Peregrine asset advisers

2nd Quarter 2018 Market Overview

Forceful headwinds have confronted markets in 2018, a sharp contrast to last year's steady rise. As this year unfolds, it is evident that it has not been a smooth ride for investors.

Even though the major US market indices have rebounded from selloffs and the S&P 500 managed a 2.7% gain for the second quarter, the six month gain is only 1.7% since the index fell in the first quarter. Weakness in the markets has been widespread. By quarter end, the Dow was actually negative. Worldwide markets are a complete mess and are down badly for the year. China and Brazil are down over 20% year to date. Europe, Japan, and Mexico are down over 10%.

The past six months mark the worst first half performance for the S&P since 2010. Consistent with this struggle is that 51.5% of all stocks in the index were in the red at the end of June. The market has shifted from the bullish run it posted in 2016 and 2017. Today, they have a more cautious and skittish tone.

An exception to the overall picture is the NASDAQ, which has fared much better posting a 9% gain through six months. But, this index is volatile and is heavily influenced by a handful of gigantic technology companies. This year, for example, Amazon raced up 44% in six months. It is up 136% in two years. Netflix rocketed up 107%this year and has climbed 334% in two years! It is dicey to invest in these stocks at current levels since they are richly valued and they trade in such a volatile manner.

Smaller capitalization stocks have been another bright spot for 2018 with this index posting a 6.5% gain, so far.

Conventional financial rhetoric cites tariffs as being the primary issue confronting the stock market.

There is probably a deeper force at work than merely tariffs. It is important to realize that it is normal and necessary for the market to sell off after a large and prolonged advance. Reasons that are cited are often merely rationalization, since eventually and inevitably, markets *must* fall. Between the beginning of 2016 and the end of January, the S&P climbed 38%! Market were due for a pullback and it happened in February when the index fell 13%. This initiated the corrective action we are now seeing. Overall, the markets needed to pull back and consolidate and the tariff dispute only provide an excuse.

Where is Goldilocks?

For stocks to emerge from their malaise, our economy needs to accelerate without a simultaneous rise in interest rates and inflation, a goldilocks scenario.

The fact that there is relative weakness in worldwide economies can actually be a contributing factor. German government long term bonds pay only 0.30% and these low rates are certain help keep our rates in check.

In addition, falling commodity prices and the recent surge of new entrants to the labor force combine to dampen the inflation outlook.

The hope for the second half of the year is to enjoy a "goldilocks" period in the economy where growth accelerates but interest rates and inflation remain muted. If this happens, the market should emerge from its recent trading range and climb higher
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Peregrine Portfolio

Returns for Peregrine clients remained in line with the S&P 500 through the first six months. For 2018, our Balanced Composite gained 1.49% and our Equity Composite gained 2.27%.

The market remains bifurcated with many strong areas accompanied by exceedingly weak sections. One of our favorite companies is Caterpillar and it is down 15% for 2018. The banking sector is also out of favor and is down 5%. We recently pointed out to clients that Estee Lauder and NextEra Energy are core holdings for our accounts and these stocks are faring well.

In the event of further market turbulence ahead, client holdings of bonds and commodities protect account values by providing diversification. We also use investments that actually appreciate in value when the stock market drops. Cumulatively, this variation of investments combines to protect our client accounts during declining markets.

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