The Ten Themes of 3Q 2018

U.S. stocks experienced their best quarter in over five years during the 3Q 2018 period. Over the three months ended September 30, 2018, large cap U.S. stocks, as measured by the S&P 500, gained +7.20%, while stocks of smaller companies, as measured by the Russell 2000, rose +3.26%. Outside of the U.S., stock returns were not nearly as favorable -- the MSCI Developed International Index, which represents mostly Europe and Japan, only rose +1.48%, while Emerging Market stocks actually declined another -0.95% during the period.

We continue to feel confident in the decision we made earlier this year to overweight U.S. stocks to International stocks, even with our recent shift to a lesser overweight focus in domestic markets. The data indicates that the disparity in returns between U.S. stocks and International stocks is likely to continue through the remainder of this year, in part, because of lowered U.S. corporate tax rates and the potential for better trade deals for American companies. We are, also, not overlooking the fact that stocks have had quite a run since their February 2018 lows. As such, beginning in September, our data suggests that investors should avoid becoming too greedy on stocks, since underlying expected corporate profit trends (while still positive) have recently started to level off gradually.

It seems that 2018 has been the year of increased fears. Trade wars, inflation, and rising interest rates, just to name a few, have been in the crosshairs of much discussion, yet, stock prices have climbed higher. As the fourth quarter of 2018 kicks off, there is renewed fear that rising U.S. interest rates will derail economic growth and that additional tariffs will adversely impact global trade. We want to convey, the data we are reviewing does not indicate weakening trends in the upcoming months, nor a recession for 2019.

While fears could run higher than reality and drag down stock prices in the short run, the first nine months of the year, in truth, saw earnings across companies in the S&P 500 index grow at a rate of almost +25%. This represents the best growth we have measured in over eight years. Yet, many are continuing to ignore the positive data points and, instead, fixate on the negative rumors. This creates both challenges and opportunities for patient, diligent investors.

Stay tuned as we objectively measure and analyze the data for any changes that could alter our opinion(s). In the meantime, **here are the ten themes** that we believe **were the most relevant for financial markets over the past three months.**

1. Trade war fears easing?
2. U.S. stock outperformance
3. Emerging Market crash continues
4. More Fed rate hikes ahead
5. Less stimulus abroad
6. Flattening yield curve
7. Commodity prices still contained
8. Bricks in the Wall of Worry
9. Fear trade on and off and back on again
10. Global stock market performance

Based on our interpretation of current data, the Resolute Wealth Advisor Investment Committee moved from a 10% overweight to a 5% overweight view on equities. Further within equities, we believe an overweight to U.S. Equities and Real Estate, and an underweight to Developed and Emerging Markets International is warranted.

In September, Resolute Wealth Advisor implemented adjustments to target allocations to reflect the above-mentioned views on equities.

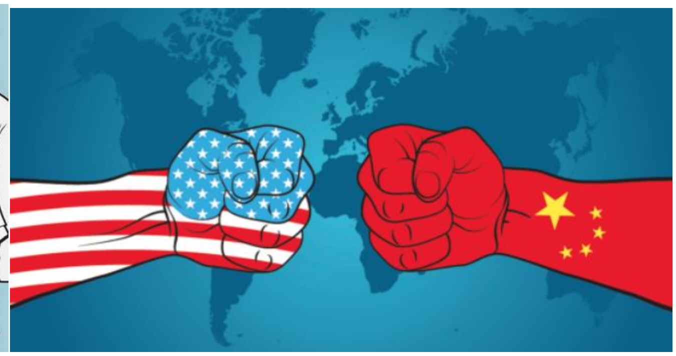
Depending on the design of your specific portfolio, this may or may not impact you. Please contact us if you would like to learn more about the factors influencing these decisions and how they affect your portfolio.

Trade War Fears Easing?

The Trump administration proposed tariffs on Chinese goods earlier this year, which should have come as no surprise as President Trump has talked about America's long-standing unfair trade deal. Still, the threat of a global trade war caused investor anxiety to run high throughout this year. Towards the end of the third quarter those fears eased, somewhat, after Canada agreed to join Mexico in a new trade deal to replace NAFTA. This gave investors hope that the U.S. and China could reach a similar agreement.

Our overall view on this topic has not changed. The threats of an escalating trade war make for great headlines, but the fact remains both China and the U.S. need each other. President Trump is trying to get better deals for the U.S., and, with that in mind, we believe the trade war fears have been overstated with regards to the genuine impact on the economy. Of course, if your business is one in the crosshairs and facing potential increased tariffs, then it could easily have a material impact on your profits; however, with respect to the larger economy and the ultimate effects of additional tariffs, the outcome will very likely be quite minimal.

Fear of a China / US trade war is a worry



A trade war is unlikely though because both sides need each other

U.S. stock outperformance

As mentioned previously, the S&P 500 Index posted its best quarterly gain in over five years during the 3Q 2018 period by rising +7.20%. In fact, the large cap index has now posted six total months of gains this year. Additionally, small cap U.S. companies saw growth during this period, but not quite as strong as large caps, with the Russell 2000 index posting a gain of +3.26% -- now up +10.49% YTD.

We continue to favor smaller U.S. companies over larger ones, as last year's tax rate cuts and the tough negotiations on trade practices seem to work in their favor. It is interesting to note, that, as trade war fears began to ease in September, the Russell 2000 index fell -2.54% during the last month of the 3Q 2018 period.

Emerging Market Crash continues

Many of the major stock indices we track in the MSCI Emerging Market index remain in decline. We have been underweight International stocks this year and we are sticking with that recommendation at this time. Our research indicates that the underlying reasons which have caused Emerging Markets to tumble do not appear to be subsiding any time soon. Any potential for less favorable trade conditions, exacerbated by the rising value of the U.S. dollar, is likely to continue having a negative impact on developing economies. During the first nine months of 2018, you can see on the next page how U.S. equities have fared when compared foreign, and how our decision to underweight global investments may have impacted recent results.

Country	Stock Index	*3Q 2018 Return	*YTD Return
U.S. Small Cap	Russell 2000	3.26%	10.49%
U.S. Large Cap	S&P 500	7.20%	8.99%
Portugal	PSI	-3.06%	-0.54%
Canada	TSX Composite	-1.26%	-0.84%
U.K.	FTSE	-1.66%	-2.31%
South Korea	KOSPI	0.73%	-5.04%
Germany	DAX	-0.48%	-5.19%
Italy	MIB	-4.23%	-5.22%
Indonesia	JSE Composite	3.06%	-5.96%
Spain	IBEX	-2.43%	-6.52%
Hong Kong	Hang Seng	-4.03%	-7.12%
Ireland	ISE	-6.59%	-7.33%
Greece	ASE	-8.70%	-13.79%
China	Shanghai Composite	-0.92%	-14.69%
Philippines	PSEi	1.16%	-14.97%

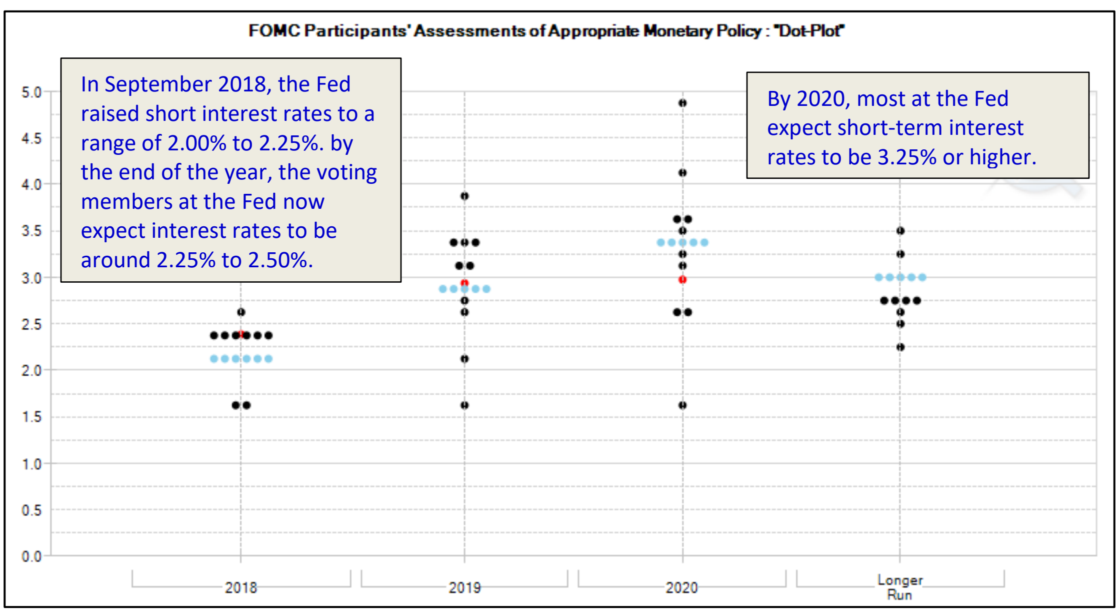
*As of September 28, 2018

Source: Bloomberg

More Fed rate hikes

On September 26, 2018, the Fed hiked its benchmark federal funds rate by another +0.25%, to a range of 2.00-2.25%. The policy setting FOMC (Federal Open Market Committee) envisions one more rate hike this year. If that occurs, it would mean a total of four rate hikes in 2018. Back in March 2018, the FOMC was only expecting three rate hikes this year. The more aggressive Fed is causing some investors to get nervous and chatter of rising inflation is increasing.

With short-term interest rates expected to be around 2.25% to 2.50% by the end of this year, we continue to track what that could mean for the economy (and stocks) with regard to the impact on overall corporate profits.



Blue dots indicate the median projection. Data is based on the economic projections from September 26, 2018. Red dots indicate the effective rate implied by the year-end FedFund future price. Each shaded circle indicates the value (rounded to the nearest 1/8 percentage point) of an individual participant's judgement of the midpoint of the appropriate target range for the federal funds rate or the appropriate target level for the rate at the end of the specified calendar year or over the longer run. One participant did not submit longer-run projections for the federal funds rate.

Less stimulus abroad

With the U.S Federal Reserve focusing on normalizing interest rates by raising them closer to former levels, central banks outside of the U.S. continue to push stimulus dollars into their economies. If you recall, the European Central Bank extended its QE bond buying program this year, even though its original intent had been to end the program at the end of last year. While stimulus efforts were extended, the effort was cut in half earlier in the year, and, was successfully cut in half, again, in September. The ECB states the focus is now to put an end to their stimulus agenda by the end of this year.

The data we've gathered detailing the impact of the global central bank stimulus efforts on improving macroeconomic expectations throughout the last decade reveals that less maneuvering from monetary policy makers could be leading to an adverse outcome on expected global economic growth. So, we remain cautious in our exposure to international markets.

Keeping the above information in mind, we cannot overlook the help we have had on the fiscal policy side in the U.S. with the Tax Cuts and Jobs Act and decreased regulation. We expect this relaxed fiscal policy to help extend the current economic cycle throughout the end of 2018, at the very least.

Flattening Yield Curve

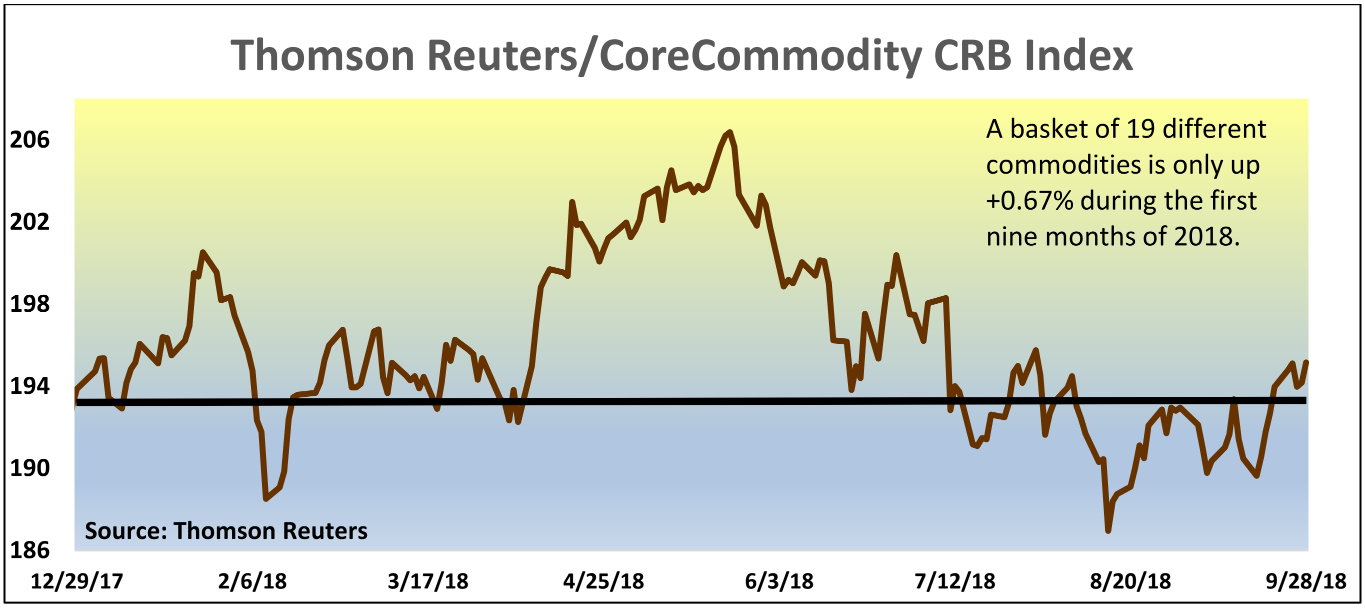
To reiterate the definition detailed in prior communications: the U.S. yield curve is often referred to as "the spread between the rate on a 2-year note and a 10-year U.S. treasury bond." When the spread widens (i.e. steepening yield curve) between the rates on 2 and 10-year notes, it usually indicates an expanding economy. When the spread narrows (i.e. flattening yield curve) it typically means less robust economic growth on the horizon. When it inverts (i.e. the rate on a 2-year note becomes higher than that on a 10-year bond), it indicates a pending recession. In the last 20 years, the yield curve has inverted twice. Once in 2000 before the dot.com collapse and again in 2007 before the financial crisis of 2008.

The yield curve was +51 basis points at the beginning of 2018, with rates on the 2- and 10-year notes being 1.89% and 2.40%, respectively. At the close of 3Q 2018, the rate on a 2-year note had risen to 2.81% while the 10-year rate only rose to 3.05% -- the yield curve narrowed 27 basis points in 2018 to just +24 bps. While we would prefer to see this yield curve steepen, predicting improved economic growth ahead, we continue to keep close watch on the long-term trend. The bond market remains cautious, as it has been all year throughout the heightening market returns we've experienced.

Commodity prices still contained

From August 15, 2018 through the end of September, commodity prices, as measured by the Thomson Reuters Core Commodity CRB index, which tracks 19 different commodities from crude oil to orange juice, rose +4.39%. However, this marks commodity prices up only +0.67% YTD.

With investors concerned over an abrupt rise in inflation, this moderate increase in commodity prices indicates we are unlikely to see it any time soon – certainly, not too aggressively. And, keep in mind that falling commodity prices are usually a sign of slowing economic activity. We are reading these gradually improving prices in commodity markets as a signal of a gradually improving economy.



Bricks in the Wall of Worry

The Wall Street adage of "stocks climbing a Wall of Worry" continues to be the case we are seeing this year. With stock prices reflecting future earnings expectations for each company, the market prices in negative rumors and speculation for a company, and those negative factors get discounted into a company's stock price, even if those negative things never occur. Ultimately, the stock price will rise "climbing a wall of worry."

In 2018, negative speculation has caused the stock market to sell off more than once. If any of this speculation begins to negatively impact corporate earnings expectations, then lower stock prices would be justified. However, at this time, we acknowledge these threats as potential negatives, but are still not measuring a deterioration in U.S. earnings expectations.

Fear trade on and off and back on again

Fears have waxed and waned and then reared their ugly heads again during the course of the year. However, the main long-term driver of stock prices are changes in earnings expectations, and those have been very stable. The 1st quarter of 2018 represented the first time in over seven years that we measured most companies in the S&P 500 *raising* their earnings expectations after reporting results. With revenue growth running near +10% among S&P 500 companies during the 1H of 2018, the chances of seeing an extended rally continue to be strong. This is why we will be closely monitoring 3Q 2018 top-line sales growth as corporations continue to report late into October 2018. If revenue growth stays strong, the market sell-off this month will be unjustified. If it weakens significantly, the end of the economic cycle may be near. Until then, we continue to let the data direct us.

How have S&P 500 EPS growth estimates changed? They are remarkably stable!

Date	3Q18E EPS Growth	4Q18E EPS Growth	1Q19E EPS Growth	2Q19E EPS Growth
6/1/2018	23.39%	15.18%	6.29%	7.58%
7/1/2018	23.82%	15.44%	7.11%	7.55%
8/1/2018	22.97%	15.51%	7.32%	7.01%
9/1/2018	22.25%	15.38%	8.45%	6.66%
10/1/2018	21.26%	15.37%	8.79%	6.47%
10/5/2018	21.25%	15.45%	8.61%	6.25%
10/11/2018	21.15%	15.29%	8.61%	6.22%
10/12/2018	21.21%	15.26%	8.57%	6.22%

Source: The Earnings Scout

Global Stock Market Performance Returns

Country	Stock Index	3Q 2018 Return	*YTD
U.S. Small Cap	Russell 2000	3.26%	10.49%
U.S. Large Cap	S&P 500	7.20%	8.99%
India	SENSEX	2.27%	6.37%
Japan	Nikkei 225	8.14%	5.95%
Brazil	Ibovespa	9.04%	3.85%
Taiwan	TSE	1.56%	3.42%
France	CAC	3.19%	3.41%
Australia	S&P/ASX 200	0.21%	2.28%
Mexico	Bolsa IPC	3.86%	0.30%
Thailand	SET Index	10.08%	0.15%
Portugal	PSI	-3.06%	-0.54%
Canada	TSX Composite	-1.26%	-0.84%
U.K.	FTSE	-1.66%	-2.31%
South Korea	KOSPI	0.73%	-5.04%
Germany	DAX	-0.48%	-5.19%
Italy	MIB	-4.23%	-5.22%
Indonesia	JSE Composite	3.06%	-5.96%
Spain	IBEX	-2.43%	-6.52%
Hong Kong	Hang Seng	-4.03%	-7.12%
Ireland	ISE	-6.59%	-7.33%
Turkey	BIST 30	4.95%	-12.78%
Greece	ASE	-8.70%	-13.79%
China	Shanghai Composite	-0.92%	-14.69%
Philippines	PSEi	1.16%	-14.97%

*As of September 28, 2018

Source: Bloomberg

Conclusion

Last year's global stock rally was built on hope and speculation that easy fiscal policy would lead to increased profits and higher stock prices. Lower U.S. corporate taxes have led us to be even more optimistic that CEO's are spending those savings on property, plant and equipment. This has already supported improved revenue growth for S&P 500 companies and has been a feather in the cap of the Trump Administration. However, markets are having a difficult time with the prospects of a Trade War with China and the Fed wanting to raise interest rates even higher.

While fears may grow and create short-term turmoil in markets, we expect more U.S. stock outperformance over International markets, as well as increased benefits for U.S. small cap companies over large cap companies. More so than ever, we will be paying close attention to U.S. monetary policy. The Fed has taken steps to raise interest rates and reduce the size of its balance sheet. We will closely monitor the impact any additional tariffs will have on global economic activity, and we continue to ask, "will all the bricks in the wall of worry derail the improving economic growth?" Maybe, but our research indicates that it is still not likely at this point.

While we take great pride in our measurement and understanding of all the economic and earnings data, it is impossible for us to know every major market factor in advance. Because of this, we continue to apply our fundamental beliefs that risk and return are related, markets are efficient over time, profitability matters and diversification is key. These fundamental beliefs continue to be the core of our short-term and long-term investment approach.

We hope you found this information useful and encourage you to approach us with any questions you may have. We look forward to our next conversation.

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