Investor Intelligence

Newsletter©

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From the Executive Desk

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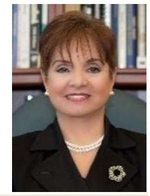

The World Economic Forum posted an interesting article recently on how emerging and developing economies for the first time account for a larger share of world GDP or global output than developed economies. Does this mean that these countries will become prosperous? Not necessarily. Less than a quarter of the world's economies can be considered rich. The World Bank estimates that of the 101 countries classified as middle-income in 1960, only about a dozen had become prosperous by 2008. However, the OECD estimates that by 2030 more than half of the world's population will be middle class, and around two-thirds of these will be in Asia. This will generate a demographic shift not seen in many years, as purchasing power increases and more countries, including China, continue to shift towards consumption driven economic growth. Interestingly, this compares favorably with previous forecasts of global equity market capitalization. Back in 2014 Credit Suisse had predicted that by 2030 the global stock market would balloon to $284.2 trillion. In their estimates the US would have 35% of the global stock market, followed by China with 19%. Developed economies would have approximately 50% of total market capitalization, while the countries we currently classify as emerging, would have the other half. Global market capitalization distribution gives us an idea of how ownership of production will be distributed and it is highly likely that by 2030 many of the current emerging economies will be promoted to developed status by index providers, and many of the economies classified as frontier, will be the new emerging countries across the globe. This is one of the reasons investors with a long-term view should continue to maintain geographic diversification as a key component of their portfolio design.

Economic Perspectives

Edmundo J. Garza
President

The unemployment rate declined to 3.9% in the U.S. during the month of July and second-quarter GDP grew 4.1%, the highest rate in almost four years. For the time being, it appears that the U.S.'s strong economic activity is overshadowing the very serious concerns of a global trade war, as the Trump Administration aggressively renegotiates trade deals with the European Union and China. Despite the strength in GDP, driven by consumer spending and nonresidential business investment, Federal Reserve policy makers are expected to continue their gradual pace of interest rate hikes, with two more in store for the year. In Europe there appears to be no change to an accommodative monetary policy, and the European Central Bank has pledged to keep interest rates the same for at least another year. Additionally, the potential for a trade war between the U.S. and the European Union seems to have diminished after President Trump and European Commission President Jean-Claude Juncker agreed to work to lower trade barriers between the two trade partners. Both parties promised to forgo placing further tariffs while negotiations are under way. Economic activity continues to be positive, as the International Monetary Fund reported real global GDP growth of 3.64% for the first quarter. Furthermore, the ECB is forecasting real GDP growth to hit 2.4% for 2018.

Indicators (As of August 10, 2018)

United States:
CPI: 2.9% Chg. from yr. ago
Unemployment Rate: 3.9%
GDP: 4.1% Comp. Annual rate of Chg. on 2018:Q2
Ind.Prod.Index: +0.6% change from previous month
Source: *St. Louis Fed. Res.*

Japan:
CPI: 0.7% Chg. from yr. ago
Unemployment Rate: 2.4%
GDP: 0.5%, Comp. Annual rate of Chg. on 2018:Q2
Ind.Prod.Index: -2.1% change from previous month
Source: *Moody's Analytics*

Eurozone:
CPI: 1.9% Chg. from yr. ago
Unemployment Rate: 8.3%
GDP: 0.4%, Comp. Annual rate of Chg. on 2018:Q1
Ind.Prod.Index: -0.7% change from previous month
Source: *Moody's Analytics*

Puerto Rico:
CPI: 0.0% Chg. from yr. ago
Unemployment Rate: 9.3%
Payroll Employment: -4.0% Chg. from yr. ago
GDB Econ. Act. Index: -7.9% Chg. from yr. ago
Source: *Economic Development Bank of Puerto Rico*

Market Recap

Evangeline Dávila, CIMA®
Chief Research & Investment Officer

Stocks: In July, the S&P 500 Index and the DJIA returned 3.7% and 4.8%, respectively, as 83% of the S&P 500 companies reported earnings per share that exceeded expectations. For the first time since February, large cap domestic stocks outperformed small cap equities, as the Russell 1000 Index returned 3.5% and the Russell 2000 returned 1.7%. Mid cap stocks also outperformed small caps, with the Russell Mid Cap Index gaining 2.5%. Value stocks outperformed growth stocks, with the Russell 3000 Value Index returning 3.8% compared with 2.8% for the Russell 3000 Growth Index.

Bonds: The yields on the 3-month Treasury Note and the 10-Year Treasury Bond increased, ending the month at 2.03% and 2.96%, respectively, resulting in a further flattening, albeit small, of the U.S. Treasury curve. Despite the strength in GDP, driven by consumer spending and nonresidential business investment, Federal Reserve policy makers are expected to continue their gradual pace of interest rate hikes, with two more in store for the year.

Alternatives: The Bloomberg Commodity Index and the energy-heavy S&P-Goldman Sachs Commodity Index incurred a loss of 2.1% and 3.5%, respectively. Meanwhile, the FTSE-NAREIT Equity REIT Index posted a gain of 0.8%. Non-U.S. REITs outperformed U.S. with the FTSE EP/NA Global ex-U.S. gaining 1.1%. Hedge strategies posted gains in July, recovering from the narrow decline from June, and effectively navigating a primarily positive earnings season. The HFRI Fund Weighted Composite Index advanced 0.6% for the month, with contributions from equity, credit, M&A and currency exposures

The Advisor's Corner

Ernesto Villarini Baquero, MBA
Advisor & Managing Director

Some companies establish corporate foundations to help them achieve Corporate Social Responsibility (CSR) objectives that are aligned with their purpose and values. A corporate foundation is a legal entity set up by a commercial business to carry out charitable activities. Well-known examples are the Merck Foundation, the UPS Foundation, and the Walmart Foundation. These, like many others, derive their income from an endowment of invested capital and from regular donations. A corporate foundation operates as a vehicle for various types of philanthropic activities. The foundation can receive funds from the parent company, its employees, and other companies, and it can invest these funds through a diversified portfolio to generate a financial return that can support grant-making on a perpetual basis. Some foundations also provide technical assistance to help community organizations make the best use of the grants they make, while others partner with universities or other non-profits to achieve the same effect. Other foundations focus on providing scholarships to help build a pool of young professionals they may be able to recruit from in the future. A foundation gives a corporation greater freedom to think strategically about the issues on which it wishes to make an impact, and its activities can be linked directly to the company's CSR objectives and be planned in a coherent, proactive manner. A corporate foundation's activities can also serve as a positive signal to other donors on causes and projects that merit support. While establishing a corporate foundation can seemingly yield a number of benefits, the first step in this undertaking should be a feasibility study that allows the company to assess whether there are other ways to make contributions to communities. A feasibility study also seeks to ensure that rules and regulations concerning corporate foundations are met, and that start-up cost are manageable. Lastly, even if most of its funding comes from the parent company, along with the name, it's important that the company gives the foundation full independence and honors that arrangement. Blurring the lines between one and the other can bring about reputational and legal risks.

What to Do?

While July provided a positive start to the second half of 2018, the environment and general mood in the market remains cautious. Continuing tension between the U.S. and its key global trade partners (Eurozone and China chief among them) is still a significant concern. The pace of rises in domestic interest rates and inflation, equity volatility, changes in currency trends, and further policy normalization by global central banks continue to worry markets. ***Amid an uncertain scenario we continue to recommend prudent asset allocation and risk assessment, based on future capital needs, for plan sponsors, institutions and individual investors. Due diligence reviews and an adherence to a well-developed investment policy remain the most prudent course for long-term investors. Continued fiduciary education is paramount.***

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