WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

# Monthly Market Comment

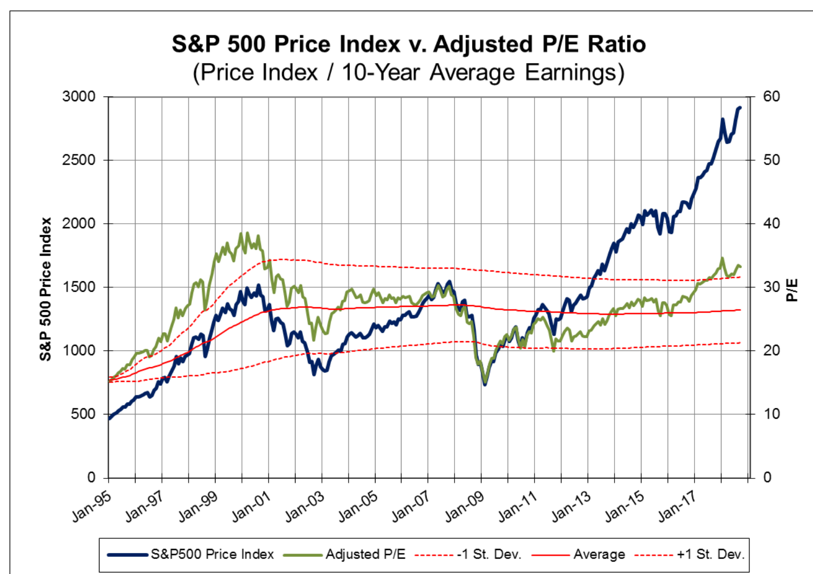
## October 1, 2018

In September, investors showed a clear preference for stocks and riskier alternative assets, while rolling out of bonds and other yield-oriented investments. Stock prices rose, setting a new record high, and commodity prices jumped. In contrast, prices for bonds and real estate dropped significantly.

**Stocks**

U.S. stock prices retreated in early September, but then regained their footing and started rising again. In fact, the S&P 500 price index set a new closing record high at 2,930.75 on September 20, before pulling back a bit in the last several days of the month. The index ended September up 0.4% from the end of August and a healthy 15.7% higher than at the end of September 2017. Taking into account dividends, the total return on the S&P 500 was 0.6% in September and 17.9% over the last year.

Looking into the future, we believe the on-going economic expansion, new tax cuts, and government spending hikes will most likely keep corporate profits on the upswing. In addition, it now appears that the administration is willing to accept relatively minor changes to the U.S. trade relationship with key allies, which has narrowed the scope for a disruptive trade war (though tensions with China remain high). We think these developments will allow stock prices to rise to further record highs in the coming months. Still, we see gathering headwinds that could eventually short-circuit the economic expansion and stock market down the road. Besides the threat of a trade war with China, 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 are rising toward the level of 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 prices now start to pull back, history teaches that they could well start a significant downturn. We are not panicking yet, but in consideration of the building risks, we have started to reduce our exposure to the more volatile asset classes across our various strategies.

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Technical indicators also support 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 performance of the Dow Jones Transportation Index has recently matched or exceeded that of the overall market, which has traditionally been a positive indicator. Finally, multiple month-end record highs like the S&P 500 has posted over the last year have historically been followed by further month-end record highs. The main "fly in the ointment" is that the share of S&P 500 stocks trading above their 200-day SMA has failed to exceed the 70% level at which we consider an uptrend to be broad based, while the main short-term momentum indicators (such as the "moving average convergence/divergence," or MACD) 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 come at the psychologically important level of 3,000. If stock prices instead start to fall again, we think the next significant support levels would be at approximately 2,856 and 2,802.

**S&P 500 Stock Price Index + "MACD" Momentum Indicator**
Source: BigCharts.com

**Bonds**

With the economy continuing to grow briskly, inflation pressures are rising, and policymakers at the Federal Reserve have warned they will keep boosting interest rates. The resulting rise in the value of the dollar has made it much harder for several big developing countries to service their dollar-denominated debt, and the threat of a financial crisis in the "emerging markets" prompted some investors to seek a haven in U.S. Treasury securities in late summer. Nevertheless, that safe-haven buying gave way to selling in September, just as investors worried about rising inflation and higher interest rates abandoned fixed income. The result was to push prices lower and drive up yields. The yield on the benchmark 10-Year Treasury Note ended the month at 3.06%, rising from 2.85% at the end of August and reaching its highest level since mid-2011. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was a negative 0.5% in September, and a negative 0.9% over the last year.

Looking forward, we think rising inflation pressure and increased government borrowing will remain a headwind for bonds. Just as important, while bond demand repeatedly rose over the last year when the

10-Year Treasury yield reached 3.00%, such buying interest failed to materialize when the yield rose above that level in late September and early October. That makes us wonder whether investors have finally become more convinced about the strength of the economy, the rise in inflation, and the threat of higher interest rates. If so, they could keep selling fixed income and pushing yields higher.

**Real Estate and Commodities**

Publicly-traded real estate investment trusts (REITs) often perform poorly when bond yields are rising, so it was no surprise that they declined in September. The FTSE NAREIT Price Index fell 3.0% during September, and it ended the month just 0.5% higher than at the end of September 2017. Reflecting their relatively high dividends, the total return on publicly-traded REITs was a negative 2.4% in September and a positive 4.3% over the last year. Looking ahead, we believe the continued economic expansion should keep REITs' operational dynamics healthy, but we are concerned that rising bond yields will continue to weigh on their price performance.

Finally, commodities turned in another good performance in September, with the S&P GSCI Total Return Index jumping 3.9%. That left the index up a strong 22.9% from September 2017. The main reason for the upturn over the last couple of months was that energy prices have continued to rebound. Even though several key producing countries agreed in June to boost output, falling stockpiles and the potential for reduced supply from particular producers have recently helped prices rebound. Easing trade tensions also removed a cloud over industrial metals, allowing their prices to rise, although gold prices suffered from the rise in bond yields and the appreciation of the dollar. Agricultural prices were mixed. Going forward, we remain hopeful that continued economic growth at home and abroad will keep commodity demand on the upswing, supporting further price gains for the broad commodity funds for a while yet.

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 | 2,913.98 | 0.4% | 7.2% | 15.7% |
| Non-U.S. Stocks | MSCI All-Cap World Ex-U.S. Price Index | 289.62 | 0.2% | 0.0% | -0.8% |
| REITs | FTSE NAREIT All-Equity Price Index | 676.71 | -3.0% | -0.1% | 0.5% |
| Commodities | S&P GSCI Total Return Index | 2,859.44 | 3.9% | 1.3% | 22.9% |
| Bonds | S&P U.S. Aggregate Bond Index | 191.00 | -0.5% | 0.1% | -0.9% |

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