ANCHOR
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.

COMMENTARY 2nd Quarter 2018

Market/Index	2015 Close	2016 Close	2017 Close	2017 Change	As of 06/29/18	2018 Change
DJIA	17,425.03	19,762.60	24,719.22	25.08%	**24,271.41**	**-1.81%**
NASDAQ	5,007.41	5,383.12	6,903.39	28.24%	**7,510.30**	**+8.79%**
S&P 500	2,043.94	2,238.83	2,673.61	19.42%	**2,718.37**	**+1.67%**
Prime Rate	3.50%	3.75%	4.50	0.75%	**5.00%**	**+0.50%**
10-year Treasury	2.27%	2.446%	2.40%	-0.050%	**2.85%**	**+0.45%**

Interest Rates, Tariffs, and Italy, Oh My….

After a First Quarter correction, the rebound in US Equity markets continued in the Second Quarter, with a couple of rough patches along the way. The pullback at the end of the quarter was expected as the Federal Reserve raised interest rates again and the tariff sabre rattling continued between the US and most other major governments around the world. As we spoke about in previous commentaries, these changes are all appropriate and have been announced in advance of the actual event.

Interest Rates. We are keeping a close eye on a flattening yield curve. A 10 year Treasury Bond currently yields 2.84%, just 29 basis points more than the 2 year Treasury at 2.55%, which could forecast an inverted yield curve in the future. Historically, an inverted yield curve (one where short term bonds pay a higher interest rate than long term bonds) is a reliable indicator of future recessions. However we see little reason for the Federal Reserve to invert the curve purposely, and we currently view the demand for US bonds as a positive indicator.

Tariffs. Much has been written in the press about tariffs. In terms of their scope, $34 Billion is a drop in the bucket for a $20 Trillion economy but what we are watching closely is China's response. Since the beginning of the year the Chinese government has taken steps to lower the value of their currency (the Yuan) vs the US dollar, perhaps to offset US trade tariffs. However a weak Yuan could cause large capital outflows from the country; the damages from which would make the US tariffs pale in comparison. China would also like for the Yuan to become an international currency that could eventually challenge the Dollar. If they are seen to be excessively manipulating the currency, international trust will fall killing all hopes of this. Their options are limited, which gives us hope that a trade war will be averted relatively quickly.

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Italy. The surprise this quarter has been Italy. As much as we love the beautiful country, their politics make the US's seem boring and their fiscal position has gone from bad to worse. Their debt has risen to 132% of GDP, second only to Greece and the recently installed government is now threatening to hold a vote as to whether or not the country should leave the EU, similar to the UK's Brexit vote in 2016. Italy is the third largest member of the Eurozone in terms of population and economic status, making an exit from the Eurozone an instrumental blow to the financial and political stability of the region. This episode continues to showcase the difficulties of tying multiple countries to one currency, without having them govern and spend similarly. There will be a rough road ahead for the Eurozone and that rough path will continue to cause a bit of global instability.

US Stock Buybacks. U.S. company fundamentals are extremely strong and S&P 500 companies are on track to announce over $650 billion worth of stock buybacks this year, surpassing the previous record of $589 billion in 2007. Equity analysts estimate that company buybacks produce roughly 3% in effective yields in addition to dividends being paid.

Buybacks have surged ever since the new tax law now encourages US companies to bring cash back to the US from overseas because of lower tax rates. Companies have the ability to invest in capital, hire more employees, increase dividends, or buy back their stock. During this economic cycle, companies have opted not to significantly boost spending on equipment, factories and other investments that create jobs and boost wages. With unemployment at 3.8%, perhaps they have no alternative?

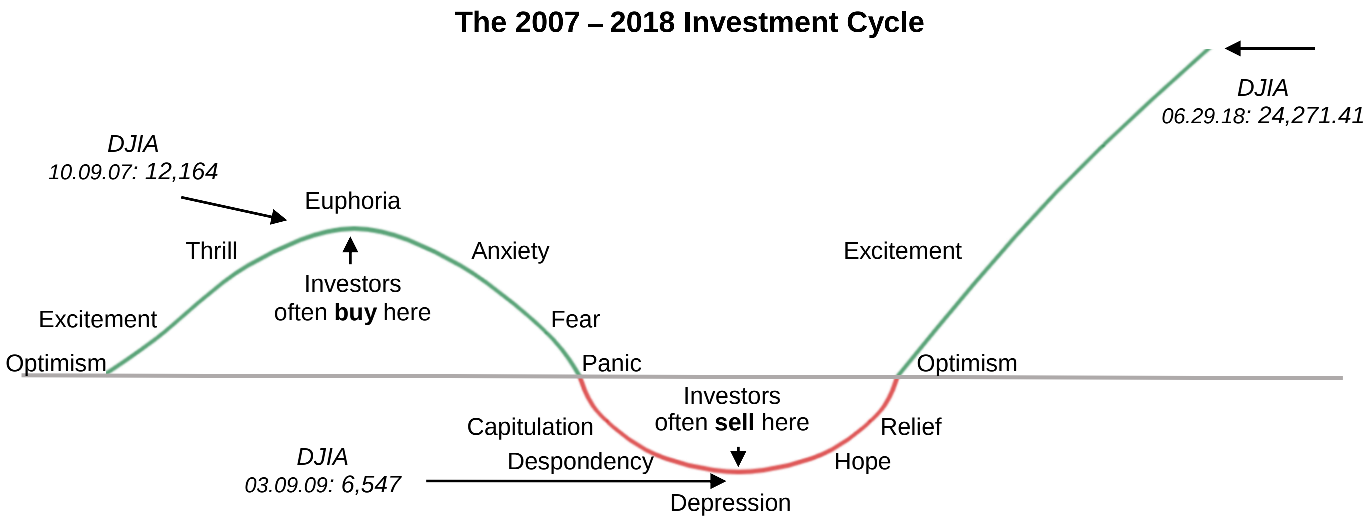
Dodd-Frank Rollbacks. The House & Senate voted on extinguishing some regulations under the Dodd-Frank legislation signed into law in 2010. Under the old law, the 38 banks over $50 Billion in assets were deemed "systemically important" and had to partake in the Federal Reserve's annual "Stress Tests." Under the new law the threshold was increased to $250 Billion, which effectively exempted 26 of those banks, including BB&T, SunTrust, American Express, and Charles Schwab, from the regulations. The rollback will allow those banks to broaden their loan base by lending more ambitiously, reduce data collection requirements, and minimize the threat of lawsuits for defaulted mortgage loans. It is important to note that the United States currently has more than 5,000 banks across the nation, yet just 13 of the largest banks account for roughly 50% of all assets and deposits. Twelve of those banks will still fall under the new law and will continue to have stronger oversite. For the smaller banks, we expect that there will be some consolidation now that banks can be much larger and not trigger the additional regulations.

Student Debt – A potential generational crisis. In the last 30 years the price of college has skyrocketed nearly 400 percent as states have shifted the costs of educating our young adults from taxes to tuition. As a result, the debt burden of those who take out loans to pay for tuition has soared as well. Student debt now totals about $1.5 trillion, **more than both credit card and auto loan debt**. These are the children of working- and middle-class families, not the affluent. In 2016, the average debt for those who took out loans to finish a bachelor's degree was $37,172 — an increase of about 34 percent since 2011.

The onerous debts sabotage the ability of a college education to serve as an instrument of upward mobility for all students, but primarily disadvantaged groups. The students from the poorest families are forced to take on the highest amount of debt. Women hold about **two-thirds** of all student loan debt in the United States, and since they still earn less than men make for comparable work, women pay their loans off more slowly, incurring higher interest payments. Students with larger debt burdens often can't begin saving for retirement or afford to buy a home, and they increasingly put off decisions about marriage and children.

The millennial generation has taken the hardest hit. Consequently, they save less than previous generations: Around 25 percent have no personal savings. Two-thirds say they would have difficulty paying an unexpected bill of $1,000. More than one-third say debt has forced them to put off buying a home, while 30 percent say they have put off saving for retirement, and 16 percent say they have put off having children.

Carefully planning for children's college education is more important than ever and if you have the resources, helping a young adult eliminate student loan debt can be one of the most life changing gifts they ever receive. Business owners wanting to hire young talent should look into offering a "Student Loan Repayment Benefit." Only 4% of businesses offer it but 70% of students currently graduate with loans.



In Conclusion

Positive economic news continues to outweigh the negative and we will, as always, continue to scan the horizon for changes in the landscape. Our job of building portfolios designed to give you your desired outcome remains our primary focus and we appreciate your trust and confidence.

Enjoy your summer!

Disclaimer

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