Financial Advisory Service, Inc.

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FAS Monthly Economic & Market Update

June 2018

As of May 31, 2018

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Economic Conditions

Last month we wrote about the narrowing gap between the number of jobless claims and number of job openings. As of April that gap has gone negative. That means there are now more job openings than number of people searching for jobs. In April US job openings rose to a seasonally adjusted 6.698M while the number of unemployed Americans was at 6.3M according to the Labor Department. The unemployment rate in May fell to 3.8% – an 18-year low. This is somewhat of a double-edged sword. On one hand, it is a positive for workers who should benefit from a tighter labor market through wage increases. On the other hand, with higher wages comes higher prices – assuming companies can pass higher input costs onto customers – or potentially lower margins for those who can't pass the costs along. With higher prices comes higher inflation. Higher inflation means higher interest rates and a potential threat to the economy if prices and/or interest rates rise too quickly or too abruptly. The Fed is expected to increase interest rates by another 0.25% in June and it would be the second rate hike in 2018 and seventh rate hike since the Fed began raising rates in 2015.

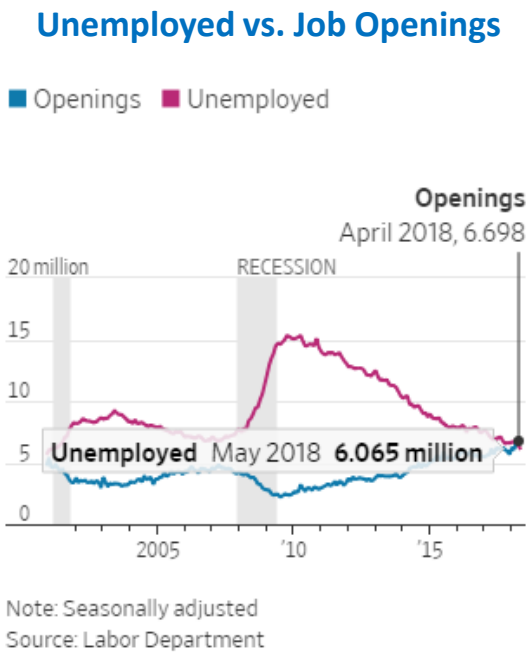

Image Source: Wall Street Journal

Market Conditions

The old Wall Street adage of "sell in May and go away" would have again been a losing strategy so far for anyone who adhered to it last month. All three major U.S. indexes were up over 1% for the month of May with tech leading the pack as the NASDAQ returned 5.32%. The S&P 500 returned 2.16% while the Dow Jones Industrial Average returned a more modest 1.05%. International stocks, specifically those in emerging markets, lagged their U.S. counterparts as the dollar rally that began in April continued to last throughout May. A weakening dollar has been beneficial for foreign markets by making imports more affordable and making it easier to service their dollar-denominated debt. A reversal in the dollar began in April as bets against the dollar started to unwind as the dollar strengthened. This could cause more trouble for returns in foreign markets as the Fed continues to raise interest rates which could lead capital to flow from foreign sovereign debt back into U.S. Treasuries. Despite reaching 3.11% in May, the 10-year Treasury yield fell slightly last month as the Barclays US Bond Aggregate rose 0.71% for the month.

Index Returns

	May '18	YTD
S&P 500	2.16%	1.18%
DJIA	1.05%	(1.23%)
NASDAQ	5.32%	7.80%
MSCI EAFE	(2.81%)	(3.15%)
Barclays Aggregate	0.71%	(1.49%)

Tit-For-Tat Tariffs

Two months ago we wrote about the prospects of a potential trade war as President Trump had recently announced that he would impose tariffs on imported steel and aluminum, citing matters that relate to national security in Section 232 of the Trade Expansion Act of 1962. Those tariffs were indeed imposed June 1 on Canada, Mexico and the European Union. Since then the President's rhetoric has grown even more aggressive, especially following the events at the recent G7 meeting in Quebec last weekend when President Trump reversed his decision to support a G7 communique that laid out a number of shared topics, one of them being trade. After lambasting Canadian Prime Minister Justin Trudeau on Twitter for stating that Canada would be following through with retaliatory tariffs and claiming he made "false statements," President Trump stated he would be instructing "U.S. Reps to not endorse the communique." Politics aside and regardless of personal views of the President, the recent events that have unfolded have the potential to further complicate issues in the trade arena. Markets were, for the most part, unshaken when the tariffs went into effect at the start of the month mainly due to the fact they were fairly insignificant with respect to each of those regions' economic growth. What is not insignificant, in addition to the retaliatory tariffs imposed by trade partners, are the threats of actions the President vowed to take next, which entail imposing tariffs on auto imports. Canada and

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Mexico are the two largest exporters of autos to the U.S. and could have a serious impact on GDP not only for our neighbors to the North and South, but also domestically because the majority of the parts used in the production process of Canadian-built vehicles come from the U.S. If President Trump's main goal is to target the unfair trade policies that favor countries like China, making the North American auto industry less competitive as a whole may not be the best tactic.

That being said, it may be easier said than done considering the fact that it will be harder to make the case that tariffs on vehicles is a matter of "national security." The case was easier to make with steel and aluminum under the guidance of Section 232 as one could argue that disadvantageous trade practices with regard to steel could hinder the U.S. steel industry when it came to building tanks and weaponry in the event of a national security crisis. This line of reasoning may not hold when it comes to Rav4s and Sonatas.

What we have seen over the past year and a half is that the President is not afraid to follow through with his statements regardless of how popular or unpopular they may be. What we now know is that other countries are not afraid to push back in response to President Trump's actions. While all parties have stated that negotiations are still ongoing, the order of trade the world has known since the

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Tit-For-Tat Tariffs

end of the second world war is now at risk of unraveling. Trade issues have been at the forefront of this administration since the start of the year and it does not look like a quick and easy solution will be agreed upon in the short-term. While taking a tough stance with regard to trade may poll positively with certain voter bases, the question is whether or not it will be at the expense of the relationships with foreign allies.

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.

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All dates are as of May 31, 2018 unless stated otherwise.

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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.