Monthly U.S. and Global Market Outlook

I. Market Performance

The month of August marked the fifth month of consecutive growth in the equity space. The S&P 500 Total Return, NASDAQ and Dow Jones is up 9.94%, 17.47% and 5.04% for the year as of month-end. For the second quarter, 80% of the S&P 500 companies reported positive EPS surprise, and 72% reported positive sales surprise. The blended earnings growth for the quarter increased to 25.0%. Positive EPS surprise has jumped to its highest point in over 5 years up to 80%. The forward 12-month P/E ratio climbed higher to 16.8. Over the past year, the significant sector contributors included Telecom Services, Health Care and Information Technology.

For Q3 earnings guidance, 72 companies issued negative EPS guidance and 24 companies issued positive EPS guidance.[1] All eleven sectors are expected to report year-over-year growth in revenue and earnings, with seven sectors reporting double-digit growth in earnings and four sectors reporting double-digit revenue growth. Forward estimates and valuations project 2018 earnings growth to reach 20.6% with 8.1% revenue growth. For 2019, analysts project a significant cut, pulling both earnings and revenue growth down to 10.3% and 5.2% respectively.

II. Economic Indicators

Macro data continue to point towards overall positive economic growth. For the month of August, 201,000 jobs were added to the U.S. economy, exceeding expectations of 191,000 jobs. While monthly employment gains have decelerated since 2015, over the past year the pace of job creation has remained relatively stable.

In the second quarter, U.S. GDP growth rate accelerated to 4.2%. The U.S. dollar continues to strengthen due to recent interest rate hikes and firm jobs data. Manufacturing continues to accelerate, PMI jumped to 61.3%, marking the highest expansion rate in factory activity in over a decade. U.S. service activity picked up for the month signaling further strengthening. The Producer Price Index slightly ticked up for the month and steadily increased year-over-year. The Consumer Price Index increased by 0.2% for the month and overall has continued a strong uptrend over the past 12-months. U.S. fiscal debt in relation to GDP remains a prominent risk given the growing level of debt and accelerated debt projections for 2019 and 2020.

Trade war tension remains a threat to both the U.S. and global economy. On September 7th, the Trump Administration discussed imposing an additional tariff increase of $267 billion worth of Chinese imports creating immediate market tension. Gold decreased to $1.192.20 per ounce, oil dropped to $67.94 per barrel and natural gas closed at 2.78 MMBtu on September 7th. [2]

III. Monetary Policy

Fed funds target rate remains at the 1.75 - 2.00% target range. The Fed is expected to shortly raise rates by an additional 25 basis points as seen during both their March and June Fed meetings. The Fed maintains its bullish viewpoint that the U.S. economy would expand at an above-trend pace for the remainder of the year with inflation in line with expectations. The next Fed meeting is scheduled to take place from September 25th – September 26th where we anticipate the Fed funds rate to be increased to the 2.00 – 2.25% target range. The ECB and BOJ are expected to meet next on September 9th and September 18th respectively.

IV. Global Outlook

The current single greatest risk to the global economy is the accelerating trade tensions between the U.S. and China. The International Monetary Fund forecasted the trade tension could impact global GDP by reducing output by -0.5% by 2020.[3] Additional risks that remain on our radar include currency fluctuations, elevated trade tensions and macroeconomic imbalances. Our investment committee will be heavily focused on global corporate earnings and revenue, pace of central bank monetary policy changes, inflation and valuation trends along with trade tension progress.

Portfolios Recap

Dynamic ETF Option Strategy (DEOS): 2.43% YTD

For the month of August, DEOS posted a 0.54% gain net of fees. The volatility index (VIX) remained range bound throughout August, ending 0.23% higher. This enabled the strategy to continue to target the 0.5% monthly net yield rate. As we start moving the strike expirations into next year, we're remaining more conservative on the strike selection as we anticipate interest rates to continue to rise over the next two quarters along with the recession probability increasing towards the end of 2019. We'll continue to monitor market conditions closely and will adjust the exposure accordingly.

Tactical Long/Short Strategy: 13.70% YTD

The Tactical Long/Short Strategy produced a 5.06% gain net of fees for the month of August bringing the year-to-date net return to 13.70%. The S&P 500 returned 3.26% for the month and closed the month up 9.94% for the year. The Tactical Long/Short Strategy has continued to maintain a strong lead against the S&P 500 primarily due to our exposure adjustments to the technology weighting back in June. During the month of August, we maintained our allocations in SPY and QQQ with a low cash weight with plans to increase the cash buffer by year-end.

Core Strategy: **14.19% YTD**
Equity Opportunity Strategy: **13.01% YTD**
Global Strategy: **11.79% YTD**

For the month of August, the Core Strategy, Equity Opportunity Strategy and Global Strategy returned 4.10%, 3.85% and 3.88% respectively net of fees. All three equity strategies have outperformed the S&P 500 Total Return by a strong margin for the month and continue to stay ahead of the benchmark for the year. The S&P 500 Total Return produced 3.26% for the month, bringing YTD to 9.94%. Last month, the investment committee made a strategic change to invest excess cash into short-term 3-month U.S. treasuries in order to provide additional annualized yield of 1.9-2.0% at current rates. In the Equity Opportunity Strategy, we eliminated two positions with exposure to industrials and technology and increased our cash level. The Equity Opportunity Strategy now holds 17.55% cash with 29 equity positions spread across technology, services, health and consumer goods. In the Global Strategy, we eliminated one position, reduced exposure in one technology position and increased the cash level.

As we approach the end of the year, our investment committee maintains its conservative approach in order to protect our portfolios. Our team is closely analyzing macroeconomic indicators, fiscal policy and trade tensions as well as broad market valuations in order to best position the portfolios going into the year-end.

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Fariba Ronnasi, *Principal*

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References

1. Factset Earnings Insight, September.
2. Trading Economics.
3. International Monetary Fund