



MARBLE TRAIL ADVISORS

Financial Planning & Wealth Management

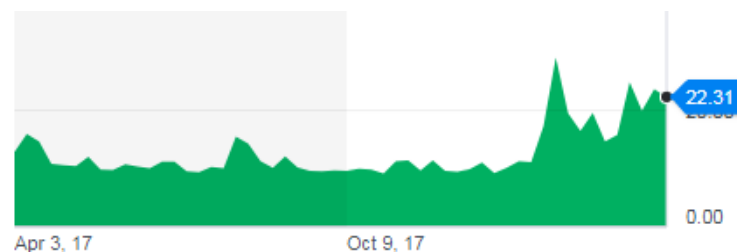
Market Update

1st Quarter 2018

Global Stock Market Highlights

- ❑ The sudden return of volatility in the US rippled through stocks globally. Developed markets across North America, Europe and Asia reversed January gains to finish down slightly for the quarter.
- ❑ In times of turbulence, emerging markets usually fare the worst, but that was not evident in Q1. Instead, rising oil prices helped regions like Latin America to respectable gains.
- ❑ With the UK seeming remarkably unprepared for Brexit, stocks sank 7%, weighing on Europe and making it again the worst performing region.
- ❑ In Asia, concerns over global trade dragged down stocks in China and Japan, offsetting gains in Taiwan and Singapore.
- ❑ Despite the pullback in markets, profit growth remains strong, driving valuation down for all but emerging markets. Relative valuations are largely unchanged, as the U.S. remains relatively expensive and emerging markets look moderately attractive.

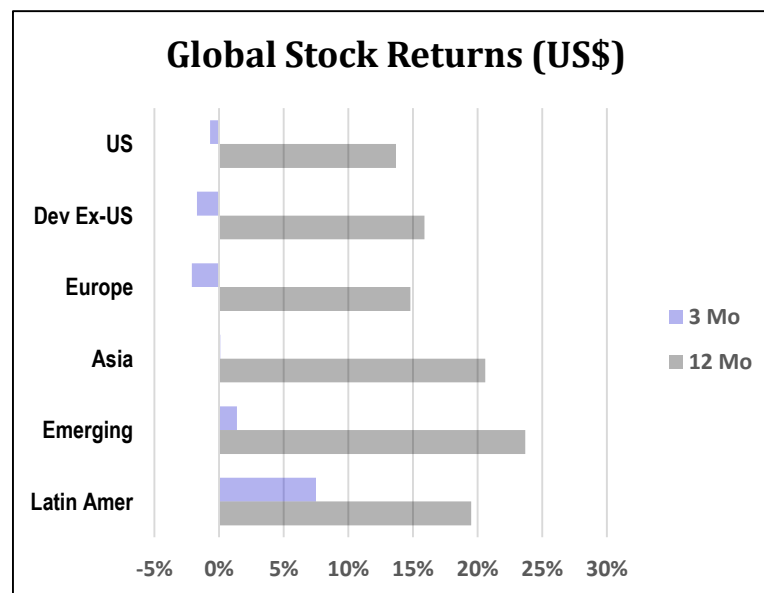
Vix Volatility Index



Source: Yahoo Finance

P/E Ratios	Current	1 Yr Ago	3 Years Ago
S&P 500	20.8	21.3	19.1
Russell 2000 (Small)	19.9	21.8	20.8
Europe	17.6	19.8	19.1
Emerging Markets	15.8	14.5	14.1

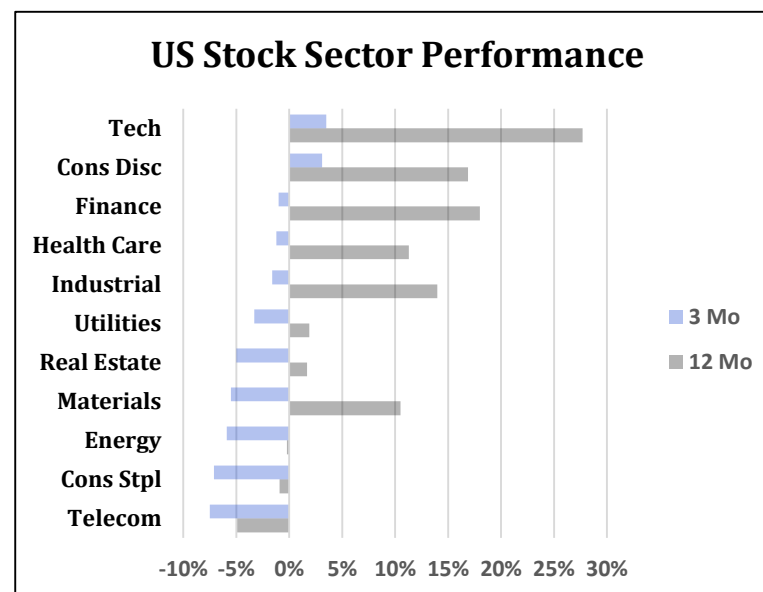
Source: Morningstar



Source: S&P Dow Jones

Stock Sector Highlights

- ❑ The first quarter was actually comprised of two distinct periods – January and the rest of the quarter. In January, stocks climbed steadily and technology remained the key driver of those gains. Netflix and Amazon, technically classified as consumer discretionary companies, were up 40% and 24%, respectively, for the *month*. Traditional tech leaders like Google and Microsoft were up 12%. It looked like 2017 had never ended.
- ❑ Then everything changed. Stocks dropped across the board in February and March, erasing earlier gains for every sector, except for the aforementioned tech and consumer discretionary sectors, which held onto modest gains.
- ❑ Corporate earnings continue to be robust with the first quarter of 2018 estimated to be up 15% year-over-year for S&P 500 companies. With last quarters pullback in prices, P/E ratios are now slightly lower than a year ago, on average. Dividend growth has mostly kept pace with prices, so yields are in line with 3 years ago, except for the tech sector.



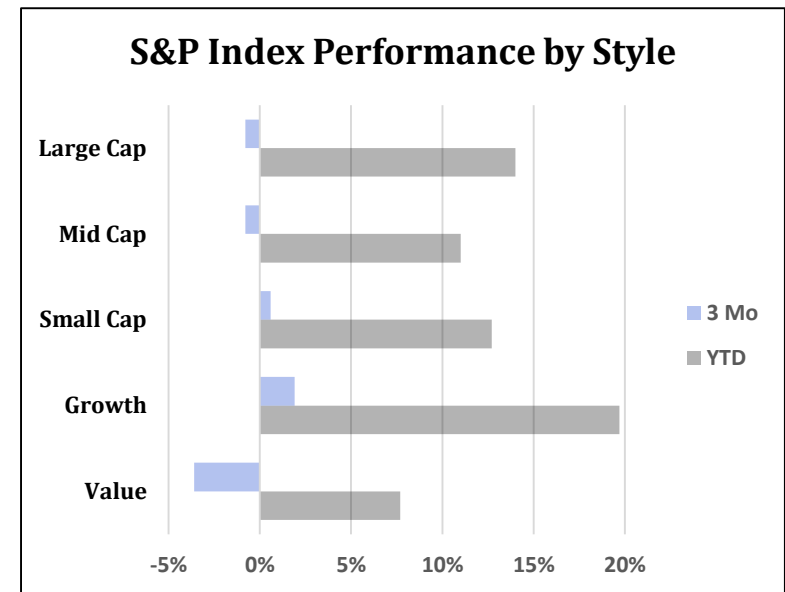
Source: S&P Dow Jones

Sector	P/E Ratios			Yields	
	Current	1 Yr Ago	3 Years Ago	Current	3 Years Ago
Consumer Discretionary	19.8	22.0	20.7	1.2%	1.3%
Consumer Staples	20.5	21.2	20.2	2.8%	2.5%
Energy	17.2	NA	16.4	3.3%	2.5%
Financials	15.4	15.8	15.5	1.6%	1.7%
Health Care	26.2	22.6	23.7	1.5%	1.3%
Industrials	20.8	21.5	18.3	1.8%	1.9%
Technology	23.6	22.3	17.6	1.4%	1.8%
Utilities	17.8	22.0	19.8	3.5%	3.4%
S&P 500	20.8	21.3	19.1	1.8%	1.9%

Source: Morningstar

Stock Market Performance by Style

- ❑ Growth companies built up a big advantage over value companies in January and held onto that lead as stocks fell broadly the rest of the quarter.
- ❑ Smaller companies, on the other hand, reversed trend and held up better than large ones during the correction. Such companies are less reliant on trade and less likely to be buffeted by fears of an impending trade war.
- ❑ With growth outperforming value again, the spread in valuation is the largest of the past decade.
- ❑ Companies that are both small and cheap appear attractively valued, but closer analysis suggests one must be discerning to find true value, as a meaningful proportion of those companies are losing money and skewing the averages.



Source: S&P Dow Jones

Style Box Valuation

18.5	21.8	26.8	Large
18.1	21.8	28.0	Mid
15.0	18.8	28.1	Small
Value	Blend	Growth	

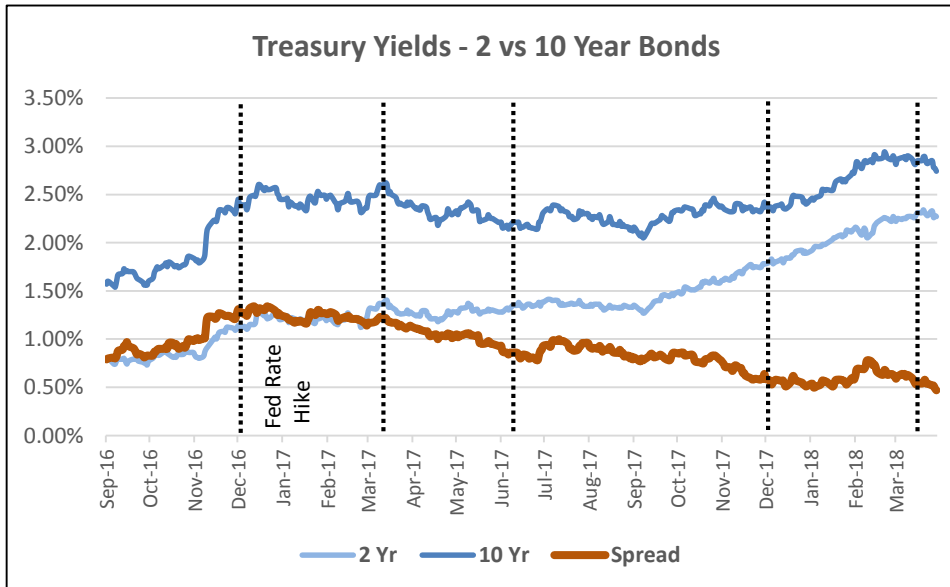
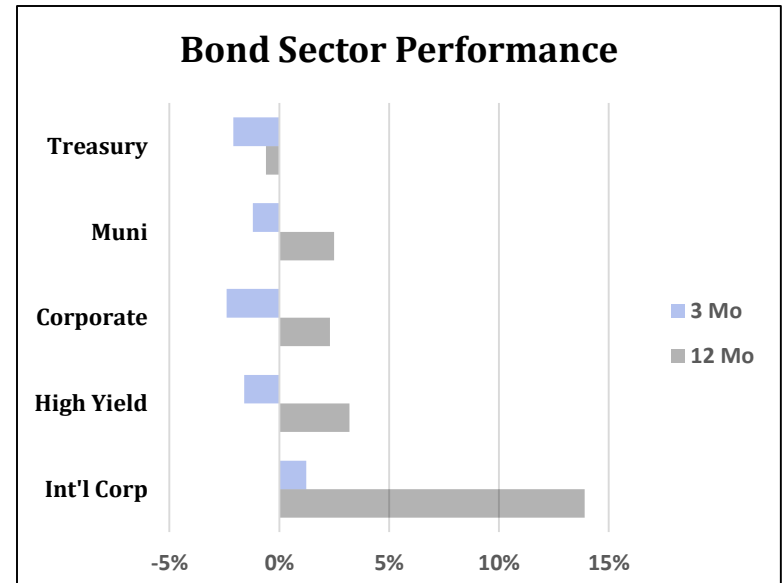
Source: Morningstar, Vanguard

P/E Ratios	Current	1 Yr Ago	3 Years Ago
S&P 500	20.8	21.3	19.1
Russell 2000 (Small)	19.9	21.8	20.8
Large Growth	26.8	24.8	23.2
Large Value	15.9	19.1	17.4
Small Growth	28.1	28.2	27.3
Small Value	15.0	19.4	16.6

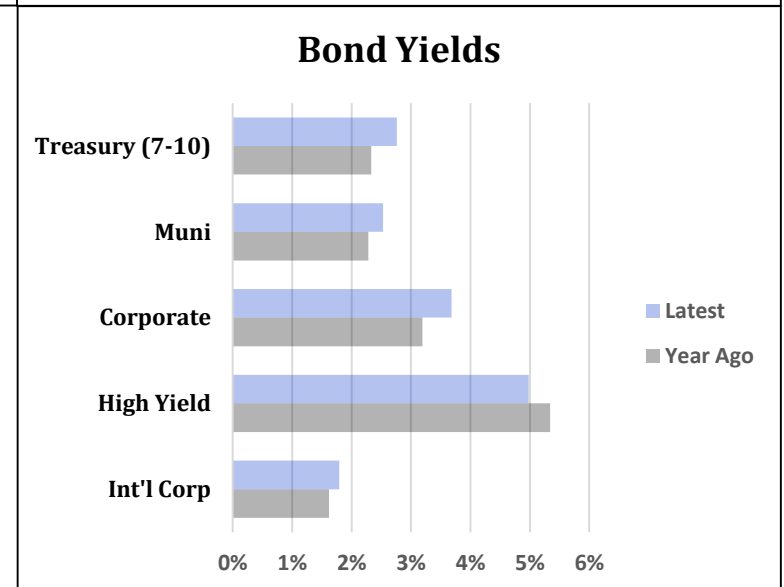
Source: Morningstar

Bond Market Highlights

- Global interest rates shot higher before moderating somewhat in March, but generally remain higher than a quarter and year ago.
- With yields still low by historical standards, price declines led to losses for investors in all sectors of U.S. debt. Foreign bond yields remain paltry, but US investors continued to benefit from a weaker dollar.
- The spread between high yield and investment grade corporate bonds remains narrow, suggesting that the market considers the risk of recession to be quite low. On the other hand, short-term rates have climbed faster than long-term rates, suggesting the market thinks the long-term outlook is less favorable.



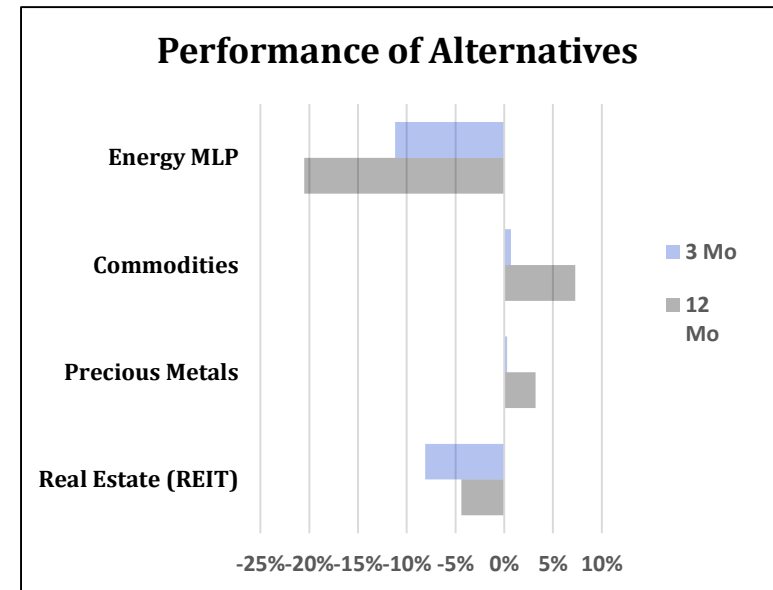
Source: St. Louis Fed



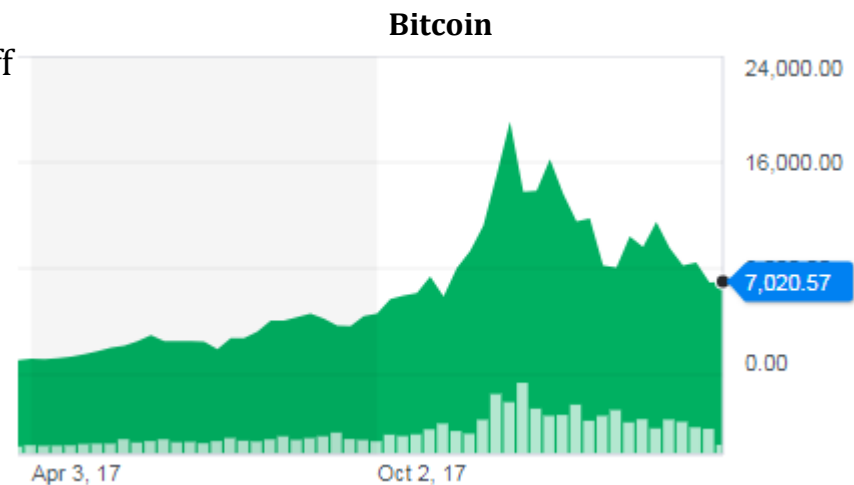
Source: S&P Dow Jones

Alternative Investments

- ❑ Crude oil was among the few commodities to see price appreciation in the 1st quarter, rising 8% to \$65 per barrel. Once again, that failed to lift shares of energy MLPs, which are facing several headwinds. First, higher interest rates have left their relatively generous dividends less attractive vis-à-vis bonds. Second, tax reform reduced the relative advantage partnerships have over C-corporations. Finally, an adverse regulatory ruling may raise the taxes MLPs are required to pay, which could reduce earnings by 1-5%. The market's significant reaction to the plethora of bad news potentially make MLPs one of the few bargains in today's markets.
- ❑ Gold edged up 1% to \$1,330. Sudden spikes in market volatility usually provide more lift to safe haven assets, but that failed to materialize in Q1.
- ❑ No asset took it on the chin more than Bitcoin. It is off by nearly two-thirds since reaching \$20,000 in December. Circumspect regulators and all too-frequent hacking thefts cloud the digital currency's future.



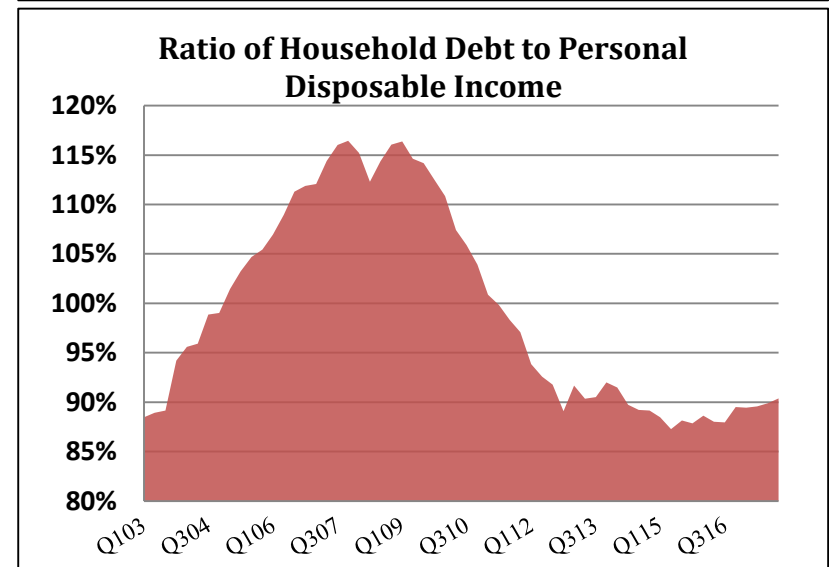
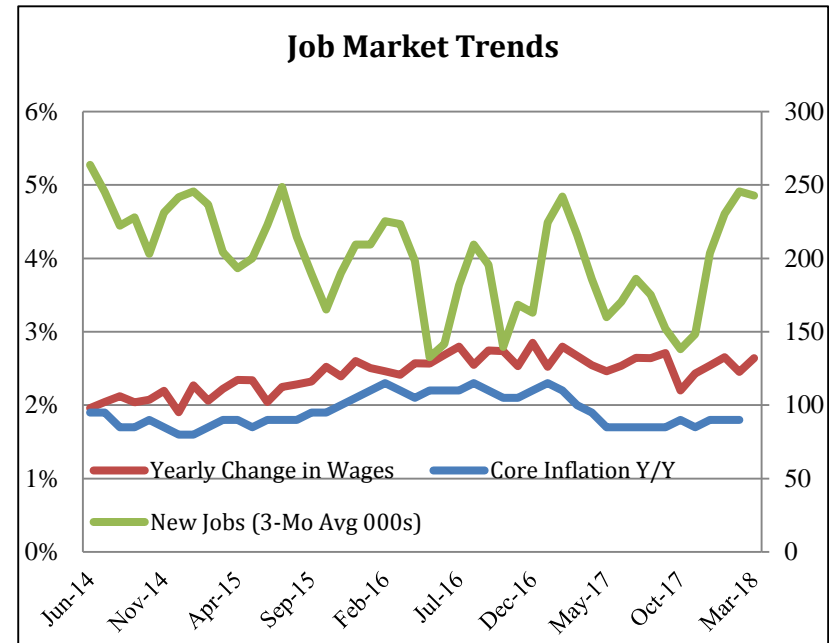
Source: S&P Dow Jones, Morningstar



Source: Yahoo Finance

Economy

- Job growth accelerated to nearly 250,000 per month, while the unemployment rate remained at a 17-year low of 4.1% as the workforce participation rate edged upwards. Reports suggested wage growth accelerated in January, which helped spark the stock sell-off, but the February and March reports were more ambiguous.
- Core inflation inched up to 1.8%, still below the Fed's 2% target. The Fed "dot plot" indicates three total rate hikes in 2018, but now includes a fourth for 2019.
- Long-term rates rose much of the quarter, before losing steam in late March. The Fed has been paring back its holdings of Treasury and mortgage bonds, just as foreign buyers seem to be reducing demand for dollar-denominated debt.
- Fiscal stimulus adds more uncertainty to the outlook, as it could prove inflationary when introduced to an economy at or near full employment.
- Consumer debt continues to edge up with credit cards passing student loans as the fastest growing segment.
- Business investment grew 6% in 2017, twice the rate of growth experienced under the Obama administration. If this leads to renewed productivity growth, the expansion may have legs. If it reflects overexuberance and leads to excess capacity, then a reversal of the business cycle may be nearer than many think.



Sources: ADP, US Depts. of Labor and Commerce, & the New York Fed

Our Macro View

Region	Current Conditions	Long-term Outlook	Investment Implications
USA	Accelerating growth; near full-employment; faintest signs of excesses that typically precede recession.	<p><u>Base</u>: Lower taxes lead to increased spending & business investment in short to medium term; rising debt and interest rates eventually lead to next recession (2-4 years).</p> <p><u>Downside</u>: Stagflation; inflation returns with tight labor markets, but low productivity growth caps growth in GDP & corporate profits.</p> <p><u>Upside</u>: Lower taxes and increased investment lead to permanent rise in growth & productivity.</p>	Stock valuations reflect effect of tax cuts leaving little upside until profit growth follows in earnest; slightly lower than normal weighting to US overall, with emphasis on suppliers to domestic market, generally smaller companies.
Europe	Slowly improving with gains in hiring and inflation; South now improving, but facing political challenges.	<p><u>Base</u>: Irreconcilable differences lead to slow dissolution of the EU in its current form.</p> <p><u>Downside</u>: Nationalist sentiment hastens the process beyond the point of prudence.</p> <p><u>Upside</u>: Germany takes more enlightened view toward providing fiscal stimulus in South.</p>	Market consensus not entirely in line with our base case. Focus on Brexit, but Euro zone could still provide shocks. Slightly lower than normal weightings, moderate currency hedges.
Japan	Marginal improvement with growth and inflation slightly positive; massive public debt.	<p><u>Base/Downside</u>: More of same until debt burden breaks view of Yen as safe haven asset, at which point inflation returns by way of devaluation.</p> <p><u>Upside</u>: Nation implements structural reforms and immigration policy to inject dynamism.</p>	Slightly below normal weightings with focus on exporters and hedging of currency exposure.
China	Slower growth than official figures; heavy industry, interior struggling; consumer strong; public & private debt growing.	<p><u>Base</u>: Continued slowing of economy creates domestic issues absorbing central government resources, pressuring the currency (CNY).</p> <p><u>Downside</u>: Government bungles slowdown, leading to rising unemployment & unrest.</p> <p><u>Upside</u>: Consumer economy grows fast enough to outweigh other problems.</p>	Market consensus seems to be that risks have receded. We are somewhat more circumspect. Selectivity is key; avoid state-owned enterprises, heavy industry; favor consumer and smaller companies.

Our Fundamental View

Fundamental	Medium- to Long-term Outlook	Investment Implications
Stock Market Valuation	Despite recent pullback, all assets are expensive relative to historical averages, which suggests that investment returns for everything from stocks to bonds and real estate will be below long-term averages. Tax cuts justify some of the appreciation since Nov 2016, but companies will have to deliver in 2018. Higher valuations mean more vulnerability to shocks, with North Korea and Trump's trade agenda still being the most proximate risks.	Achieving 5-7% annual returns over the next 5-10 years will require embracing stock market volatility to the extent afforded by your risk tolerance and portfolio withdrawal rate. Diversification will remain key to generating decent returns while managing risk.
Interest Rates	The era of policy divergence has moved to the middle stages with the US tightening and most of the world still accommodative. Powell unlikely to push major policy changes at Fed. Europe, Japan and China, awash in money, have helped contain long-term interest rates in U.S., but weakening dollar has reduced their appetite for our debt. Europe is around two years behind the U.S. in policy, which suggests tightening starts in next 3-5 quarters; disparate North-South conditions cloud that outlook, however. Draghi's successor in 2019 may be German and less supportive of easy money policies.	Continue to employ reasonable hedges against rising rates, including laddered bond portfolios, floating rate notes and cash. With short-term rates high relative to long-term, focus on the near-end of the yield curve for now.