August 2018

MEEDER INVESTMENT MANAGEMENT

Monthly Market Commentary

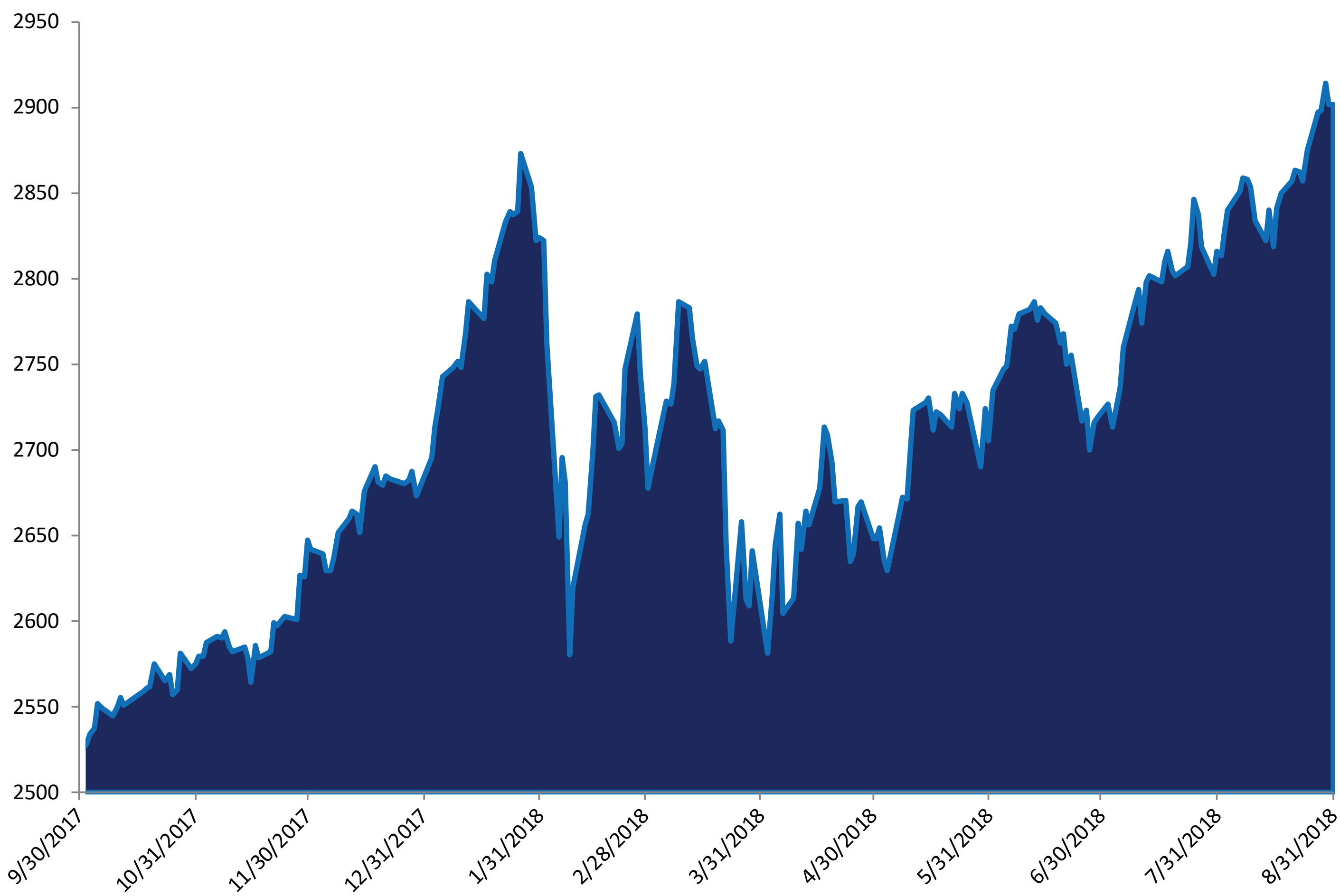
Discussion Points

- S&P New High
- Broad Economic Strength
- U.S. Mexico Trade Agreement

Capital Markets Update

While there is no "industry standard definition" on what constitutes a bull market's beginning, some investors feel that this expansion became the longest bull market in history. The definition these investors are referencing is based on an expansion continuing until there has been a 20% correction. Technically, this did not occur in October 1990 as the market fell 19.9%. Therefore some feel the longest bull market began after the crash in 1987 and continued to 2000. Others believe that a bull market isn't born until a new high is reached. Regardless of which definition you follow, economists on both sides of the argument likely agree that the economy is still showing strength. This month, the S&P 500 Index hit a new all-time high, surpassing the 2900 level. The Index is now up 9.94%, year-to-date. By reaching this new high, it has officially pulled out of the base-building process that began after reaching correction territory on February 8th when it declined by more than 10%.

The End of Base Building



Source: Bloomberg, S&P Price Return

There has been broad support in the marketplace that has propelled stocks upward. One illustration is August's ISM Manufacturing Index reading of 61.3, which easily exceeded estimates of 57.7. Consumers also felt good about the outlook of the economy as the University of Michigan's Consumer Sentiment Index rose significantly. Many investors feel that the most important indicator is the Conference Board's Index of Leading Economic Indicators. This index is used to attempt to predict economic conditions for roughly the next six months and exceeded consensus estimates in July, reaching yet another new all-time high. So where do we go from here?

One catalyst that could propel the market higher is government spending. It has lagged significantly this year because a budget deal was not reached until late March 2018. This caused Federal agencies to restrain from spending at their normal levels. Once the budget deal was reached, it provided some agencies with higher levels of funding than the previous budget. Now, this money must be allocated before the fiscal year ends on September 30th. In 2017, government spending made up roughly 17% of GDP and, if this increase is spent, it could provide a boost to U.S. economic activity.

International markets represented by the MSCI EAFE and MSCI EM indices continue to be in negative territory year-to-date, down -2.28% and -7.18%, respectively. At the time of this writing, the MSCI EM index has officially reached bear territory as it is fallen 20% from peak to trough.

Fixed income markets have continued to struggle and remain down -0.96%, year-to-date. The Treasury yield curve continues to flatten, but remains positively sloped. This month, the difference between the 10-year and 2-year Treasury spreads reached as low as 0.18% before finishing August at 0.24%. An inversion of the curve has occurred prior to each recession since 1960. The Fed meets on September 26th and markets are predicting that the meeting will be all but a formality to raising rates by 0.25%. The real question is whether the Fed does the same thing at the December meeting. According to Bloomberg, the likelihood of this happening has now reached 75%. However, the odds may start to moderate as some data recently reported much weaker than expected results. The Consumer Price Index and Producer Price Index results both fell short of expectations. New home sales, which account for nearly 10% of the housing market, have fallen to a 9-month low. Part of this has been due to rising material costs as well as a shortage of labor. These factors have limited the number of homes being built and have continued to keep housing prices inflated.

U.S. & Mexico Reach New Trade Agreement

Earlier this year, President Trump fulfilled a campaign promise by pulling the U.S. out of the North American Free Trade Agreement (NAFTA) that had been in place since 1994. Recently, Mexico agreed to renegotiate new terms that are designed to be more beneficial to both countries. Early indications are that under the new provisions of the trade agreement, Mexican employees will have the right to form unions and follow more favorable labor laws that meet standards set by the United Nations. In addition, the percentage value of any vehicle produced in North America rose from a minimum of 62.5% to 75% and a minimum of 40% of the cars that are assembled in Mexico will need to be constructed by workers earning a minimum of $16 per hour. This is three times Mexico's current minimum wage. In 2017, Mexico exported 1.8 million vehicles to the U.S. Now, Mexico will now be able to export up to 2.4 million cars and sport utility vehicles without a tariff. If this amount is exceeded, the U.S. has the ability to impose a 25% tariff. Finally, Mexico will continue to be permitted to export their agricultural products to the U.S tariff-free. The new trade agreement is valid for 16 years and can be reviewed and renewed every six years. Canada was part of the original NAFTA agreement, but at this time the U.S. remains in talks with the country and negotiations will likely come to a head in the near future.

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