Investor Intelligence

Newsletter©

A bi-monthly publication from Consultiva Internacional, Inc. - A Registered Investment Adviser September 25, 2018

From the Executive Desk

Myrna Rivera, CIMA®
Founder & Chief Executive Officer

Global equity markets posted a positive month in August as corporate earnings continued to outpace expectations and earlier fears of inflation were overcome. Favorable equity returns were driven by the US equity market. Federal Reserve Chairman Jerome Powell appeared to reassure the markets with his commitment to gradual normalization of interest rates, acknowledging that there was little pressure to sharply increase rates. Progress in NAFTA talks also helped US stocks. Markets remained concerned about trade disputes, which spurred selling in rest of the world. In the Eurozone Italy's heavy debt and the populist rhetoric of its new coalition government, along with uncertainty about Brexit, also weighed in on euro stocks. China's growth continued to show signs of moderation, adversely affecting many Asian equity markets. Emerging market equities have borne the brunt of interest rate, currency and policy turbulence in 2018, but fundamentals have held strong, with stable-to-higher earnings growth estimates for 2018 and 2019. Information technology stocks resumed their market leadership in last month and remained the strongest sector for the year. Health care stocks also performed well, continuing their recent strength. Material and energy stocks lagged in the month, reflecting weaker prices and uncertainty over the global economy.

Economic Perspectives

Edmundo J. Garza
President

The European Commission's 2018 Summer Outlook projected resilient growth amid increased uncertainty. The Commission forecasts strong growth in 2018 and 2019, at 2.1% this year and 2% next year in both the EU and the euro area. However, in August, the Economic Sentiment Indicator (ESI) decreased slightly in the euro area (by 0.5 points to 111.6), and in September the consumer confidence indicator decreased compared to august. The decrease in the euro-area economic sentiment indicator resulted from a marked deterioration of confidence among consumers and a milder decrease in the services sector, which were only partly offset by increases in the retail trade and construction sectors. Confidence in the industry sector remained broadly stable. Amongst the largest euro-area economies, the ESI remained virtually unchanged in Germany (-0.1), while it decreased in France (-1.3), Italy (-0.8), Spain (-0.7) and the Netherlands (-0.5). The Business Climate Indicator (BCI) for the euro area decreased slightly (by −0.08 points to +1.22). Managers' appraisals of their overall order books and past production worsened markedly, while their views on export order books and the stocks of finished products merely edged down. These developments might be short-lived, but investors are encouraged to be mindful of long-term effects.

Indicators (As of September 25, 2018)

United States:
CPI: 2.7% Chg. from yr. ago
Unemployment Rate: 3.9%
GDP: 4.2% Comp. Annual rate of Chg. on 2018:Q2
Ind.Prod.Index: +0.4% change from previous month
Source: *St. Louis Fed. Res.*

Japan:
CPI: 0.9% Chg. from yr. ago
Unemployment Rate: 2.5%
GDP: 0.7%, Comp. Annual rate of Chg. on 2018:Q2
Ind.Prod.Index: -0.1% change from previous month
Source: *Moody's Analytics*

Eurozone:
CPI: 2.0% Chg. from yr. ago
Unemployment Rate: 8.2%
GDP: 0.4%, Comp. Annual rate of Chg. on 2018:Q1
Ind.Prod.Index: -0.8% change from previous month
Source: *Moody's Analytics*

Puerto Rico:
CPI: 0.4% Chg. from yr. ago
Unemployment Rate: 9.1%
Payroll Employment: -2.3% Chg. from yr. ago
GDB Econ. Act. Index: -0.3% Chg. from yr. ago
Source: *Economic Development Bank of Puerto Rico*

City View Plaza—Tower 1, Suite 801 Carr. 165 Km. 1.2 #48 Guaynabo, PR 00968 / Phone: (787) 763-5868 **Fax:** (787) 763-5397 **Email:** info@consultiva.com

Market Recap

Evangeline Dávila, CIMA®
Chief Research & Investment Officer

Stocks: Domestic equity returns continued to dominate the headlines and financial market returns in August. The S&P 500 return of 3.26% helped produce a 6.74% 3rd quarter to date return. The current fundamentals are positive. Strong GDP growth translated into record sales, earnings and margins. Non US equity markets fell in August as both developed and emerging markets posted negative returns in August, and for the 3Q to date. The stronger US dollar, trade concerns, and individual country crisis (i.e. Turkey, South Africa, China, and Italy) led global investors to shift assets into the US.

Bonds: The Federal Reserve kept interest rates unchanged in August. The market bid down the yield on the 10 Year Treasury to 2.86% from 2.96% at the, end of July, but above the year end 2017 yield of 2.41%.

Alternatives: The dollar index (a measure of value of the United States dollar relative to a basket of developed market currencies) reached a high of 96.845 in mid-August. The inverse correlation between precious metals and the U.S. currency weighed on many raw material prices as metals moved lower, with gold and palladium falling to new lows for 2018 and silver falling to its lowest price since 2016. Copper, plunged from a high of more than $3.30 in early June to lows of $2.5520 per pound in mid-August.

The Advisor's Corner

Eileen Rivera, CFA®
Due Diligence Officer & Managing Director

Undoubtedly, 2017 was an extraordinary year in the global capital markets. Almost every asset class, except a small minority (such as energy), had high single-or-double-digit returns. To date, 2018 has proven to be a year where the synchronization of global capital market returns has come unhinged. As shown in the tables below, as of September 17, 2018, non-US developed countries and emerging markets are struggling and delivering negative returns. On the other hand, US equity markets are performing strongly, led by small capitalization stocks and the technology and consumer discretionary sectors. In the fixed income markets, most global sectors have negative performance (with the notable exception of US high-yield bonds). Emerging market bonds are not faring well, with a -4.2% return year-to-date.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	1.2%	8.7%	16.4%	1.9%
U.S. Small Caps	0.5%	13.1%	22.4%	1.2%
Non-U.S. World	1.4%	-5.0%	0.1%	3.3%
Non-U.S. Developed	1.8%	-3.4%	1.7%	3.4%
Japan	1.9%	-2.6%	7.1%	2.3%
Emerging	0.6%	-9.5%	-4.3%	2.9%
Asia ex-Japan	0.8%	-7.3%	-1.0%	2.7%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	-0.2%	-1.5%	-2.0%	3.0%
U.S. TIPS	-0.3%	-0.7%	-0.2%	3.1%
U.S. Investment Grade	0.1%	-2.4%	-1.1%	4.1%
U.S. High Yield	0.5%	2.3%	3.3%	6.2%
U.S. Municipals	-0.2%	-0.2%	0.0%	2.8%
Non-U.S. Developed	0.1%	-2.3%	-1.8%	1.0%
EM $ Bonds	0.6%	-4.2%	-3.5%	6.6%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	1.6%	16.8%	40.8%	$78.09
Gold	-0.2%	-8.3%	-10.1%	$1,195
Copper	0.7%	-17.6%	-8.1%	$5,973

Currencies	Week	YTD	12 Months	Level
Euro/USD	0.6%	-3.2%	-2.5%	1.16
USD/Yen	1.0%	-0.6%	1.7%	112.06
Pound/USD	1.1%	-3.3%	-2.5%	1.31

Source: Blackrock Investment Institute Weekly Commentary, September 17, 2018

There are several reasons for this year-to-date performance, including:

1. Two interest rate hikes in the US so far in 2018, which have put pressure on the fixed income markets and exposed portfolios to duration risk.
2. The global tariff war, particularly between the US and China, which continues to escalate and has put economic pressure on many countries, specifically on many emerging markets.
3. The strength of the US dollar and the weakness of many foreign currencies, such as the Turkish lira, the Argentinian peso, the Brazil real, and the Mexican peso.
4. A strong US consumer sentiment, record corporate earnings and full employment environment, which make US equity assets more attractive in comparison to other developed countries.
5. A fear of global contagion of the woes being experienced by emerging markets.
6. Leftist election results and growing anti-immigrant sentiment in many developed countries outside the US, for example in Germany, Sweden and Italy.
7. Fears and uncertainty regarding Trump administration policies.

So, what are investors to do in such a global environment? At the beginning of the year, Consultiva's global asset allocation (GAA) model called for a slight overweight to non-US equity markets (at 28% vs, 25% for US), given the brighter economic and growth prospects for non-US economies. Although stronger long-term growth prospects and metrics reside outside the US, and US equity markets have had a long bull run, risk averse investors might want to tactically tilt their allocation weights towards US assets during the rest of the year. If you are a client of Consultiva, please contact your advisor at Consultiva if you would like to this discuss these issues further or wish to adjust your investment portfolio.

What to Do?

While the positive U.S. stock market trend continued in August, the environment and general mood in the market remains cautious. International developed and developing markets still lag behind. In market environments like the one we are experiencing so far in 2018, it is important to remain faithful to a total portfolio's investment policy, which typically calls for a long-term outlook, a steady adherence to the policy allocation and an avoidance of changes based on short-term swings or dislocations. ***Hence, 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.***