Bangor Wealth Management
A Division of Bangor Savings Bank

Wealth Management Newsletter | Market & Performance | Spring Edition 2018

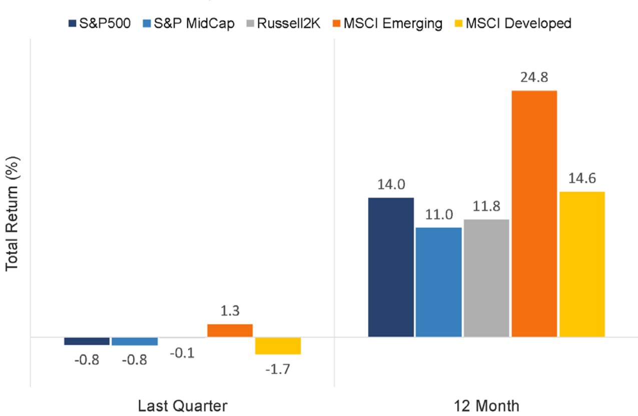
Key Market/Economic Update

- The healthy job market and favorable tax/fiscal policy provided a supportive backdrop for equity markets.
- All major U.S. stock indexes closed modestly lower in Q1 after very strong January returns.
- Emerging market stocks continued to outperform both developed international and U.S. markets.
- U.S. corporate profits accelerated through Q4 are expected to increase to more than 26% in 2018.

Stock Market Review

In Q1, US stock markets channeled "a tale of two cities". January was the best of times as the S&P 500 continued its momentum and delivered a 5.7% return, the best monthly return in over two years. However, unusually calm markets were jolted when volatility returned with fervent force. Equity indices then saw the worst of times, suffering consecutive monthly drops in February and March. Q1 closed with a modest loss of 1.22%, the first quarterly decline in two and a half years!

Fig 1. Emerging market continued to dominate US and Developed International Stock markets

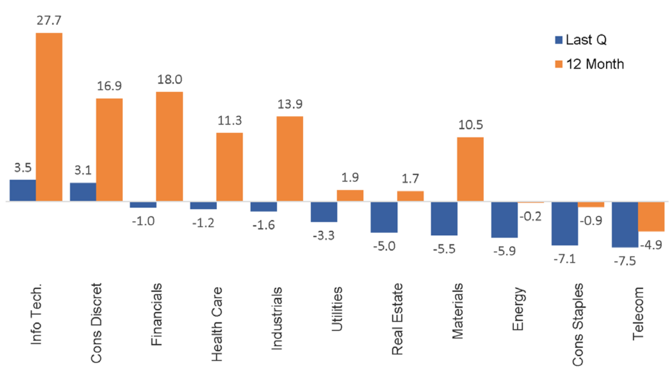


Data Sources: Bloomberg Financial LP, Bangor Savings Bank

Like the large-cap stock indexes, medium and small-cap stocks also wilted during the first quarter. Despite dramatic selling at quarter end, many of the loved mega-cap tech and consumer stocks, such as Amazon, Microsoft, and Netflix still delivered strong returns for investors and provided spotty support for the broad market.

Information technology and consumer discretionary companies delivered the highest returns among S&P sectors. Defensive sectors like telecom, utilities, and consumer staples significantly underperformed as investors favored growth and momentum names, hoping to benefit incrementally from strong economic growth and increasing inflation expectations.

Fig 2. Information tech and consumer discretionary stocks were the only two sectors that delivered positive returns for investors and led S&P sector performance in Q1.

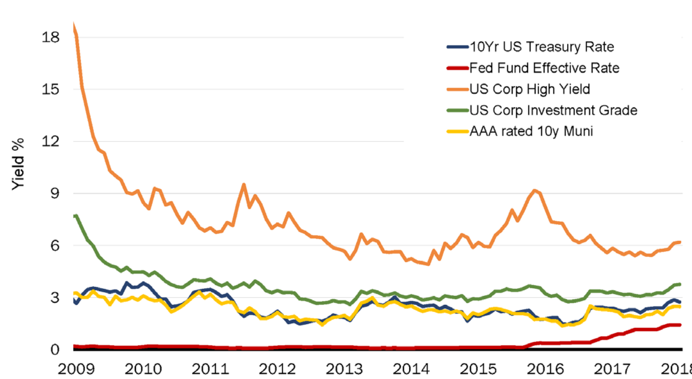


Data Sources: Bloomberg Financial LP, Bangor Savings Bank

In the international stock markets, strong performance from Latin American countries and some eastern European countries boosted emerging market performances. Emerging markets was the only major equity class to show positive returns for Q1. At the same time, driven by rising concerns over a potential global trade war, developed international markets as measured by the MSCI EAFE index suffered a 2.2% decline.

Fig 3. US historical interest rates and major fixed income yields

Healthy macroeconomic conditions and rising inflation expectations have led to the Fed hiking short interest rates six times since the end of 2015, lifting rates to 1.75% from almost zero. Corporate and muni yields also trending modestly higher.

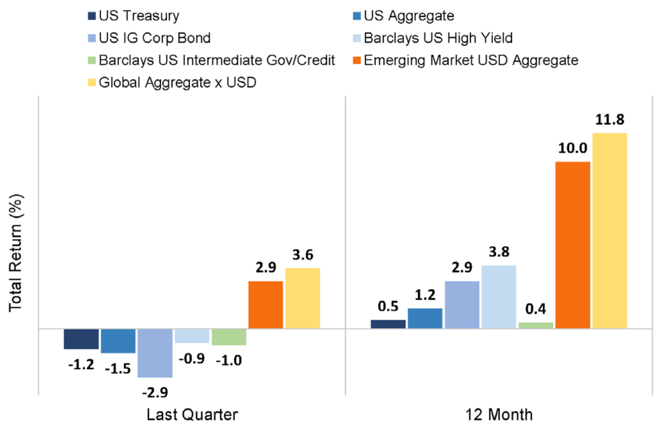


Data Sources: Bloomberg Financial LP, Bangor Savings Bank

Bond Market Review

Fixed income investors saw improving economic conditions, tax and fiscal policies and rising inflation expectations. As expected, the Federal Reserve increased the Federal Funds rate in March by 0.25% for the sixth time since the end of 2015. The U.S. central bank may hike the rate 2 - 3 additional times in 2018. The expectation for rising rates and inflation have inflicted some modest damage across most domestic bond indices.

Fig 4. Rising interest rates hurt global fixed income markets



Data Sources: Bloomberg Financial LP, Bangor Savings Bank

Global bond markets, on the other hand, fared much better than the U.S. counterparts. The European Central Bank and Bank of Japan are still running Quantitative Easing programs or monthly bond purchases. The consensus opinion is that neither are expected to tighten policies until 2019. Non-dollar denominated bonds from developed and emerging markets produced modestly positive returns, driven by relatively low interest rates and the weakening dollar.

Outlook and Portfolio Positioning

As volatility returned with a vengeance, there were factors offering some positive takeaways for investors. According to Bloomberg, S&P 500 companies reported a nearly 15% earnings jump in Q4 last year. Going forward, S&P 500 companies are expected to deliver earnings of $156 per share in 2018, a 26% increase over last year! This would be the strongest profit growth since 2010, a direct windfall from the Tax Cuts and Jobs Act of 2017.

The U.S. economy maintained its momentum as annualized GDP growth finally broke above 3% in Q2 and Q3 last year. Labor markets exhibited robust growth near full employment levels. Consumers have not shown this much optimism in over a decade. Despite FOMC actions to raise rates nearly 2% since late 2015, the real interest rate is still near zero and accommodative.

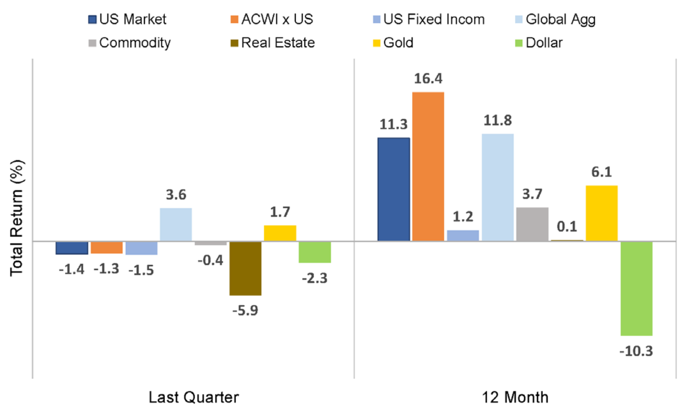
Ongoing market challenges include an aging business cycle, stretched valuations, elevated debt loads, along with political risks. Any one, or a combination, of these could mute investment returns despite strong earnings results.

At Bangor Wealth Management, we made small strategic asset allocation changes at the beginning of year. We believe that newly adopted corporate tax legislation will largely benefit small and mid-size U.S. companies with domestic operations, along with select large U.S. corporations that formerly paid the highest tax rates. Consequently we reduced our overweight to large-cap stocks and increased U.S. mid and small-cap equity allocations.

At the same time, we expect the U.S. dollar to be under pressure from fiscal and trade deficits. A depreciating dollar can not only facilitate economic growth for emerging markets but also adds incremental returns to non-domestic investments for domestic U.S. investors. As part of our overall asset allocation strategy for 2018, we increased both developed and emerging international exposures for client portfolios tolerant of higher volatility.

Last year was a great year for almost all traditional asset investors, as both stock and bond markets delivered remarkable returns with historically low levels of market volatility. The rest of 2018 could very well behave much like the most recent quarter and nothing like the previous year. Though the U.S. economy is on solid footing, the Federal Reserve is gradually withdrawing its support to the financial markets. While rates are far from constraining levels, the rate trend is no longer a tailwind. Business fundamentals and corporate earnings should play a supportive role for stock investors with longer investment horizons. In the long-run, proper diversification, discipline and preparation for the unexpected will be important components of investment success.

Fig 5. Foreign bonds and gold were the only investments providing positive returns among major asset classes YTD



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