existing home sales remain near post-recession highs, and some supply came back online during the spring selling season. Builder sentiment remains near decade highs. New housing activity remains in an uptrend and prices continue to rise. Interestingly, lumber prices are up 70% since early 2017 due to a confluence of exogenous factors, including a 20% tariff on lumber imported from Canada. This massive price increase is giving U.S. producers the confidence to boost production and hiring. This could have positive knock-on effects for other housing related industries and may help to relieve previously noted labor and supply shortages.



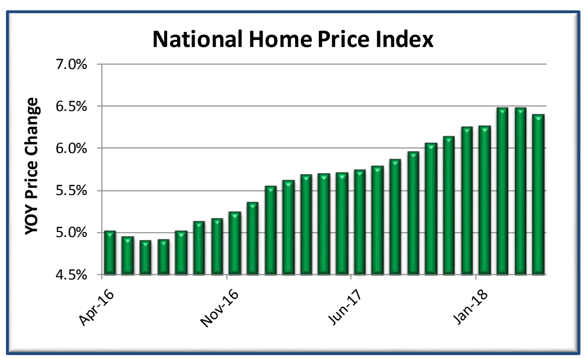
Data Source: National Association of Realtors



Data Source: National Association of Homebuilders



Data Source: U.S. Census Bureau



Data Source: S&P/Case-Shiller

CAPITAL MARKETS REVIEW

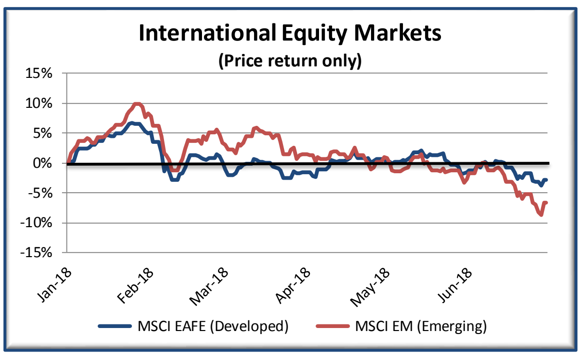
Returns

	2nd Qtr 2018	YTD 2018
Cash and Fixed Income		
U.S. Treasury Bills	0.4%	0.8%
Barclays U.S. Aggregate Bond	-0.2%	-1.6%
Barclays Municipal Bond	0.9%	-0.2%
Barclays Global Agg. ex. U.S.	-4.8%	-1.3%
Hedge Funds and Alternatives		
Bloomberg Commodity	0.4%	0.0%
DJ US Real Estate	7.8%	1.4%
HFRI FOF Composite	0.9%	1.2%

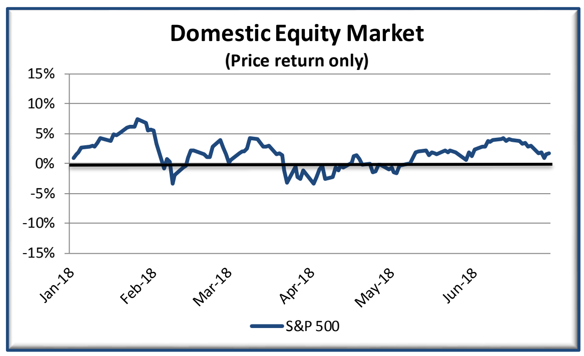
Data Sources: Morningstar & Hedge Fund Research, Inc.

	2nd Qtr 2018	YTD 2018
Domestic Equities		
Wilshire 5000	3.8%	3.0%
S&P 500	3.4%	2.6%
Russell 2000	7.8%	7.7%
International Equities		
MSCI ACWI ex. U.S.	-2.6%	-3.6%
MSCI EAFE (Developed)	-1.2%	-2.7%
MSCI EM (Emerging)	-8.0%	-6.7%

Equity Markets

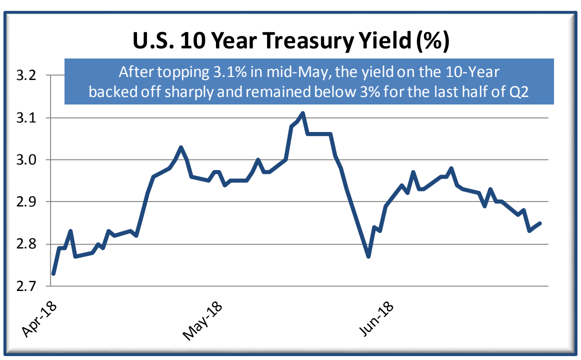


Data Source: Morningstar

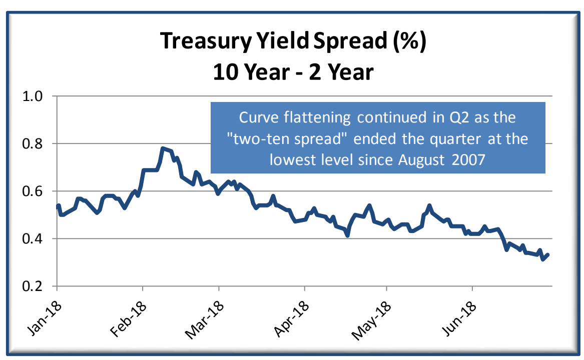


Data Source: Morningstar

Fixed Income Markets



Data Source: U.S. Department of the Treasury



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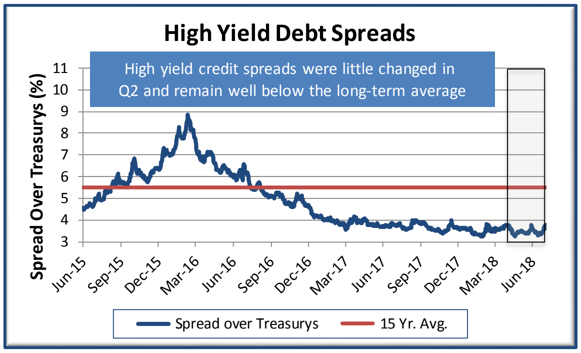
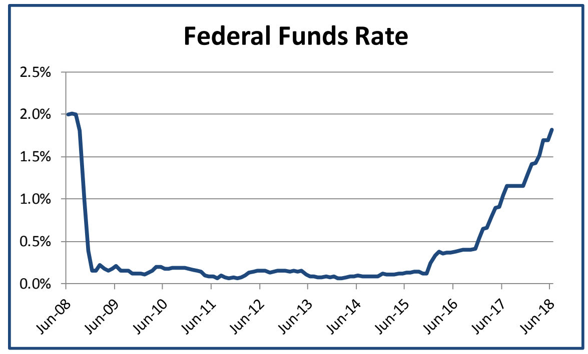
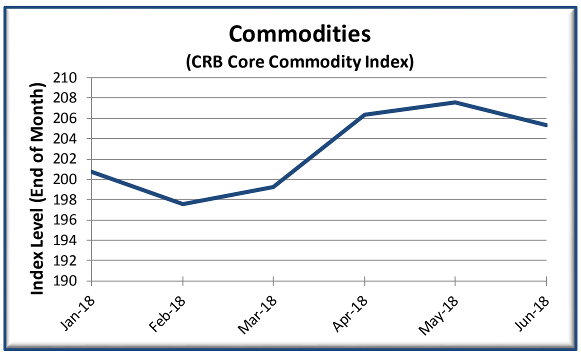


Data Source: BofA Merrill Lynch

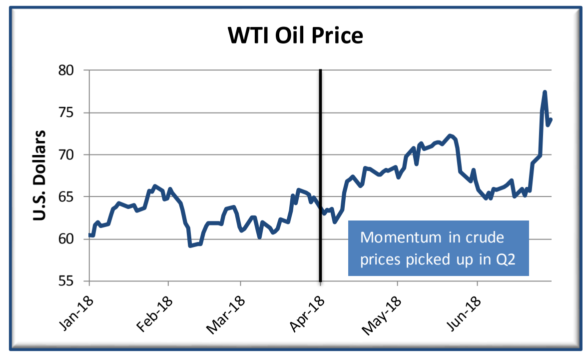


Data Sources: U.S. Federal Reserve

Alternatives



Data Source: Thomson Reuters



Data Source: U.S. Energy Information Administration

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