

MARKET AND ECONOMIC REVIEW & OUTLOOK

AN UPDATE FROM THE ADVISORS AT GASKIN ASSET MANAGEMENT

CHARLOTTE, NORTH CAROLINA

On Thursday, July 26th, Facebook, Inc. shares lost 19% of their market value. Deepa Seetharaman of *The Wall Street Journal* noted that the dramatic price drop was the largest-ever one-day loss for a U.S.-listed company in U.S. market historyⁱ. Let that sink in for a second. Facebook CEO Mark Zuckerberg is alleged to have lost nearly \$16 billion in personal net worth in one day. We heard a rumor that Willie Nelson has plans to organize a “Tech-Aid” fundraiser to help Mr. Zuckerberg recoup his losses. Maybe Amazon’s CEO – Jeff Bezos – will kick in a little for the cause. After all, Amazon is hitting record profits these days after passing \$2 billion in quarterly profits for the first time ever, according to *The Wall Street Journal* writer Laura Stevensⁱⁱ. Okay, so we threw in the Willie Nelson thing just for a chuckle, but the short-term reversal of fortunes is no joke. Should you be concerned about Facebook’s price gyrations? Maybe but probably not for the reasons you might imagine.

It may seem hard to believe but Facebook is only 14 years old and has been publicly traded for just a little over six years following an IPO date of May 18, 2012.ⁱⁱⁱ Yet the loss on July 26th was more than just 19% of its value. That loss was equal to the total market value of the bottom 457 of the 500 companies in the S&P 500 according to Seetharaman & O’Reilly.^{iv} Now let that sink in a bit longer. Facebook is not alone in its dominance in the S&P 500 index as a handful of stocks make up the majority of the market value of the most widely tracked U.S. index. While the weightings may wax and wane over time based on market movements, the index has historically held a much larger weighting in certain sectors of the U.S. economy over others. So, if you are heavily invested in a portfolio that tracks the S&P 500 index, your performance is largely influenced by the fortunes or misfortunes of a handful of leading U.S. companies including Facebook, Amazon, and Apple, which recently became the first U.S.-based company to surpass \$1 Trillion in market value^v. These little details are important since an economic condition which may benefit one company or sector could very well have a different and possibly opposite effect on another.

First Half Review

The three major domestic equity indices ultimately ended in positive territory for the second quarter, after zigging and zagging on headline news, particularly toward the end of June. Volatility due to the threats of escalation on trade continues to be an overhang on the market, explains Ed Mills, Raymond James managing director of equity research and Washington policy analyst. In the past month, the administration has threatened an additional \$400 billion worth of tariffs on Chinese goods, and reports circulated that the administration had planned to invoke an emergency economic power to restrict Chinese tech investment in the United States and implement export controls on technology transfers.

Uncertainty, in this case regarding global trade tensions, often leads to concern among investors. And it seemed investors were trying to digest somewhat conflicting reports of peak earnings, tariff threats and political divisiveness, shrinking yield spreads, lower unemployment and gradually rising inflation.

Foreign financial markets weathered an eventful month as well, as global tariffs hurt these traditionally more open economies. However, Raymond James European Strategist Chris Bailey believes that any lessening of these concerns – which remains very plausible – provides investment opportunities.

Despite end-of-the-month volatility, all of the major domestic equity indices were up for the second quarter. A longer view shows that the NASDAQ, the Standard & Poor’s 500 and the Russell 2000 ended the first half of the year in healthy territory, but the Dow Jones Industrial Average didn’t keep pace.

	12/29/17 Close	6/29/18 Close	Change YTD	% Gain/Loss YTD
DJIA	24,719.22	24,271.41	-447.81	-1.81%
NASDAQ	6,903.39	7,510.30	+606.91	+8.79%
S&P 500	2,673.61	2,718.37	+44.76	+1.67%
MSCI EAFE	2,050.79	1,958.64	-92.15	-4.49%
Russell 2000	1,535.51	1,643.07	+107.56	+7.00%
Bloomberg Barclays U.S. Aggregate Bond Index	2,046.37	2,012.55	-33.82	-1.65%

Performance reflects price returns as of 4:30 ET on June 29, 2018.

Here is a look at what’s happening in the economy and capital markets, as well as key factors we are watching:

Economy

- “The U.S. economy is doing very well,” according to Federal Reserve (Fed) Chair Jerome Powell. The job market has continued to tighten. Inflation, as measured by the core PCE Price Index, has moved up near the Fed’s 2% goal, explains Chief Economist Scott Brown.
- Monetary policy is still accommodative, and Fed officials believe that further gradual increases in short-term interest rates are likely to be warranted. The Fed is trying for a soft landing, a task that has been difficult to achieve in the past.
- Trade policy uncertainty has had a modest impact on the overall economy so far (more significant for some industries than others), but investors may fear that a broader trade war would be more disruptive to the U.S. and global economies.
- Real gross domestic product (GDP) growth is expected to have picked up in the second quarter, but comprehensive benchmark revisions (due July 27) may shift things around.
- Brown believes GDP growth should ultimately settle around a more moderate pace (i.e., 1.5% to 2.0%), reflecting slower growth in the labor force.

Equities

- Despite recent volatility, domestic equities have held up much better than the rest of the world with emerging markets getting hardest hit on trade tensions and the rising U.S. dollar.
- Economic activity and earnings remain pillars of support for the U.S. equity market. Second-quarter earnings season will begin in a few weeks, and estimates have ticked higher since the end of a very strong first-quarter earnings season.
- Managing Director of Portfolio & Technical Strategy Michael Gibbs and Senior Equity Portfolio Analyst Joey Madere are looking to get more color from companies on the impacts of global trade negotiations, margins, inflation and interest rates.

Fixed income

- In three instances since 1986, Fed tightening has led to an inverted curve that was then followed by a recession, but that pattern may not necessarily hold given some of the unique aspects of the current climate, explains Senior Fixed Income Strategist Doug Drabik.
- Drabik notes that it has been two and a half years since the Fed’s first hike (December 2015) which is significantly longer than what led to the past three inverted curves. There is no guarantee we will invert the curve resulting in a recession or that we won’t. The latest round of Fed hikes was preceded by more than seven years of zero interest rates and market effects spurred by quantitative easing.
- Yields and spreads have shifted such that even investors in the highest tax brackets may optimize their short-term returns (i.e., five years and in) with corporate bonds.
- The most recent bond activity appears to be a reaction to headline news. Although some information, such as the potential trade war, is inflationary in Drabik’s view, the safe haven trade into U.S. bonds is at least temporarily countering those effects.

International

- Concerns about disruptions to world trade flows continue to build, particularly impacting emerging markets (e.g., the Indian rupee hit an all-time low against the dollar, and the Chinese stock market flirted with bear market territory), according to European Strategist Chris Bailey.
- In Europe, Germany experienced some unexpected domestic political instability as Chancellor Merkel faced a new challenge to her current political coalition.
- European economic reform efforts appear to be taking a slight backseat to discussions of potential trade tariff responses and internal regional debates such as immigration.
- Using conventional valuation criteria, both emerging and developed markets outside of the United States appear to be attractively positioned for medium-term capital growth and income investors.

We believe you should continue to make decisions based on your long-term goals. A well-diversified portfolio should allow you to participate in upside potential here and abroad, as well as serve as ballast against any short-term volatility as we referenced in our opening comments. Thank you for taking the time to read through this newsletter. We welcome your calls or emails and look forward to speaking with you again soon.

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ⁱ Seetharaman, Deepa and O'Reilly, Lara. “Facebook Loses \$119 Billion in Day”. [The Wall Street Journal](#). July 27, 2018. pB1.

ⁱⁱ Stevens, Laura. “Amazon Hits Record Profit On Services”. [The Wall Street Journal](#). July 27, 2018. pA1

ⁱⁱⁱ Pepitone, Julianne. “Facebook trading sets record IPO volume”. [CNN Money](#). May 18, 2012

^{iv} Seetharaman, Deepa and O'Reilly, Lara. “Facebook Loses \$119 Billion in Day”. [The Wall Street Journal](#). July 27, 2018. pB1.

^v Gurman, Mark. “Apple Becomes First U.S. Company to Hit \$1 Trillion Value”. [Bloomberg.com](#). August 2, 2018.