WEALTH MANAGEMENT INTERNATIONAL, LTD.
Proactive Investment Management & Financial Planning

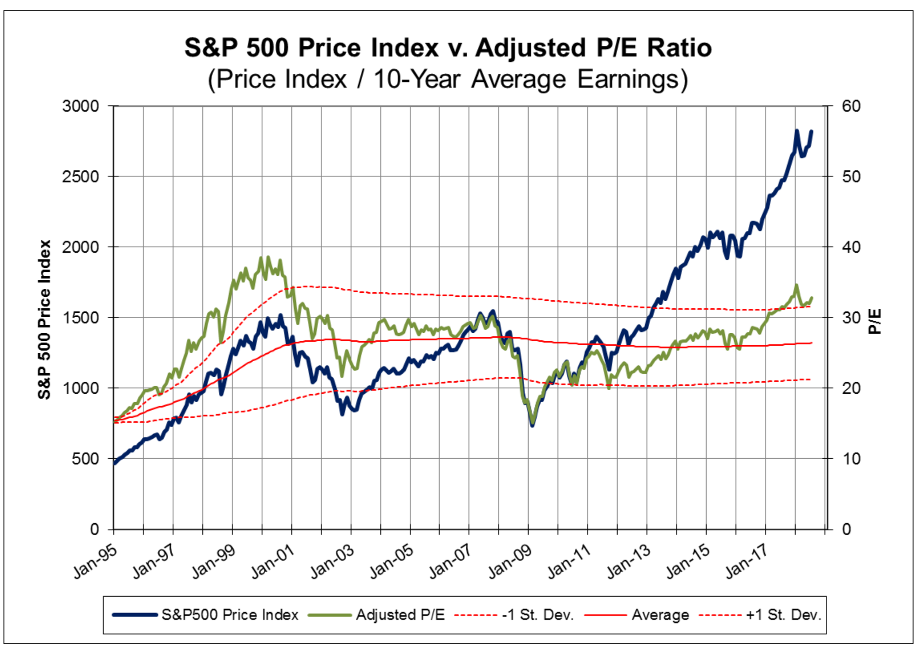
Monthly Market Comment
August 1, 2018

It may not have felt like it, but July was a strong month for the stock market, with U.S. equity prices posting their best monthly gain since the beginning of the year. Unfortunately, returns were much more muted for bonds and alternative assets.

Stocks

U.S. stock prices trended strongly upward through most of July, as investors took their eyes off the continued rise in interest rates and the worsening trade war. Instead, they appeared to focus on the recent rebound in economic growth and the positive impact of lower tax rates on corporate profits. The S&P 500 stock price index ended July up 3.6% from the end of June and 14.0% higher than at the end of July 2017. The index ended the month just 2.0% shy of its record close in late January. Taking into account dividends, the total return on the S&P 500 was 3.7% in July and 16.2% over the last year.

Looking ahead, we think stocks will continue to receive support from the on-going economic expansion and the new tax cuts and government spending hikes. We think stocks could even rise to a new record high before long. Still, we see gathering headwinds that could short-circuit the economic expansion and stock market later in the year. Besides the threat from intensifying trade tensions, soft spots seem to be developing in certain sectors of the domestic economy (such as housing), while rising cost pressures could eventually erode profit margins and/or prompt the Federal Reserve to start raising interest rates more aggressively. Short-term interest rates have now risen almost to the point where they are equal to long-term rates, which has historically been a negative sign for the economy and stocks, while corporate earnings have surged to extreme and probably unsustainable levels. Finally, stock valuations are very high. If they now start to pull back, history teaches that stocks could well start a significant downturn. Signs such as these have historically shown up six months to a year before such a downturn gathered force. We are therefore not panicking yet, but we think it's time to start preparing to reduce risk.



We think technical indicators now bolster the case for a near-term rise in stock prices before any substantial downdraft starts. For example, the S&P 500 price index now stands above all its key simple moving averages (SMAs), with its 20-day SMA standing above its 50-day SMA, and its 50-day SMA standing above its 200-day SMA. That pattern has historically pointed to a continued uptrend in stocks. In addition, the share of S&P 500 stocks trading above their 200-day SMA has been gradually rising toward 70%, which is the level at which we consider an uptrend to be broad based. Finally, the performance of the Dow Jones Transportation Index has recently matched or exceeded that of the overall market, which has traditionally been a positive indicator for stocks. These good indicators add to the fact that a string of month-end record highs like the S&P 500 posted through January has historically been followed not by an abrupt, sustained downtrend, but by a continued uptrend where the record highs simply start to come less frequently. The only significant negative in the technicals is that the main short-term momentum indicators (such as the "moving average convergence/divergence," or MACD) now suggest stocks are somewhat over-bought. If the S&P 500 continues to rise as we anticipate, we believe its next significant resistance level will be at 2,872 (the record high reached in January). If stock prices instead start to fall again, we think the next significant support level would be at approximately 2,700.

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

Source: BigCharts.com

Bonds

With the continued strength in the economy, inflation pressures are rising, and policymakers at the Federal Reserve have reiterated their intention to keep boosting interest rates gradually. Easing tension between the United States and North Korea has also eliminated some safe-haven buying. That has helped push down the demand for bonds, pushing yields higher. The yield on the benchmark 10-Year Treasury Note ended the month at 2.96%, compared with 2.85% at the end of June. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was 0.1% in July, and a negative 0.6% over the last year.

Looking forward, we still think solidifying inflation pressure and increased government borrowing will be a headwind for bonds in the near term, but we remain optimistic that the selling will not get too intense. Indeed, so far this year, buying interest has increased whenever the 10-Year Treasury yield has reached the 3.00% range, suggesting that investors can still be enticed into bonds when they perceive juicy yields. We also think increased policy risks could well keep investors interested in the relative stability and safe-haven characteristics of fixed-income investments.

Real Estate and Commodities

Since publicly-traded real estate investment trusts (REITs) often face headwinds when bond yields rise, and since they posted particularly good gains in the previous two months, it probably should be no surprise that they were nearly stagnant in July. The FTSE NAREIT Price Index rose just 0.5% over the course of the month, leaving it up a mere 0.1% from July 2017. Reflecting their relatively high dividends, the total return on publicly-traded REITs was a positive 0.6% in July and 4.3% over the last year. Looking ahead, we believe the outlook for these REITs is modestly positive, so long as economic growth continues and bond yields don't rebound too much.

Commodities were the weakest asset class in July, with the S&P GSCI Total Return Index falling a steep 3.5%. However, the index was still up a strong 20.0% from July 2017. Energy commodities were the main source of the uptrend over the last year, but prices for crude oil and refined products have been trending downward ever since several key producing countries agreed in June to boost output. Meanwhile, gold and other precious metals prices have been falling in response to rising interest rates, the stronger dollar, and reduced international tensions. Along with the trade war, those same forces have also pushed down prices for industrial metals. The concerns about the trade war had been a particular headwind for many agricultural commodities earlier in the summer, but those same goods posted a strong rebound in July in response to worsening weather conditions and a sense that the selling in June had gone too far. Going forward, we think the strong global economy, rising demand, and various supply disruptions are more likely to push energy prices higher again, while heat and drought could keep bolstering agricultural prices. We think that will produce further price gains for broad-based commodity baskets unless and until the trade war intensifies further.

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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	2,816.29	3.6%	6.4%	14.0%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	295.96	2.2%	-2.7%	3.3%
REITs	FTSE NAREIT All-Equity Price Index	680.68	0.5%	7.5%	0.1%
Commodities	S&P GSCI Total Return Index	2,722.02	-3.5%	-0.8%	20.0%
Bonds	S&P U.S. Aggregate Bond Index	190.97	0.1%	0.6%	-0.6%

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