JB MERIDIAN ADVISORS

FINANCIAL & ECONOMIC REVIEW

While the broader U.S. equity markets rebounded from a dismal first quarter of 2018, many of the same themes continued into the second quarter with a few new observations. We saw crude oil prices increase over 17% with a corresponding increase in gas prices felt at the pump. We attribute the increase to several geopolitical factors. OPEC engineered a temporary supply shortage by decreasing their combined output, thereby lowering world supply and driving crude prices higher. At the same time, Venezuela's output has ground to a standstill as the country remains in crisis from its Socialist economic collapse. Additionally, the output from Iran has come into question, as the Trump Administration abandoned the nuclear accord that was established by his predecessor. In the short-term, the likelihood of U.S. Shale producers filling the supply shortage has increased, so we believe the spike in oil prices should remain temporary and likely settle somewhere below $70 per barrel in the intermediate-term.

The Federal Reserve continued on its path toward normalizing interest rates by raising the Fed Funds Rate another 0.25% or 25 basis points on June 13th to 1.75-2.00%. This flattening of the yield curve continued, as the 30-yr Treasury bond ended the quarter only 13 basis points above the 10-yr bond. While the overall employment and jobs outlook is positive for the economy, we remain cautious and restrained due to the implications of a potentially inverted yield curve. Specifically, real estate, utilities and other more rate sensitive sectors of the economy could come under pressure and struggle to achieve gains in this interest rate environment. As we've reiterated in past quarters, managing interest rate risk is key to mitigating losses in fixed-income investments. Subsequently, the Barclays Aggregate Bond index returned -0.2% for the quarter and -1.6% year to date.

The best performing equity sectors in Q2 2018 were Energy, Real Estate and Healthcare, returning 13.1%, 8.0% and 5.8%. Industrials, Financials and Precious Metals were the worst performing sectors, dropping -1.3%, -0.9% and -0.4% respectively. The S&P 500, Dow Jones Industrial Average and NASDAQ Composite Index returned 3.4%, 1.3% and 6.6% in the second quarter, while internationally, the EAFE Index retuned -1.2%. Basic Materials remained the most overvalued sector trading at a 23% premium, down from a 39% premium to start 2018. Communication Services remained the most undervalued sector, trading at an 18% discount to fair value respectively. All other equity sectors ended the quarter within 5% of their fair value estimates. We continue our cautious posture and remain selective when putting new investment dollars to work. We are currently favoring individual stocks that offer higher dividend yields, a strong balance sheet and show positive confirmation on the charts for new money investments.

We appreciate your allowing us to manage your investments and look forward to continually earning your trust and referrals in the second half of 2018.

Jack A. Kennedy
Chief Investment Officer

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[1] Results referenced from Morningstar.com

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