

HORTER INVESTMENT MANAGEMENT, LLC

Weekly Commentary

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May 7, 2018

Investors are fleeing emerging markets, and more pain could be ahead. Here's why

Emerging markets stocks have been under pressure as the U.S. dollar has gained ground, and one portfolio manager is expecting more pain for the group.

Last week, U.S.-based emerging market equity funds posted their first weekly outflows of the year, according to Reuters, citing Lipper data. The EEM emerging markets ETF fell nearly 2 percent in that time, and 3 percent in the last month.

Chad Morganlander, portfolio manager at Washington Crossing Advisors, explained to CNBC's "Trading Nation" his reasons for selling emerging market stocks. Here's why:

- Emerging markets logged a banner year in 2017, with the EEM

rallying nearly 35 percent for its best year since 2009, as global growth ramped up and the U.S. dollar fell substantially. This year won't be so rosy.

- The U.S. dollar just posted three straight weeks of gains, depressing emerging market stocks in that time, which will likely continue as a headwind going forward.
- The eventual deceleration in China's credit growth, too, will pose a headwind. At this point, however, the U.S. trade policy with China and recent turmoil in the space is not a major factor in emerging markets' performance.

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Historically low unemployment looks great, but April's jobs report carries a warning

April's solid job growth and historically low 3.9 percent unemployment rate are positive signs for the economy, but sluggish productivity growth and tepid wage growth raise red flags.

The economy added 164,000 jobs last month, and unemployment fell more than expected, but wage growth was just 0.1 percent, half of what was expected.

Economists said the report was mostly positive. But along with other data this week, it highlights the divide between a tightening labor market and slow productivity growth, running at a sluggish pace of 0.7 percent in the first quarter.

While the market sees slower wage growth as a potential brake on Fed rate hiking, economists say the Fed will look at the strong hiring and the drop in the unemployment rate as a green light to continue raising interest rates.

The trend of low productivity growth suggests businesses are not yet pumping money into the type of spending that will sustain higher economic growth and future earnings growth, potentially causing longer term problems for the economy if the Fed keeps hiking rates.

"Main Street is doing okay without productivity picking up. Wages are climbing. Job creation is wonderful. Confidence is high," said James Paulsen, chief investment strategist at Leuthold Group. "But for Wall Street, 3.9 percent unemployment, and if you're still going to create 100,000 jobs, you're still going to pressure costs, wages and inflation, and you're still going to have the Fed raising rates. The problem, without productivity is the lack of growth is problematic for Wall Street and for equities."

Economists had expected strong job growth of 192,000 and a drop in unemployment to 4 percent. Despite the lower payroll number, with prior month revisions, the three month average for job growth was 208,000.

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QUOTE OF THE WEEK

"Silence is the sleep that nourishes wisdom."

-Francis Bacon

Taking a comprehensive look at the overall current stock market

Taking a comprehensive look at the overall current stock market, you can see the chart below representing eight major indices and their returns through the week ending May 4, 2018. In a truly diversified portfolio, the portfolio's total return is determined by the performance of all of the individual positions in combination – not individually.

So, understanding the combined overall performance of the indices below, simply average the 7 indices to get a better overall picture of the market. The combined average of all 7 indices is -1.07% year to date.

<u>Index</u>	<u>Last Week</u>			<u>One Month</u>		<u>Year-to-Date</u>	
	<u>Close</u>	<u>Net Change</u>	<u>% Change</u>	<u>Net Change</u>	<u>% Change</u>	<u>Net Change</u>	<u>% Change</u>
S&P 500 Index	2663.42	-6.49	-0.24%	18.73	0.71%	-10.19	-0.38%
Dow Jones Industrial Average Index	24262.51	-48.68	-0.20%	-1.79	-0.01%	-456.71	-1.85%
Nasdaq Composite Index	7209.62	89.82	1.26%	167.51	2.38%	306.23	4.44%
60/40 Portfolio (BAGPX)	12.93	-0.1	-0.77%	0.02	0.15%	-0.16	-1.22%
US Aggregate Bond Index	1999.85	0.39	0.02%	-15.57	-0.77%	-46.52	-2.27%
Markit iBoxx USD Liquid High Yield Index	268.29	-0.04	-0.01%	2.05	0.77%	-0.84	-0.31%
20+ Year Treasury Bond (TLT)	118.85	-0.04	-0.03%	-2.18	-1.80%	-7.49	-5.93%

Data Source: Investors FastTrack, Yahoo Finance

Term of the Week: Rollover

A rollover occurs when reinvesting funds from a mature security into a new issue of the same or a similar security; transferring the holdings of one retirement plan to another without suffering tax consequences; or moving a forex position to the following delivery date. The distribution from a retirement plan is reported on IRS Form 1099-R and may be limited to one per annum for each IRA. The forex rollover fee arising from the difference in interest rates between the two currencies underlying a transaction is paid to the broker.

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Dow Jones - Week Ending

WEEKLY MARKET SUMMARY

Global Equities: US equities finished the week mixed, with the Nasdaq Composite leading the other major indices with a 1.2% gain. The S&P 500 and the Dow Jones Industrial Indexes were each slightly negative for the week losing .26% and .20%, respectively. An excellent performance from Apple Inc. (ticker AAPL, discussed below), boosted the Nasdaq Composite and helped the Technology sector lead all other S&P sectors for the week. Healthcare lagged all sectors for the week, likely in anticipation of an upcoming Trump speech on drug pricing. A stronger US dollar likely contributed to Emerging Market equities, represented by the iShares MSCI Emerging Markets Index ETF (EEM), under-performance of -1.71% for the week.

Fixed Income: The yield on the US 10-Year Treasury Note again tested the 3% level mid-week, but failed to break above the psychological level to close the week lower, at 2.949%. The Federal Reserve Open Market Committee (FOMC) meeting contributed to the retreat. High-yield debt funds recorded slight inflows as their corresponding spreads over risk-free securities widened slightly for the week. The iShares iBoxx High-Yield Corporate Bond ETF (ticker: HYG) ended the week down .4%.

Commodities: Oil prices remain defiant in the face of a strengthening US dollar and what should have been a very bearish mid-week Energy Information Administration (EIA) inventory report, which showed an increase of 6.2 million barrels. The May 12 deadline for the US sanctions waiver on Iran looms large on the calendar as the oil market tries to quantify potential repercussions of increased sanctions. International Brent Crude ended up slightly for the week to \$74.96 per barrel, while the American West Texas Intermediate

price increased to \$69.79 per barrel. Natural Gas prices ended the week lower by over 2%, to \$2.71/MMBtu.

WEEKLY ECONOMIC SUMMARY

Federal Reserve Announcement: The Federal Reserve Open Market Committee (FOMC/Fed) announced no change to the benchmark Federal Funds Rate after its meeting on May 2. The lack of a rate hike was widely anticipated, however, changes to the language of the Fed statement were viewed by market participants as being more dovish (accommodative) in the outlook for inflation. Fed Funds Rate projections are definitely pricing in two more rate hikes for 2018, but are increasingly uncertain of a fourth. The Fed has maintained a continued gradual pace of rate hikes, perhaps reinforced by a comment on Friday by San Francisco Fed President John Williams, where he said, "I see us maybe modestly overshooting our 2 percent inflation target".

Employment Situation: Nonfarm payrolls missed expectations by rising only 164k versus expectations of a 198k gain for the month of April. There was strong growth in the above-average paying professional and business services employment. Oil services and manufacturing jobs continued to show solid growth, while construction jobs bounced back after a disappointing March to add 17k jobs. The figure for March was also revised higher to 135k from the disappointing 103k that had initially been reported. The US unemployment rate has fallen to an 18-year low of 3.9% in April.

Last Week's Manager Moves—

HIM #15 —Sold 2% technology on 4/30

HIM #23—Sold 100% to CASH on 4/30

Current Model Allocations

Low Risk

HIM #2	25% municipal bonds/75% municipal bond mutual fund
HIM #1	15% high yield/85% high-yield mutual fund
HIM #3	43% convertibles/14% NASDAQ 100/ 29% dividend equities/14% long treasury
HIM #20	100% CASH
HIM #19	50% MBS/50% real estate mutual fund
HIM #23	100% CASH

Moderate Risk

HIM #2	100% mid-cap
HIM #9	20% long S&P /80% alternative equity mutual fund
HIM #8	100% trust
HIM #22	100% S&P 500
HIM #10	100% invested
HIM #15	100% invested
HIM #11	80% (16) stocks/20% CASH
HIM #21	25% CASH/75% real estate mutual fund

Summary

In utilizing an approach that seeks to limit volatility, it is important to keep perspective of the activity in multiple asset classes. We seek to achieve superior risk-adjusted returns over a full market cycle to a traditional 60% equities / 40% bonds asset allocation. We do this by implementing global mandates of several tactical managers within different risk buckets. For those investors who are unwilling to stomach anything more than minimal downside risk, our goal is to provide a satisfying return over a full market cycle compared to the Barclays Aggregate Bond Index. At Harter Investment Management we realize how confusing the financial markets can be. It is important to keep our clients up to date on what it all means, especially with how it relates to our private wealth managers and their models. We are now in year nine of the most recent bull market, one of

the longest bull markets in U.S. history. At this late stage of the market cycle, it is extremely common for hedged managers to underperform, as they are seeking to limit risk. While none of us know when a market correction will come, even though the movement and volatility sure are starting to act like a correction, our managers have been hired based on our belief that they can accomplish a satisfying return over a full market cycle, -- while limiting risk in comparison to a traditional asset allocation approach. At Harter we continue to monitor all of the markets and how our managers are actively managing their portfolios. We remind you there are opportunities to consider with all of our managers. Hopefully this recent market commentary is helpful and thanks for your continued trust and loyalty.

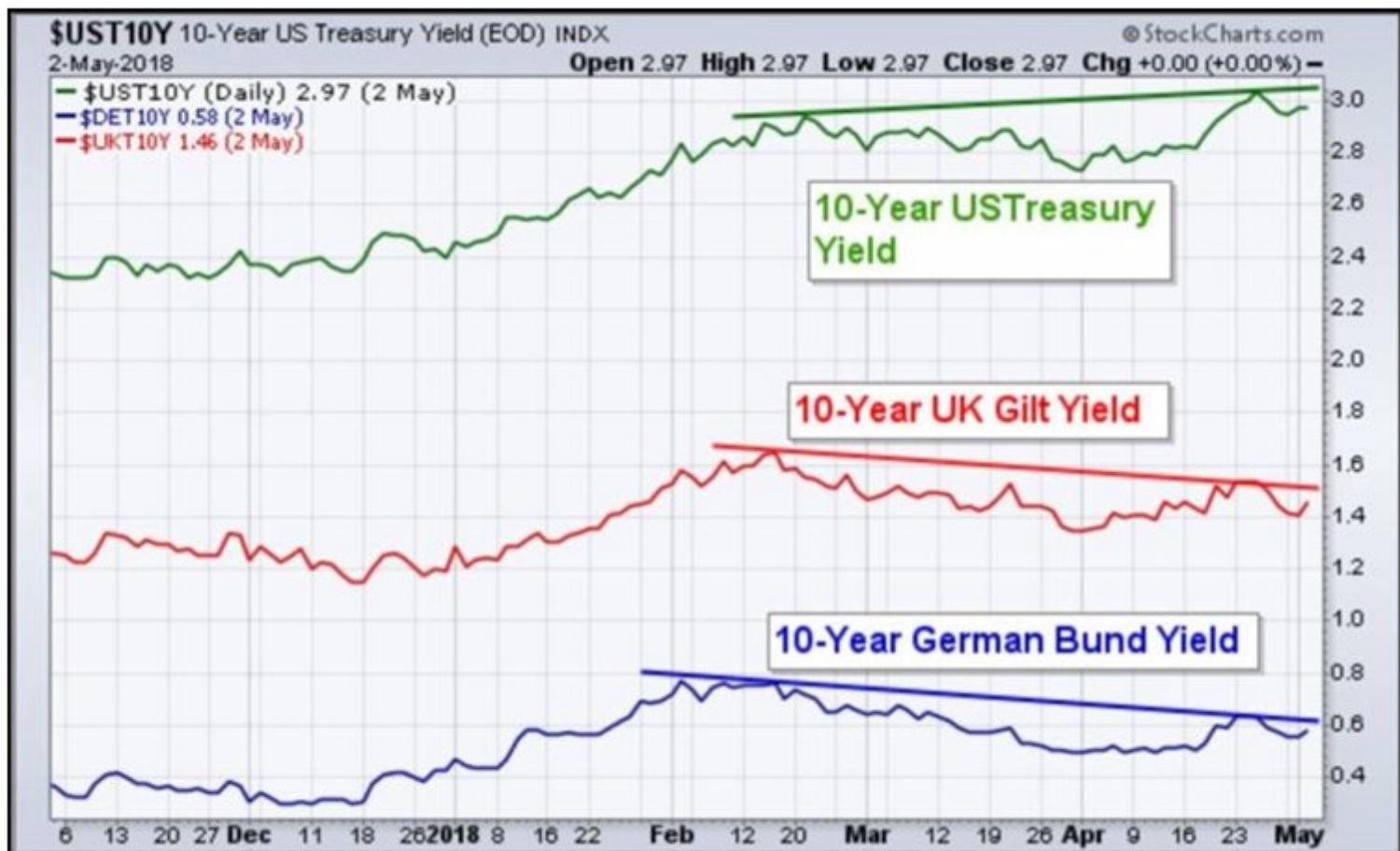


Chart courtesy of Stockcharts.com. Commentary and opinions are those of Hanlon Investment Management.

Chart of the Week:

The Chart of the Week shows yields on 10-year yields for; US Treasuries, UK Gilts, and German Bunds. The spread between US Treasuries and German Bund/UK Gilts are hitting new highs, as US rates rise, while UK and German rates are moving down. That widening divergence explains why money is flowing out of the euro and sterling and into the dollar,