MONTHLY UPDATE AND COMMENTARY
JUNE 2018

Dear Investor,

Several cross currents have surfaced on our radar in addition to the “wall of worry” we addressed in our last update. As you recall, the market has been creeping up with the help of stronger earnings and a very positive economic backdrop, while trade fears and rising rates have tempered the gains. With the 10-year U.S. Treasury yield in a recent trading range of 2.75% to 3.12% it appears the rate headwind may be off the table as long as the Fed can execute on its soft-landing strategy. Trade tensions will continue to keep a cap on the rally, but Emerging Market and Euro-breakup risk may be the new macro factors to keep an eye on. While Italy struggles to form a new government, it’s possible we could see Euro risk continue throughout the year. This is best reflected in the yield on the Italian 10-year bond, which has spiked from 1.8% to 3% in the last six weeks. In addition there is rhetoric coming out of the ECB about ending QE, which would be very poorly timed given the Italian uncertainty. More than likely a pro-Euro coalition will rise out of the Italian political ashes and this should be reflected in Italian sovereigns which we are closely monitoring.

Of more concern to us from a macro perspective is the meltdown going on in Latin America. In a monthly update about a year ago we pointed out the laughably oversubscribed Argentine 100-year bond issue from a country that has defaulted multiple times in the last hundred years, and it now looks like the home of Messi is on that path again. Just today the IMF agreed to a $50 billion stand-by loan to Argentina which is loaded with austerity requirements. While Argentina accounts for under 1% of global GDP, much-larger Brazil may be the next shoe to drop. They are dealing with anemic growth following a recent recession, and the toxic political situation has put renewed pressure on the Real, which has dropped over 18% in the last six weeks.

These risks combined with the other wall of worry issues bring into doubt the global synchronized-recovery mantra that has been promoted all year. As long as the U.S. economic engine continues to fire on all cylinders and China continues to grow in the 6% plus range, we remain sanguine about the prospects for positive market returns this year and will continue to favor an overweight in U.S. equities. We still believe we are in the sixth or seventh inning of a bull market but the risks continue to mount. Please call or email me with any questions or comments.

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