Financial Advisory Service, Inc.

FASKC.COM

# FAS Monthly Economic & Market Update

March 2018

As of February 28, 2018

# Contents

# Economic Conditions

Inflation continued to be the buzzword throughout February as markets around the globe took a breather for the month. Increases in both job growth and wage growth in January spooked the markets in early February causing the largest one day drop in the Dow Jones Industrial Average at nearly 1,200 points. However, the "strong" job and inflation report from January might not have been as strong as initially perceived. The employment number estimate for January was lowered by economists just before the release of the data, making it look like the reading had surpassed expectations by much more. Additionally, the winter weather at the start of the year had an effect on employees, preventing them from coming into work causing hours worked to fall and hourly earnings to rise at a seemingly higher rate. We're still seeing a gradual rise in wages, just maybe not as much as investors may have thought judging by the market's reaction. The Fed's preferred measure of inflation, the personal consumption expenditures (PCE) price index, is expected to have risen 1.7% in January from the prior year which is still below the Fed's target of 2%. Regardless, new Fed chairman Jerome Powell was positive in his remarks regarding the strength of the economy during a House Financial Services Committee meeting last month, which caused stocks to fall again and the fed funds futures market to price in a 33% chance of four rate hikes this year with the first expected to come in late March.

# Market Conditions

| Index Returns | Feb '18 | YTD |
|---|---|---|
| S&P 500 | (3.89%) | 1.50% |
| DJIA | (3.96%) | 1.69% |
| NASDAQ | (1.87%) | 5.35% |
| MSCI EAFE | (4.71%) | 0.05% |
| Barclays Aggregate | (0.95%) | (1.24%) |

It was a difficult month for the markets as February got off to a rough start with the markets overreacting to improving economic figures. On February 5 the Dow Jones experienced its largest single day drop in history at nearly 1,200 points. However, it is important to point out that from a percentage standpoint this single day drop didn't even crack the top ten for the Dow. But 4.6% (the percentage drop on Feb 5, 2018) on 25,000 is quite a bit more in points than say, 4.6% on 2,200, which is about where the Dow was before its largest *percentage* drop (22.6%) in history in October of 1987. Markets recovered throughout the month before quickly regressing back down near key technical levels after the release of slightly *underwhelming* economic data while the Fed's new Chairman Jerome Powell hinted at the potential for more rate hikes in 2018 than originally planned. After being down across the board in February all major stock indexes remain positive for the year while bonds continue to lag as the fear of rising interest rates looms. In a long overdue move, volatility came crashing back into the markets in early February when the CBOE Volatility Index (VIX) spiked over 115%. However, the market's "fear gauge" (the Vix) came back down to earth and stabilized within a few days, after reminding investors that its presence should not be ignored.

# Tariffs and Trade Wars

Just last week President Trump announced that he would impose 10% and 25% tariffs on imported steel and aluminum, respectively, claiming that he is trying to help the American worker. Regardless of the political views readers have of this, we wanted to discuss the impact that policies like these can have on the economy. It's hard to say what kind of effect a move like this will truly have on the economy before seeing how other countries will react or retaliate with their own policies. But we do know for sure more than anything that this creates one thing that the markets fear most and do not need right now… uncertainty. On the one hand, the President has announced that Canada, the largest US trading partner in steel, and Mexico will be exempt from these tariffs under the agreement that the three countries renegotiate the terms of NAFTA and stated that there could be reductions for countries who "treat us fairly." On the other hand, this move still leaves in doubt the future of US trade policies with our second largest steel trading partner, the European Union, who have already announced a number of tariffs that would be placed on American goods if the US were to follow through with the steel and aluminum tariffs (which appear likely). This is the kind of retaliation that could be detrimental to economic growth as the effects will ultimately be felt by the consumer.

*(Continued on Next Page)*

# Tariffs and Trade Wars

At about 200,000 jobs, steel and aluminum workers account for about 0.13% of the 154M workers in the US labor force. That's a very small number compared to the amount of people that a trade war could affect. Additionally, the knock on effect from the rise in steel and aluminum prices could be felt in other sectors of the economy such as manufacturing and energy. Also, it could end up costing people jobs as costs begin to rise for manufacturers of metal components according to global research firm Trade Partnership Worldwide. In addition to higher overhead, increased costs will also ultimately be passed on to the consumer and could hinder the economic gains that we've seen in this recovery. The pain wouldn't necessarily stop with manufacturers either. Assuming that other countries retaliate against the tariffs set in place by the US, this move could end up hurting other heavy export sectors such as agriculture.

The move by the President has clearly created more of a rift not only between the Administration and Republicans but between some within the Administration as well. Just days ago, Gary Cohn resigned as President Trump's top economic adviser, leaving President Trump largely surrounded by advisers with more protectionist views. While the economy may not initially feel the effects of these tariffs that are set to take effect on March 23, the markets will definitely be on edge in the coming months waiting to see

*(Continued on Next Page)*

# Tariffs and Trade Wars

how other countries are going to react in response. One thing we can certainly expect in the near term is the continued presence of the heightened volatility we saw throughout the month of February as the markets wait for new information and potential changes to trade policies that come from our trading partners.

# Disclosures & Index Definitions



Under style performance boxes, indexes referenced in the equities section for large, mid and small reference the Russell 1000, Russell MidCap and Russell 2000 stock indices, respectively. The Barclays US Government, Barclays Credit and Barclays High Yield fixed income indices refer to Gov't, Corp, and HY, respectively. Short, Intermediate and Long refer to the time frame of the investments and their positions on the yield curve.

The information and opinions stated in this presentation are not intended to be utilized as an overall guide to investing; nor should they be taken as recommendations to buy, sell or hold any particular investment. This presentation is not an offer to sell or a solicitation of any investment products or other financial product or service, an official confirmation of any transaction, or an official statement of presenter. The opinions and views conveyed are for informational purposes and make no recommendations in regards to how a client's portfolio should be managed, as that involves inquiring, in depth, of a client's or prospective client's risk tolerance, investment objectives, time frame for investing and any other details pertinent to said client's or prospective client's financial situation. The presentation may not be suitable to be relied on for accounting, legal or tax advice.

Past performance is not indicative of future returns. Prices and values of investment vehicles will rise and fall as broad market conditions change. Investors' portfolios may fluctuate, to varying degrees, in tandem with market conditions. Diversification neither guarantees returns nor does it eliminate the risk of a portfolio decreasing in value. Equity securities tend to be more volatile than bond/fixed income products and carry greater risk factors than that of fixed income products. Smaller capitalization equities (i.e. mid and small caps) typically involve more risk than that of larger capitalization stocks. Political, economic, and currency risk are all risks subsumed under the additional risk factors of investments in international securities, to include those in both developed and emerging markets. In addition, political conditions in emerging markets can tend to be more volatile than in those of developed markets.

Investments in bonds will be subject to credit risk, market risk and interest rate risk. Interest rates will have an inverse effect on prices of bonds. Bonds of lower credit ratings, also known as High Yield bonds which hold a rating of less than investment grade (BB+ and below), will have greater risks attached than will those of investment grade bonds and will experience greater volatility.

All dates are as of February 28, 2018 unless stated otherwise.

Presentation prepared by Financial Advisory Service, Inc., an SEC Registered Investment Adviser. Securities offered through FAS Corp., an affiliated insurance agency and broker/dealer.

Any dissemination, distribution, copying, or other use of this presentation or any of its content by any person other than the intended recipient is strictly prohibited. FAS only transacts business in states where it is properly registered or notice filed, or excluded or exempted from registration requirements. Follow-up and individualized responses to this presentation that involve either the effecting or attempting to effect transactions in securities, or the rendering of personalized investment advice for compensation, as the case may be, will not be made absent compliance with state investment adviser and investment adviser representative registration requirements, or an applicable exemption or exclusion.

**Index Definitions**

The **S&P 500 Index** is based on the market capitalizations of 500 large companies whose stocks are listed on the NYSE and NASDAQ. This is widely regarded as the single best gauge of large cap US Equities.

The **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials. It is used as a barometer of how shares if the largest US companies are performing.

The **NASDAQ** is a market capitalization weighted index of the more than 3000 common equities listed on the NASDAQ Stock Exchange. These securities include American Depository Receipts, common stocks, real estate investment trusts, and tracking stocks.

The **MSCI EAFE (Europe, Australasia, Far East) Net Index** is recognized as the pre-eminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America, Europe, Australia, and the Far East.

The **MSCI Emerging Markets Index** captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 822 countries, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **Barclays US Aggregate Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS.

All index information has been gathered from public sources who are assumed to be reliable, although we cannot guarantee the accuracy or completeness of those public sources.