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Relative Market Performance

	2Q	YTD	1YR	3YR
Dow Jones Industrial Average (U.S. Large Stocks)	3.95	9.35	22.12	11.01
Standard & Poor's 500 (U.S. Large Stocks)	3.09	9.34	17.90	9.61
Wilshire 5000 (U.S. Stocks)	2.95	8.73	18.54	9.34
MSCI EAFE (Foreign Stocks)	6.12	13.81	20.27	1.15
MSCI EM (Emerging Market Stocks)	6.27	18.43	23.75	1.07
MSCI ACWI (World Stocks)	4.27	11.48	18.78	4.82
Barclays Capital U.S. Agg. Index (U.S. Bonds)	1.45	2.27	(0.31)	2.48

Source: Morningstar

Market Outlook

Going forward, U.S. investors may need to lower their long-term return expectations and raise their volatility assumptions. Years of excessive central bank liquidity have driven asset values to new highs while keeping equity volatility low. With the Fed indicating their intention to further tighten monetary policy, careful consideration of where valuations are today is prudent.

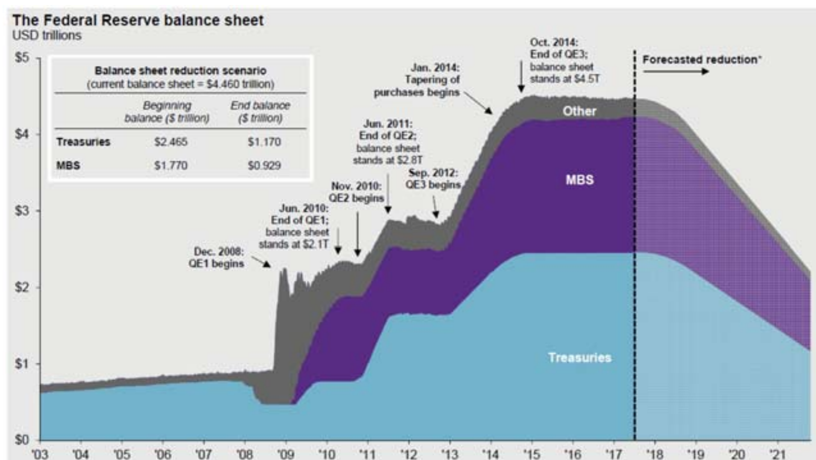
From an equity perspective, while valuations in the U.S. are full, they are not incredibly high. Positive trends in earnings also remain generally supportive of equities. Overall, current fundamentals would allow the market to run much longer. From a technical standpoint, market breadth has narrowed due to the return of the S&P 500 year-to-date being driven by a handful of stocks. This in itself is not a sign of a pending correction as it can be a common occurrence, but it could signal a less than favorable outcome. Following years of strong performance from U.S. equities, keeping an open mind and maintaining a diversified allocation is important because timing the market can be difficult. From a fixed income viewpoint, bond valuations are stretched further than equities. Bonds should find support from natural buyers who need a reliable stream of income such as pension funds and endowments. However, this late in the cycle, investors should be aware of the potential risk in credit from defaults or spread-widening if interest rates rise as bond prices move inversely to yields.

Outside the U.S., equities look more attractive and the market has started to take notice. Fundamentals across Europe continue to improve as earnings momentum grows amidst broadening global growth supported by accommodative central banks. Populist sentiment that was a cause for concern at the beginning of the year seems to have subsided as pan-European election results have remained decidedly pro-Europe. Meanwhile, emerging markets remain the engine of global expansion. Like Europe, earnings momentum for emerging market stocks has accelerated. Although sentiment continues to improve, political and policy risks remain.

KEY POINTS

- Going forward, investors may need to adjust their long-term return and volatility assumptions.
- The trend of global balance sheet expansion may be near an end.
- Going forward, look for a more diverse set of outcomes across both region and asset classes.

Interest Rates



Source: JP Morgan Asset Management

As the U.S. economy has approached the Federal Reserve's definition of full employment and stable pricing, the focus of the Fed has shifted from the normalization of not only interest rates, but to that of its balance sheet. At $4.5 trillion of treasury and agency securities, a reversal from the Fed should stop the expansion of global reserve balances. The Fed anticipates reducing its reserve balances to a level which has not been seen in recent years. This may put pressure on the price of bonds, potentially pushing long-term rates higher. Financial stocks could benefit in a market were yields are steepening, but if rates rise too quickly it could dampen economic growth as well. While the Fed is looking to initiate balance sheet normalization as early as September or October, the easing of the European Central Bank and the Bank of Japan may damper on how high rates in the U.S. ultimately move.

In Summary

It is hard to time the markets, but nearly a decade into recovery one must begin to question how long it can last. As central banks begin to tighten their grip on monetary policy, it is possible to see a more diverse set of outcomes across both region and asset classes. Correlations between stocks in the U.S. have already begun to fall whichh is an indication that this trend may be in motion. Despite the length of the recovery, the breadth of global growth and earnings momentum is encouraging and could propel the U.S. to one of its longest expansionary periods in history. However, complacency with regard to risk expectations could surprise some investors. As an investor, one of the biggest risks is the one that you do not forsee. Mitigating hazards through a systematic approach to portfolio diversification is an integral process in targeting an appropriate risk and return outcome.

In volatile markets investors should remain focused on their long-term objectives. Asset allocation strategies developed for a portfolio provide a roadmap to follow in times of duress. Steps may need to be taken to ensure capital preservation, but must be weighed against their potential impact on long-term performance. Implementing a disciplined, strategic approach with portfolio allocation across varying asset classes is an important element of a successful investment strategy. That's why at TrustCore, we believe in creating a customized, well-diversified portfolio to help you meet your long-term financial goals.

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