Northport Investment Management, LLC
A Registered Investment Adviser

Market Commentary – 2nd Quarter 2018

It was a jittery, volatile, quarter, with U.S. stocks grinding broadly higher through a thicket of concerns including: global trade tensions, rising interest rates, increasing inflation pressures, and fear of new regulations on giant tech companies. For the quarter, the Dow gained .7%, the S&P 500 advanced 2.9%, and the NASDAQ Composite posted a gain of 6.3%. For the first half of 2018, the Dow is down 1.8% and the S&P 500 stock index is up 1.7% (+2.7% with dividends). The NASDAQ Composite, helped as major technology and internet stocks continued to outperform, came in best, appreciating 8.8%. Small-cap stocks, having more domestic revenue, and therefore deemed less susceptible to global trade wars, have been outperforming in 2018 (the small-cap Russell 2000 index +7.0% year-to-date). International stocks have been underperforming U.S. stocks this year, reversing last year's trend (the developed markets MSCI EAFE Index -2.3% in 2Q 2018, -4.5% year-to-date, and the emerging markets MSCI BRIC Index -7.4% in 2Q 2018, -5.6% year-to-date). Only four of the eleven S&P 500 sectors are positive year-to-date. Consumer Discretionary (+10.8%) and Technology (+10.2%) are the best. Telecom (-10.8%) and Consumer Staples (-9.9%) are the worst.

Bonds turned in mixed, lackluster, performance in 2Q 2018. The taxable Barclay's U.S. Aggregate Float Adjusted Index returned -.21% for the quarter and the tax-exempt Barclay's 1-15 year Muni Bond Index returned +.85%. Both indices are negative year-to-date. The yield on the benchmark ten-year Treasury note rose from 2.741% to 2.847% (yields up, prices down) during the quarter. The ten-year Treasury note yield broke 3% during the quarter, but it didn't hold. The markets appear to be underestimating the Fed's mission to "normalize" interest rates. The markets weak response to inflation data suggests a looking ahead to slower growth coming after the long economic expansion we just experienced.

We expect U.S. economic growth to continue for a while longer. We anticipate the Fed to continue to gradually raise rates another percentage point, or more, over time. We expect the ten-year Treasury note yield to eventually peak somewhere in the mid-to-upper 3% range. The difference between short- and long-term Treasury yields, known as the Treasury yield curve, moved to its flattest level in more than ten years in Q2 2018. The Treasury yield curve is seen as an indicator of the direction of the economy. Steeper curves (long-term rates higher than short-term rates) suggest faster future economic growth. Inverted yield curves (short-term rates higher than long-term rates) usually indicate a recession is coming. We don't see the Treasury yield curve inverting in the near term. When it does invert, there is usually a gap of a year, or more, before a recession starts. We will be monitoring this, historically accurate, indicator, but we do not see the next economic recession coming before 2019-2020.

It’s hard to be bearish on stocks with the strong employment numbers the U.S. economy is producing. Earnings estimates for U.S. companies for the next few quarters are also very strong. The U.S. economy, after a 9-year expansion, is still in a good shape. We remain optimistic on equities, but it is reasonable to expect more modest returns than the recent past. After 2017’s calm, steady, unexpected, spectacular, advance, it is natural to see a volatile consolidation period in 2018. The stock market is adjusting to both modestly higher inflation and interest rates. This environment tends to compress price-to-earnings multiples, making us more reliant on earnings growth. We remain bullish on corporate earnings.

Recent market focus has been on growth and momentum. A relative handful of big tech names has dominated performance. The surge in index funds and ETF’s (exchange traded funds), where many investors do not know the underlying composition of what they own, exacerbates this condition. Narrowly concentrated markets can increase market volatility. The NASDAQ Composite’s outperformance has not dissuaded us from our value-oriented approach. As long-term investors, we know that wealth is not made in three or six months, but over a decade or more. Northport portfolios rebounded in Q2 2018, to near, or slightly above, the flat line year-to-date. Portfolio cash flow was a big part of our positive performance/stability during a volatile time. We are comfortable with our dividend oriented, total return focus. We favor U.S. equities. We expect improving, broader, positive, performance in 2018, with bumps along the way.

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