# Verdence Capital Advisors

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## Weekly Investment Strategy Update

### Weekly Economic Recap – *Housing Data Beats Expectations*

- The December NAHB Housing Market Index rose to the highest level since 1999. Optimism was seen across all three components of the Index (the present and future sales gauge and housing traffic). Homebuilders in the survey attributed the strong optimism on low interest rates and less regulation.
- Existing home sales saw the largest monthly increase in 23 months (+5.6% MoM) to the highest annual rate since 2006. The months' supply is at the lowest level (3.4 months) on record, suggesting that home prices will continue to rise.
- November new home sales saw the biggest monthly jump (+17.5% MoM) since 1992 and rose to the highest level since 2007. The months' supply fell to the lowest level (4.6 months) in 16 months. The south and west led the increase which may be due to weather related rebuilding and/or homeowners buying before the mortgage interest deduction tax changes.
- Personal spending rose 0.6% (MoM) in November and outpaced the gains in wages (personal income +0.3% MoM). The savings rate dropped to the lowest level in 10 years.
- November durable goods orders rose 1.3% (MoM) led by a surge in nondefense aircraft orders (+14.5% MoM).

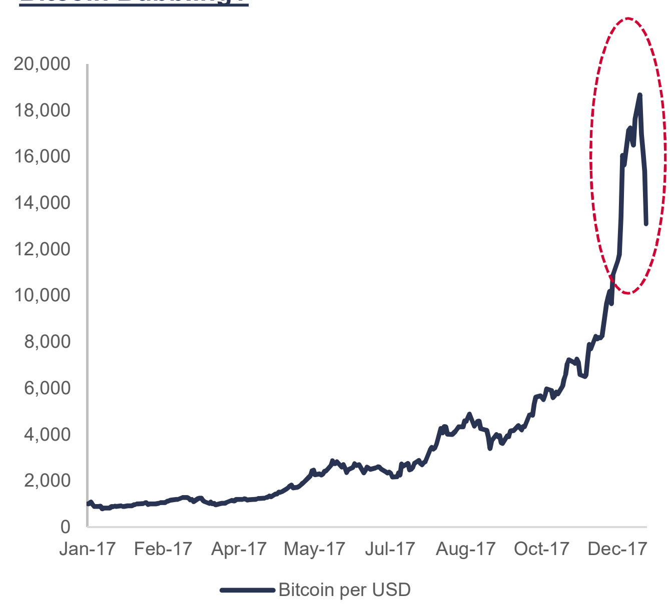
### Weekly Market Recap – *Tax Euphoria Continues; Bitcoin Falters*

- **Fixed Income:** The passing of the tax bill and rise in inflation expectations pushed yields higher. The 10YR Treasury yield saw its largest weekly rise in 14 weeks (to 2.49%). In addition, inflation expectations as seen by the 10 YR inflation breakeven rate rose to an eight month high (1.95%). Credit outperformed Treasuries with EM bonds outperforming high yield.
- **Equities:** U.S. equities outperformed their international counterparts as Congress passed and the President signed comprehensive tax reform. From a sector perspective, those sectors with high effective tax rates (e.g. energy) and those poised to benefit from better global growth (e.g. materials, industrials) outperformed select interest rate sensitive sectors (e.g. real estate and utilities).
- **Commodities/FX:** The Bloomberg Commodity Index saw its biggest weekly gain in 10 weeks as the dollar weakened and GDP growth prospects were boosted by the passing of the tax reform bill. Copper rallied for its second consecutive week while oil rallied for the first time in four weeks. Bitcoin dominated the headlines after falling into bear market territory (a drop of more than 20%). The plunge brought margin call fears, a halt in trading on Coinbase and a major hedge fund to shelve plans to start a cryptocurrency hedge fund.

### New Home Sales Surge


*Footnotes: Data as of December 2017.*
*Source: Bloomberg Finance LP, Verdence Capital Advisors.*

### Bitcoin Bubbling?




*Footnotes: Data as of December 22, 2017.*
*Source: Bloomberg Finance LP, Verdence Capital Advisors.*

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### Weekly Strategy View – *Tax Reform is Here; What Can We Expect*

With the final tax bill signed into law we look towards what the impact may be to the economy and asset classes. While the tax bill is often compared to the Reagan era tax cuts of the 1980s, from an economic and asset class performance perspective it is unfair to use that time period to define what the impact may be on growth and equities. First of all, when the first tax bill was enacted (1981), the economy was fighting a massive inflationary environment. Second, the additional changes to the tax bill occurred after a back to back (80 & 81-82) and worst recession since the Great Depression. We could use the 2001 and 2003 tax cuts but these would also not be a completely fair assessment given the bursting of the dot com bubble, 2001 recession and 9/11 terrorist attack. Some of the impacts we expect to see in 2018 from this tax bill include, but are not limited to:

- **Higher GDP**: Economic growth should be supported by stronger business and consumer spending. The tax bill entices businesses to spend and in 2018 the majority of tax payers should see higher paychecks. The Bloomberg consensus estimate for 2018 U.S. GDP has increased 30 bps (to 2.6%) over the past two months as the tax bill grew more likely.
- **Disinflation to Inflation**: The tax bill should boost growth and may finally incentivize companies to increase wages. Stronger GDP, higher wages and the roll off of negative base effects (e.g. telecom prices) should push inflation higher.
- **Higher Interest Rates**: With inflation and economic growth accelerating, the Fed should feel comfortable with its balance sheet reduction plan and additional Fed rate hikes. As a result, the 30+ year bond bull market may be coming to an end.
- **Earnings Boost:** The tax bill is a historic tax cut for corporations. The repatriation and lower taxes should ultimately result in higher earnings than previously expected. The estimates for the boost to S&P 500 earnings from analysts on the street is a wide range (from a $5-$20 boost from initial estimates) but suggest double digit earnings growth in 2018.
- **Equities Should Outperform Bonds:** Late cycle dynamics and higher interest rates should result in a more volatile climb higher in equities next year. However, better economic growth and earnings as well as interest rates moving higher supports equities over bonds. As a result, we would continue to evaluate periods of equity weakness as potential buying opportunities. From a sector perspective, financials should benefit as interest rates move higher while tech should benefit from the repatriation of cash. Lastly, sectors such as industrials and energy may benefit from better global growth and the corporate tax cut (industrials and energy have higher effective tax rates).*

### Asset Class Performance

| U.S. Equities | Current | 1WK | 1MO | 3MO | 1YR | YTD |
|---|---|---|---|---|---|---|
| Dow Jones Industrial Average | 24,782 | 1.1% | 5.3% | 11.5% | 27.3% | 28.4% |
| S&P 500 | 2,685 | 1.3% | 3.5% | 7.9% | 20.9% | 22.3% |
| Russell 1000 Growth | 1,359 | 1.1% | 2.4% | 9.2% | 29.1% | 30.8% |
| Russell 1000 Value | 1,226 | 1.6% | 4.3% | 6.4% | 12.8% | 13.9% |
| Russell Midcap | 2,077 | 1.6% | 2.6% | 7.3% | 16.9% | 18.3% |
| Russell 2000 | 1,547 | 2.7% | 2.0% | 7.5% | 14.0% | 15.4% |
| Nasdaq | 6,965 | 1.6% | 1.6% | 8.7% | 28.8% | 30.9% |

| International Equities | Current | 1WK | 1MO | 3MO | 1YR | YTD |
|---|---|---|---|---|---|---|
| MSCI AC World (USD) | 511 | 1.2% | 2.3% | 5.7% | 23.8% | 24.1% |
| MSCI EAFE (USD) | 2,034 | 0.9% | 2.0% | 3.8% | 25.4% | 24.6% |
| MSCI Europe ex UK (USD) | 2,104 | 1.0% | 1.3% | 1.1% | 25.4% | 23.8% |
| MSCI Japan (USD) | 3,424 | 0.0% | 1.9% | 9.0% | 23.0% | 24.1% |
| MSCI UK (USD) | 1,226 | 1.6% | 4.0% | 4.7% | 27.9% | 26.2% |
| MSCI EM (USD) | 1,134 | 1.2% | -1.3% | 2.6% | 36.8% | 34.6% |
| MSCI Asia ex Japan (USD) | 699 | 0.3% | -2.1% | 3.5% | 40.0% | 39.0% |

| Fixed Income | Current Yield | 1WK | 1MO | 3MO | 1YR | YTD |
|---|---|---|---|---|---|---|
| U.S. Aggregate | 2.8% | -0.6% | -0.2% | -0.1% | 3.8% | 3.0% |
| U.S. Govt/Credit | 2.7% | -0.7% | -0.2% | -0.1% | 4.1% | 3.4% |
| U.S. 10 Year Treasury | 2.5% | -1.2% | -0.8% | -1.3% | 2.5% | 1.4% |
| U.S. TIPS (1-10YR) | 2.3% | -0.3% | -0.1% | -0.1% | 2.3% | 1.4% |
| U.S. High Yield | 5.8% | 0.0% | 0.3% | 0.5% | 7.7% | 7.3% |
| EM Bonds (Local) | 4.9% | 0.8% | 1.7% | 0.0% | 13.6% | 13.1% |
| Municipal Bonds | 2.5% | -0.6% | -0.2% | -0.2% | 5.4% | 4.8% |

| Commodites | Current | 1WK | 1MO | 3MO | 1YR | YTD |
|---|---|---|---|---|---|---|
| Bloomberg Commodity Index | 85 | 1.7% | -1.4% | 0.6% | -1.3% | -2.6% |
| Crude Oil (USD/bbl) | $58.3 | 2.3% | 2.8% | 16.2% | 13.7% | 8.6% |
| Gold ($/oz) | $1,266.5 | 1.5% | -1.4% | -1.8% | 12.9% | 10.6% |
| Copper | $319.5 | 3.3% | 2.4% | 9.9% | 28.8% | 28.2% |
| Wheat | $427.0 | 1.6% | -3.6% | -9.5% | -9.6% | -11.0% |
| U.S. Dollar | 93 | -0.5% | 0.2% | 1.4% | -9.4% | -8.6% |
| VIX Index | 10 | -8.3% | -1.1% | -0.5% | -14.6% | -31.5% |

*Footnotes: Data is weekly and as of December 21, 2017. *According to Goldman Sachs 5 YR median effective tax rate calculations.*
*Source: Bloomberg Finance LP, Verdence Capital Advisors.*

Discover true independence.

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*Past performance is not indicative of future returns*