Wealth Management International, Ltd.
Proactive Investment Management & Financial Planning

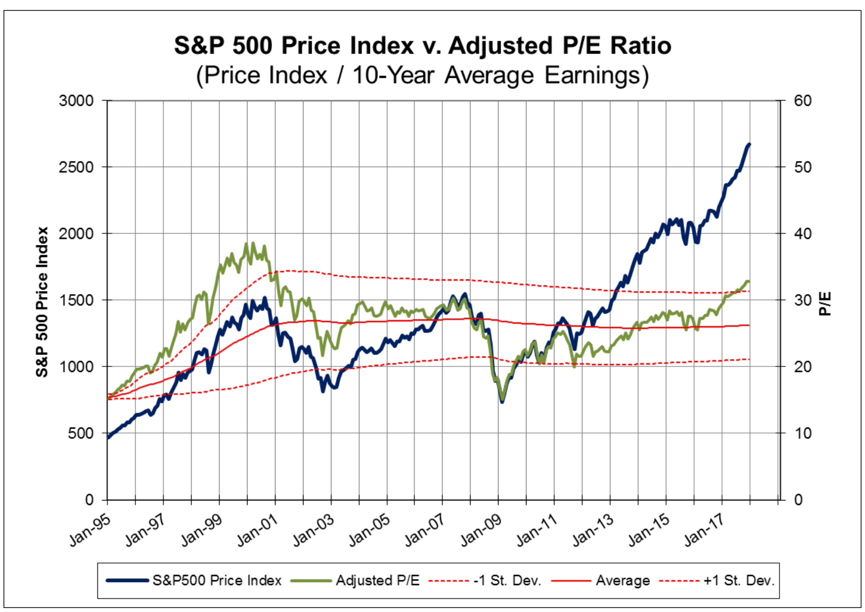
Monthly Market Comment
January 1, 2018

In December, U.S. stock prices continued their extraordinary, inexorable uptrend. Many investors are now well aware of the strong total return on stocks over the last year, but returns on other assets also have been positive, including in December. However, the recent returns on non-stock assets have merely been average rather than spectacular.

Stocks

The S&P 500 stock price index continued its recent pattern in December, as it marched steadily upward with only a few minor pullbacks over the period. The index ended the month up 1.0% from the end of November and 19.4% higher than at the end of 2017. That means the S&P 500 notched a month-end record high in each of the last nine months, and in 13 of the last 14 months – a feat that it had never accomplished before. Taking into account dividends, the total return on the S&P 500 was 1.1% in December and a strong 21.8% in all of 2017.

The long bull market, which began in March 2009, has been fueled by a steady expansion in the economy. As we've repeatedly argued, the economic growth rate may be modest by historical standards, but that has helped retard the build-up of inflation pressures. We think this "Goldilocks" scenario should allow global central banks to continue tightening monetary policy only gradually, so we expect continued economic growth and increased corporate profits over time. On top of the long-established economic momentum, the tax reform legislation just signed into law should help boost corporate profits even farther. The expected rise in profits is especially important to our outlook, as the price/earnings ratio is already extended and may not be able to improve much further. Indeed, one developing risk is that investors may at some point get skittish about high stock valuations and start to sell *en masse*, though at this point we can discern no obvious trigger for such a sell-off. Other key risks include geopolitical tensions with North Korea, a possible trade war, and the potential for policy mistakes. Nevertheless, we remain optimistic that stocks could keep trending higher for a while yet.



Technical indicators also suggest to us that stocks could potentially keep moving higher. In a pattern that clearly points to a well-established uptrend, the S&P 500 price index remains above its 20-day simple moving average (SMA), while its 20-day SMA stands above its 50-day SMA, and its 50-day SMA stands above its 200-day SMA. In addition, the recent string of consecutive month-end record highs suggests stocks will continue to climb, though perhaps with new records coming less frequently. Another positive sign is that over 77% of the stocks in the S&P 500 index are now trading above their 200-day SMA, indicating the market uptrend is quite broad. Finally, the Dow Jones Transportation Index has recently been rising in line with the overall market, which has traditionally been a positive indicator for stocks. The main short-term negative is that momentum indicators (such as the "moving average convergence/divergence," or MACD) suggest stocks remain relatively over-bought and are susceptible to a short-term pullback or correction. If such a pullback materializes, we suspect the S&P 500's next significant support level would be at approximately 2,680, with a secondary support level at about 2,650. If stocks keep rising instead, we suspect the next significant resistance levels would come around the psychologically important reading of 2,800.

S&P 500 Stock Price Index + "MACD" Momentum Indicator

Source: BigCharts.com

Bonds

Bonds were relatively volatile in December, with prices initially strengthening but then falling sharply as it became clear the tax-cutting legislation would pass and potentially produce stronger economic growth, higher inflation, wider budget deficits, and higher interest rates at some point. Nevertheless, the resulting rise in yields tempted some investors back into the market. By month's end, prices had risen slightly from the end of November, and yields had fallen a bit. The yield on the benchmark 10-Year Treasury Note edged down to 2.405%, compared with 2.417% at the end of November. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was 0.4% in December and 3.3% over all of 2017.

Looking forward, we think investors should continue to put a high value on the income, stability, and safe-haven characteristics of fixed-income investments, especially if geopolitical tensions continue to rise. In addition, while there are some signs that inflation may be strengthening in the domestic production sector, we still doubt that consumer prices will start rising fast enough to spook the policymakers at the

Federal Reserve. We think the Fed will most likely continue to hike interest rates and reduce its bond buying slowly and gradually enough to avoid disrupting the financial markets, though we admit that there is a risk that the policymakers could panic in the face of strengthening economic growth and somewhat higher inflation. On balance, we don't look for total returns on bonds to be particularly juicy for the foreseeable future, but we do think they can be modestly positive.

Real Estate and Commodities

For publicly-traded real estate investment trusts (REITs), the FTSE NAREIT Price Index fell 0.9% in December, but it was still up 4.5% for all of 2017. Because of their relatively high dividends, the total return on these REITs was a negative 0.3% in December and a positive 8.7% in full-year 2017. Publicly-traded REITs remain in the trading range they've been stuck in over the last year, reflecting a tug-of-war between those investors who see moderate economic growth as positive for real estate and those who see gradually rising interest rates as an opportunity to roll out of higher-yielding risk assets and back into bonds. Going forward, we suspect that tug-of-war will continue, so we think returns for these assets could well be challenged as long as interest rates are gradually rising.

For commodities, the S&P GSCI Total Return Index ended December up a strong 4.4% from the end of November, and the index rose 5.8% during all of 2017. The jump in December stemmed in part from a continued rebound in the price of crude oil and related energy products, reflecting not only improved fundamental factors such as rising demand and constrained production, but also temporary issues like a major pipeline outage in the North Sea and renewed international security concerns. In addition, the strengthening world economy boosted prices for a range of industrial metals and other basic materials, such as lumber, while the renewed geopolitical fears and a pullback in the dollar late in the month boosted gold prices. In contrast, prices were down for most major agricultural products. Going forward, we agree that fundamentals in the energy market are starting to look better, but we still worry that rising crude production in the United States could swamp some of the recent increase in demand and offset much of the output cuts that the Organization of Petroleum Exporting Countries (OPEC) and its partners agreed in late 2016 and extended further in May and November 2017. We are therefore neutral regarding the near-term outlook for the broad commodity sector. We still believe that excess supplies in many commodity categories will gradually be brought under control in the coming months and quarters, ultimately allowing prices to rise again, but we think prices will remain volatile and could post meaningful retreats in the near term.

Patrick Fearon, CFA
Chief Investment Officer

Asset Class	Index	Ending Reading, Latest Month	1-Month Change	3-Month Change	12-Month Change
U.S. Stocks	S&P 500 Price Index	2,673.61	1.0%	6.1%	19.4%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	305.67	2.1%	4.7%	24.1%
REITs	FTSE NAREIT All-Equity Price Index	683.05	-0.9%	1.5%	4.5%
Commodities	S&P GSCI Total Return Index	2,556.71	4.4%	9.9%	5.8%
Bonds	S&P U.S. Aggregate Bond Index	193.54	0.4%	0.4%	3.3%

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