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Stock performance was strong in July. Large stocks in the S&P 500 index finishing the month up 3.72% bringing its year-to-date return up to 6.47%. Small cap stocks in the Russell 2000 index were up 1.74% for the month bringing their year-to-date return up to 9.54%. International stocks in the MSCI EAFE index were up 2.46% for the month but year-to-date returns were still negative at -0.36%. Emerging market stocks had a monthly return of 1.68% but year-to-date returns are still in negative territory at -6.13%.

Yields on the 10-year US Treasury bond ended the month near their highs at 2.96%. Bond returns for the Barclays Aggregate Bond Index were basically flat for the month at 0.02%. Because of the increase in yields during the year, bond prices are lower and performance continues to suffer; the Barclays Aggregate Bond Index is currently down -1.59% year-to-date.

Second quarter earnings are looking good so far. Estimates have continued to rise during the quarter. Earnings growth was 27% in first quarter. Of the S&P 500 companies that have reported so far in second quarter, earnings have grown 24.1% and revenues have grown 10%. Small cap stocks in the S&P 600 that have reported showed 34.8% growth in earnings and 10.2% growth in revenues.

Initial readings for second quarter GDP growth came in at 4.1%. This is the best growth since third quarter of 2014 when GDP grew 4.9% and the third best quarterly growth rate since 2009. The second half of 2018 is expected to show GDP growth around 3%. Consumer and business spending were both strong as were exports. Anxiety around a possible trade war accounted for some of the increase in exports as US exporters tried to complete shipments before tariffs were imposed.

Economic growth will likely begin to slow in the second half of next year. The boost from tax reform will be largely incorporated by then. In addition, unemployment is very low now at 4.0%. It may get close to 3.2% but probably will not be able to go lower than that. As such, companies will not be able to hire additional workers to fuel their growth because the workforce will already be near full employment, baby boomers are retiring, and immigration is curtailed currently.

Slower growth does not automatically mean recession but David Kelly, chief strategist at JPMorgan, feels that if there was a recession resulting in a bear market, both would be mild – not like what we experienced in 2001 and 2008. He cites that valuations are more reasonable today – there isn't a tech bubble or housing bubble like the last two recessions. The last two recessions were extreme. Since World War II, there have been 11 recessions and the other 9 of those were short-lived and mild with an average correction of only 25% that was easily manageable in a diversified portfolio.

With the strong economy, the Federal Reserve is likely to raise interest rates four more times in the next twelve months. As the Fed has raised short-term rates, long term rates have not risen as much leading to a flattening yield curve. JPMorgan forecasts that the 10-year Treasury yield will top out around 3.35% next year while the short-term Fed Funds rate will reach between 2.75% and 3.0%. Thirty-year mortgage rates are expected to stabilize around 5%.

Markets are likely to remain somewhat volatile over the summer. In recent past mid-term election years, stocks have rallied after the election regardless of the outcome. Diversification should help to smooth out some of the bumps along the way. If you have any questions about your account, please do not hesitate to contact us. Also, if your situation has changed, please let us know that too as investment changes may be necessary.

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