OPES ADVISORS
A Division of Flagstar Bank
Wealth Management


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MARKET RETURNS: The first quarter of 2018 provided a bumpy ride for investors with volatility returning after the relatively smooth 2017 experience. Early February concerns regarding increased inflation pressures sent both stocks and bonds lower. Additionally, an uptick in rhetoric involving tariffs generated worries of a global trade war and the potential for lower future global growth. In spite of the increased volatility, the S&P 500 Index finished the quarter with only a slight loss of -0.8%. The concerns over trade, coupled with the potential for tightening monetary policies from European and Japanese central banks, also affected developed markets outside of the U.S., ending up with a loss for the MSCI EAFE Index of -1.5% for the quarter. As inflation concerns sent yields higher in February and the Fed raised short–term interest rates 0.25%, U.S. bonds fell in value, with the Bloomberg U.S. Aggregate Bond Index dropping -1.5% and one month U.S. Treasuries up 0.4%. Despite the volatility and limited negative or positive returns in the 1st quarter, trailing 12 month returns in stocks are strongly positive, with emerging market stocks leading the way at 24.9%.

Asset Class	Index	1st Qtr. 2018	12 Months ending Q1
US Large Cap Equities	S&P 500 Index	-0.76%	13.99%
Int'l Developed Equities	MSCI EAFE Index	-1.53%	14.80%
Emerging Market Equities	MSCI Emerging Equities Index	1.42%	24.93%
Fixed Income	Bloomberg Aggregate Bond Index	-1.46%	1.20%
Cash	US Treasury Bill 1-month average	0.37%	1.10%

YOUR PORTFOLIO: Positive returns were hard to come by in the quarter as global developed stocks and U.S. bonds delivered negative returns, resulting in slight negative returns for portfolios in the quarter. However, since 2017 was a strong year for global stock performance, portfolios delivered positive returns over the trailing 12 months that exceed our long-term planning assumptions. While U.S. growth stocks outperformed value stocks last quarter, technology stocks fell towards the end of the quarter as the potential for new regulations in the sector dragged on performance. The threat of a global trade war also helped small cap stocks outperform large cap stocks this last quarter, as the greater domestic focus of smaller companies provides insulation from this potential threat. This helped our results given our tilt in favor of small caps. Our bond strategies outperformed last quarter, benefitting by our relative underweight to U.S. Treasuries relative to the index. While our Alternatives allocation generated a slight loss last quarter, it outperformed both a broad-based alternatives index and U.S. bonds.

LOOKING FORWARD:

U.S. Economy: As we wrote three months ago in our 2017 review, the economic environment in the U.S. is favorable for stocks, and this remains the case despite the uptick in volatility experienced this past quarter. The economy's GDP growth rate is possibly rising close to 3% this year. The end-of-2017 tax cuts will definitely add to corporate profits, and may spur increased consumer spending that will boost profits as well, with operating earnings likely rising 25% year-over year. Unemployment is quite low at 4.1%, and is likely to continue to drop slightly this year, although we're getting close to the lowest level of unemployment our economy can sustain with limited labor supply.

With unemployment at these low levels, both economists and investors are closely watching the pace of wage growth, as faster increases may lead to higher inflation expectations. Adding to concerns around inflation is the weaker U.S. Dollar and the recent rise in commodity prices, both of which are inflationary. Commodity prices may experience further price increases depending on the developments in global trade and tariffs. A risk for the markets is that the Fed may feel forced to accelerate the pace and magnitude of interest rate increases in an attempt to cool down the economy and thwart inflation, but could potentially overshoot, leading to a decline in economic growth and even recession. While our view on the U.S. economy is generally positive, we are keenly aware of potential risks that could provide more headwinds to investment markets.

Global Stocks: The spike in volatility in 2018 does not automatically indicate the U.S. stock bull market is over. As we have outlined, the U.S. economy is growing and corporations have some advantages in the form of tax cuts that may continue to offer benefits. While U.S. stocks are no longer the bargain they were 9 years ago (shortly after the Global Financial Crisis), U.S. stock valuations have improved recently due to level prices, and future earnings expectations have risen, partly driven by the recent corporate tax cuts. The S&P 500 was selling for a multiple of 16.4x future earnings as of March 31, 2018, less than the 18.5 multiple at the end of 2017. While this is good news for U.S. stock investors, non-U.S. stock valuations are even cheaper and, in the case for emerging markets, offer higher earnings growth potential. So far in 2018, emerging market stocks have delivered positive returns while developed market equities (including the U.S.) fell in value, potentially signaling investors are realizing the better value emerging markets offer. While U.S. stocks can continue to perform well with relatively higher valuations, we believe that maintaining exposure to non-U.S. stocks offers both the benefits of potentially higher returns (based on lower valuations and higher earnings growth) and of greater portfolio diversification.

Bonds and Interest Rates: The Fed raised short-term interest rates last month, and forecasts potentially two more increases in 2018. Given the favorable economic environment expected this year, this seems likely to happen. Interestingly, the Fed's own forecasts for inflation have it at 1.9% by 2018 end of year, with inflation only running at about 2% over the long run. As a result, if inflation were to unexpectedly increase, we may see the risk mentioned earlier of accelerating interest rate increases, which can be a headwind for bond performance as yields and prices move in opposite directions. (At the same time, higher bond yields make them more attractive investments for future returns) The risk of rising interest rates is one of the major reasons that we allocate a decent portion of our portfolio to alternative investments, which can act as a portfolio diversifier to stocks but offer potentially better returns than bonds.

Conclusion: While volatility has increased, fundamentals for the U.S. economy are generally favorable; when combined with better valuations, this can provide a good backdrop for stock returns. More market benefits from tax cuts may be realized this year, although increased inflation risk is an area we will be watching. We anticipate that volatility will stay elevated, driven by such things as the uncertainty concerning global trade and the media focus on the White House. As always, we will continue to monitor the global markets and your investments closely.

Thank you for your continued trust in us and we hope you are enjoying the spring weather!

(Your 1Q18 and trailing periods personal account performance is reflected on your quarterly performance report, a version of which your advisor will review with you during your next portfolio or annual planning meeting.)