CORRIGAN FINANCIAL, INC.

Market Update: August 2018

U.S. stocks advanced for the fifth straight month and reached fresh new highs during August. Solid economic data, including strong corporate profits, propelled domestic equities to returns of greater than 3% for the month and over 10% year-to-date.

Everywhere else on the planet, stocks continued to pullback. Hurt by trade jitters and currency concerns, international stocks declined more than 2% for the month and are down over 3.5% for the first eight months of 2018.

The yield on the 10-year U.S. Treasury note ended August at 2.853%, down from July's 2.964% closing yield. Prices rise as yields fall, so the broad U.S. bond market ended the month in positive territory. However, the current yield is higher by 44 basis points (0.44) from the start of the year, which is why U.S. bond investments are down by about 1% for 2018.

To recap performance for the past eight months: U.S. stocks have been rising, while foreign stocks and pretty much all bonds have been declining. Therefore, global stocks and bonds are up 3.4% and down 1.5%, respectively … which works out to only about a 1% year-to-date total return for a globally diversified portfolio.

It's important to recognize that international markets are still in their earlier stages of economic recovery. Both historically and relative to the U.S., European stocks would seem to offer good value. The growing middle class in emerging market economies also offers long-term opportunities for investors.

> **While only 12% of India's population is considered middle class today, we project this to grow exponentially to almost 80% by 2030. This means over one billion people moving to urban locations, enjoying more disposable income and demanding more products and services. With more people that have never had a bank account – 400 million, in fact – than the entire U.S. population, India is truly under-banked.**
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> **J.P. Morgan Asset Management – 2nd quarter 2018**

Tariffs and currency movements continue to cloud the investment horizon. U.S. stocks should suffer less in a trade war. This has influenced their relative outperformance and helped to support the dollar's rise. Rising U.S. interest rates also helped to strengthen the dollar, which ultimately hurts emerging market equities. A rising dollar makes it more difficult for emerging markets to pay back dollar-denominated debt. Turkey is currently in the eye of the storm, as its currency (the lira) declined 25% against the dollar in August alone. Overall, currency moves seem to be driving all trade-related market moves.

It's the main thing we're monitoring from a risk standpoint.

John Toohey, USAA Asset Management – WSJ 8/31/18

It's been ten years since the "Great Recession". In fact, September will mark the 10th anniversary of the fall of Lehman Brothers. The resulting coordinated global stimulus allowed many emerging economies to borrow aggressively over the past ten years.

I suppose you could say that high emerging market debt levels are the "unintended consequence" of global stimulus measures. Now, with the U.S. Federal Reserve increasing interest rates, you could also say that emerging market economies have become "collateral damage". Certainly, Turkey could be considered the poster child for that synopsis.

Here are some of the recent economic highlights:

- The Commerce Department revised upward its estimate of GDP to 4.2% from its earlier 4.1% estimate.
- The Commerce Department also reported that its broadest measure of after-tax profits across the U.S. rose 16.1% for the second quarter … the largest year-over-year gain in six years.
- Taxes paid by U.S. companies in the second quarter were down 33% from a year earlier … or more than $100 billion at an annual rate.
- The average rate on a 30-year fixed rate mortgage in July was 4.53%, up from 4.03% in January.
- The Fed's preferred measure of inflation rose by an annualized 2.3% in July, the biggest increase since early 2012.
- Existing home sales fell 0.7% in July from June … the fourth straight month of declines.

With housing prices and mortgage rates on the rise, it is cheaper to rent instead of own in many local housing markets. According to Realtor.com, the monthly costs of buying and owning a home are up 14% over the past year. Rents are up only 4% during the same period.

Even setting aside big upfront expenses like a down payment, rising month-by-month costs are likely keeping many people from purchasing … Since home ownership has historically been an important source of household wealth creation, it could be problematic if this trend continues for too long.

Danielle Hale, Realtor.com – CNBC 8/6/18

Consumer spending represents two-thirds of our economy, and Americans are spending at a strong clip. And why not? Americans have more money in their pockets … thanks to strong job growth, rising pay, and tax cuts. Also, confidence is high … thanks to rising wealth from a booming stock market and escalating home values.

The August *jobs report* (released September 7) showed continued employment expansion and an uptick in wages. Strong growth and rising inflation should make it a virtual certainty that the Fed will raise rates again at the conclusion of their September (25 – 26) policy meeting … and there is a high probability for one more rate hike before year end.

> **Few investors would argue against the notion that the massive quantitative easing (QE) coming out of the financial crisis helped fuel stock gains. We are now in an era of quantitative tightening (QT) … and it's naïve to assume the move toward monetary policy normalization won't bring some significant jolts to market performance … We never suggest trying to time the market in the short-term, but do believe discipline around strategies like rebalancing and diversification is essential at this stage in the cycle. Risks are rising.**
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> **Liz Ann Sonders, Charles Schwab – Advisor Perspectives 8/17/18**

Not sticking to the plan is what gets many investors in trouble during times of turbulence. The problem isn't being *in the markets* when they go down … the problem is being *out of the markets* when they go up.

> **It's been 10 years since the financial crisis saw banks crumble, homes foreclosed on, and portfolio values plummet. And as the global community looks back on what became a worldwide calamity, the obvious question is whether today's investors are better prepared for the next market crash.**
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> **Amanda Schiavo – Financial Planning 8/27/18**

AQR Capital Management researched superstar investors – including Warren Buffet and Peter Lynch – and concluded that discipline is the key reason why they are so successful. They all followed basic rules and exhibited strict adherence to a select few investment strategies.

> **There's a commonality to the performance of all these guys and the commonality was they had an approach. They had a philosophy, and they stuck to it.**
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> **Jordan Brooks, AQR – CNBC 8/4/18**

Since 1950, September has been a difficult month for investors, with the S&P 500 averaging declines of about 0.5% according to the Trader's Almanac. We are obviously in the late innings of this expansion. Let's not get caught up in the excitement of a faster growing economy, or be overly concerned about the potential for rising volatility.

> **Cautious optimism has always been the best way to invest and is certainly the best way to live.**
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> **John Mauldin, Mauldin Economics – Advisor Perspectives 8/17/18**

Consistent with the superstar investors of our time, we will remain disciplined and cautiously optimistic. *Adherence to the plan* has been our approach for the past 29 years. We intend to stick with what works.

Daniel G. Corrigan, CPA/PFS, CFP®