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July 2018

2nd Quarter 2018 Market Commentary

Halfway Through the Year

It's been an interesting first half of the year economically with plenty of volatility inducing headlines. Currently, a frequent topic of discussion is the tariffs imposed by the administration on imports of aluminum and steel, as well as $50 billion worth of tariffs on a list of Chinese goods and products. What remains to be seen is if this a tactic pushing for better trade agreements or something more permanent. Historically, long-term tariffs have a negative impact economically, so we'll continue to monitor these developments with keen interest.

Period Ending June 30, 2018

		Annualized Total Returns					Calendar Period Total Returns						
	YTD	1 year	3 year	5 year	7 year	10 year	2017	2016	2015	2014	2013	2012	2011
Dow Jones Industrial Average	-0.73%	16.31%	14.07%	12.96%	12.85%	10.78%	28.11%	16.50%	0.21%	10.04%	29.65%	10.24%	8.38%
NASDAQ Composite Index	9.37%	23.60%	15.96%	18.54%	16.68%	13.87%	29.64%	8.87%	6.96%	14.75%	40.12%	17.45%	-0.83%
S&P 500	2.65%	14.37%	11.93%	13.42%	13.23%	10.17%	21.83%	11.96%	1.38%	13.69%	32.39%	16.00%	2.11%
Russell 2000	7.66%	17.57%	10.96%	12.46%	11.83%	10.60%	14.65%	21.31%	-4.41%	4.89%	38.82%	16.35%	-4.18%
MSCI EAFE	-2.75%	6.84%	4.90%	6.44%	4.89%	2.84%	25.03%	1.00%	-0.81%	-4.90%	22.78%	17.32%	-12.14%
Barclays US Aggregate	-1.62%	-0.40%	1.72%	2.27%	2.57%	3.72%	3.54%	2.65%	0.55%	5.97%	-2.02%	4.21%	7.84%
Barclays Global Agg. Ex-US	-1.31%	2.78%	3.23%	0.88%	0.08%	1.76%	10.51%	1.49%	-6.02%	-3.08%	-3.08%	4.09%	4.36%

Based on U.S. dollars

Source: RBC Wealth Management as of June 30, 2018

Index Returns

With the exception of the NASDAQ, which is a technology heavy index, domestic large cap indices are relatively flat on the year as seen in the chart above. This is to be expected following a year when most domestic indices were up in excess of 20%. Small cap stocks are trading higher, relative to their large cap counterparts, and international equities are trading lower at the annual halfway point.

Fixed income indices are also lagging through the first half, as they have been impacted by rising short-term interest rates. As rates rise, bond prices have an inverse relationship which has led to the early decline. In our Portfolio Focus models, we are positioned for flat-to-rising interest rate environments which will help us to perform if rates continue their gradual rise.

Portfolio Focus Models

In our Mutual Fund and ETF/Index Fund models, we continue to overweight the international sector, relative to a neutral weighting. We are finding that values in this space are attractive, and we believe that the international markets could have an opportunity to outperform their domestic counterparts over the intermediate term.

In our Core Stock Model, we continue to hold an overweight in the large cap growth sector, but have begun adding to the large cap value sector, as that arena begins to show signs of value.

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Recession Risks

While the bull market that began in the spring of 2009 is still very much intact, pundits and economists are always on the lookout for the next U.S. recession. While there are currently no "flashing red lights" indicating an imminent recession, here are a couple of items to keep an eye on going forward:

Tariffs
As we mentioned previously, a long-term and expansive tariff policy could have a detrimental effect on the economy, both domestically and abroad. While tariffs could ultimately raise prices on imported goods for consumers, they could also end up costing jobs in certain sectors in the long run. If the recent imposed tariffs, and any additional future tariffs, were to remain in place long-term, economic consequences could permeate.

Inverted Yield Curve
Another hot button topic as of late is talks of an inverted yield curve, which occurs when short-term yields rise above long-term rates. This has historically been *one* indicator of a possible recession, with no recession in the past 60 years not preceded by an inverted yield curve (source: RBC Global Portfolio Advisory Committee). However, employment remains near historic lows, wages continue to rise (albeit slower than we would expect given unemployment figures), and the economy continues to accelerate as a measure of GDP.

Federal Deficit
Finally, the federal deficit continues to climb. While the budget deficit is not an immediate concern, it does matter. The government overspends for a variety of reasons, including trying to bolster jobs and the general economy. Increases in military and entitlement spending (Social Security & Medicare) are driving a bulk of the deficit figures. Until Washington can figure out how to address its spending practices, this will continue to be a focus area in the years ahead.

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CD Ladders

As short-term interest rates have begun to rise, we have seen the yields on bank CDs increase. With a number of our clients' "safe money," we have been purchasing laddered CDs. A bond or CD ladder is simply a number of individual securities that mature at staggered intervals. For example, you could build a 3-year CD ladder with bonds that come due every 6 months. Please find attached an easy-to-read fact sheet that provides a bit more detail about this strategy.

Currently, we're finding 6-month CDs, in the 2.00% range, 1-year CDs near 2.50%, and 3 year CDs at 3.00%. All CDs are FDIC insured, up to the FDIC limit of $250,000. If you have cash you're looking to put to work at a competitive short-term rate, please contact us to discuss your needs further.

If there's something you would like to see us address in future issues, email colby.spann@rbc.com so that we can do our best to provide material of interest to you in coming editions of our newsletter.

We want to thank you for taking the time to read this quarter's letter, and more importantly, for choosing to work with us.

Happy Spring (finally)!
The Abrahamson Investment Group
-Kirk, Mike, and Colby

Fixed income ladders

RBC Wealth Management

Take the guesswork out of interest rates

Investing in the fixed income securities can be challenging, because every decision requires you to evaluate credit ratings, maturities, and ever-changing interest rates, among other considerations.

Projecting interest rates is one of the most difficult considerations. However, using a portfolio strategy called "laddering" may help take the guesswork out of fixed income investing by positioning your portfolio to take advantage of opportunities when interest rates go up and reduce risks when interest rates go down.

What is a fixed income ladder?

A fixed income ladder is a portfolio of fixed income securities with a series of staggered maturities. The objective of laddering is to systematically schedule maturities so a portion of the portfolio matures at regular intervals and becomes available for reinvestment in different interest rate environments.

With this approach, you can take advantage of any increase in interest rates by reinvesting these amounts at the higher rate. Should interest rates fall, you can lessen the drop in returns by having the remaining amounts still invested at higher rates.

Illustrated above is a hypothetical five-year, fixed income ladder. Yours may consist of any combination of corporate bonds, U.S. agency and/or Treasury securities, municipal bonds, or certificates of deposit.

		Year 1	Future portfolios			
Initial ladder	1yr Security	3.45%	Year 2			
	2yr Security	3.50%	3.50%	Year 3		
	3yr Security	3.55%	3.55%	3.55%	Year 4	
	4yr Security	3.60%	3.60%	3.60%	3.60%	Year 5
	5yr Security	3.65%	3.65%	3.65%	3.65%	3.65%
Hypothetical reinvestment rates	5yr Security		3.65%	3.65%	3.65%	3.65%
	5yr Security			3.75%	3.75%	3.75%
	5yr Security				3.50%	3.50%
	5yr Security					3.55%
Blended return		3.55%	3.59%	3.64%	3.63%	3.62%

Yields shown are for illustrative purposes only and do not reflect current or future market conditions

When building your ladder, the key is to have securities mature in one-year increments. This schedule of maturities allows you to ladder across the investment horizon (the initial ladder). To maintain your ladder, purchase a new five-year fixed income security to replace the maturing one, thus keeping the maturities staggered in your portfolio.

Ladders may offer peace of mind

As demonstrated in the sample ladder, when continuing to reinvest in this manner, you gain several important benefits: interest rate diversification (no concentration in a single maturity), lower overall volatility, short average maturity, and higher blended return (the reinvestment ladder).

Ladders provide interest rewards

Fixed income ladders provide predictable income and can be structured to provide monthly or quarterly payments. Rather than spend these payments, investors may choose to reinvest the interest payments from the portfolio in the purchase of the replacement bond, thus compounding their investment returns.

Gain confidence in your financial future

Fixed income ladders are a prudent diversification strategy for fixed income investors. The regular maturities and interest rate payments provide a disciplined approach for investors as they will have funds to invest at higher (and lower) rates. This can help to lessen the impact from interest rate fluctuations and reduce risks to investors. To find out more about fixed income strategies and bond ladders, please contact your RBC Wealth Management financial advisor.

Non-deposit investment products: • Not FDIC insured • Not bank guaranteed • May lose value