



# Forward Focus

## October 2018



### Quarterly Market Review

After a shaky first half of the year, U.S. markets came back to life in the third quarter. Business and consumer confidence are hitting highs, the unemployment rate is hitting lows, and corporate earnings continue to be robust.

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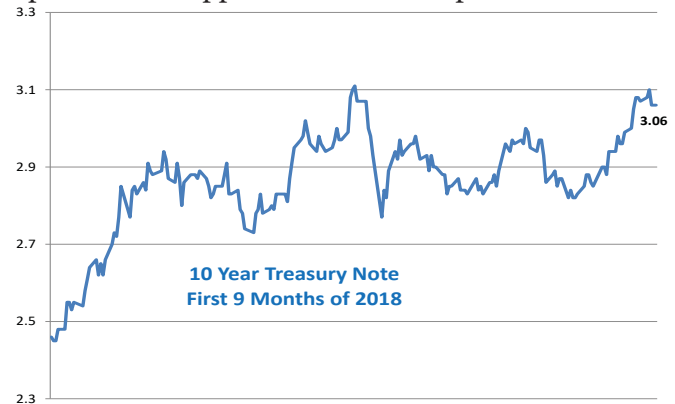
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As you can see from the chart below, interest rates have risen throughout this year. The 10-year Treasury now stands at 3.06% after starting the year at 2.40%. Due to the inverse relationship to yields, bond prices have dipped. Thus, municipal bonds, mortgages, treasuries, corporate bonds, and emerging market bonds all have posted negative returns year-to-date. Only the riskier high yield bond market, which more closely aligns with movements in stocks, has managed a positive return this year.



International markets continue to struggle. Aside from geopolitical uncertainty, foreign markets are weighed down by the continuing strength of the U.S. dollar, uncertainty regarding trade, ongoing Brexit negotiations, and tariffs.

During the 3<sup>rd</sup> quarter, growth stocks outperformed value stocks, and large cap stock returns beat small cap stock returns by a wide margin, 7.7% for large cap versus 3.6% for small cap. The best performing sectors for the quarter were Health Care and Industrials, while the worst performing sectors were Materials and Energy.

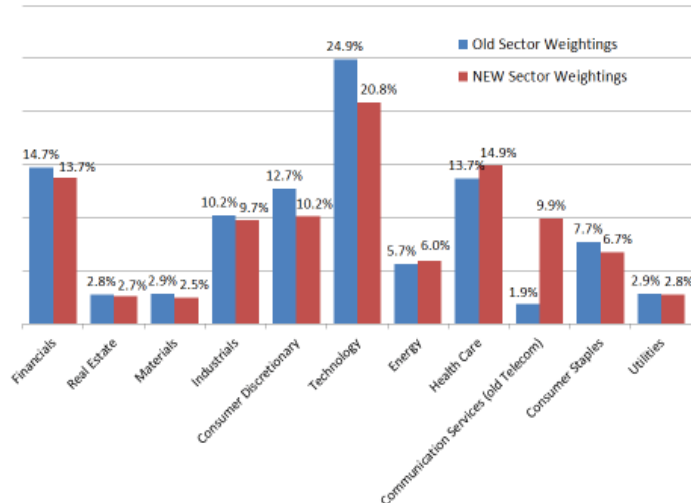
**Here is a summary list of events that occurred during the quarter:** Miraculous Thailand cave rescue • France wins FIFA World Cup • President Trump and President Putin meet in Helsinki • Heatwave kills hundreds in Japan • Wildfires in Greece and California • Earthquakes in Indonesia • Flooding in Laos, India, Nigeria, Vietnam, Italy, North Korea, and the United States claim hundreds of lives • Apple becomes 1<sup>st</sup> company worth a trillion dollars • Aretha Franklin dies at age 76 • Constellation Brands invests in Canopy Growth, a marijuana producer • PepsiCo to buy SodaStream • Coca-Cola to buy Costa Coffee • Mexico and U.S. reach new trade terms • Argentina hikes interest rates • Anonymous New York Times Editorial criticizing President Trump • Les Moonves resigns from CBS • Massachusetts gas explosion • Senator John McCain dies • Venezuela replaces currency to fight inflation • Hurricane Florence pounds the east coast • Hurricane Lane hits Hawaii • Super Typhoon Mangkhut kills 95+ in the Philippines • Ethiopia ethnic violence kills 58 • Trade Tariffs applied to Russia, China, & Turkey • Amazon briefly becomes 2<sup>nd</sup> trillion dollar company • Supreme Court Nominee Brett Kavanaugh hearing • Dow Jones Industrial Average and S&P 500 hit record highs • Longest bull market in U.S. history • 10 Year Treasury yield above 3% • Oil hits \$82.72 bbl. • U.S. Dollar remains strong • Fed raises rates for third time this year • Italian government budget woes • More tariffs placed on China • Initial Jobless claims lowest since 1960s • U.S. Trade deal between Mexico and Canada reached •

#### Third Quarter 2018

Dow Jones Industrial Average 9.0% • S&P 500 7.7% • MSCI EAFE (International) 1.5%  
Russell 2000 (Small Cap) 3.6% • MSCI EMI (Emerging) -1.0% • Barclays Capital Aggregate Bond -0.1%

# Communication Services: A New Sector is Born

The Global Industry Classification Standard (GICS) system has classified stocks into sectors since 1999. Sectors are simply industries or areas of the economy that a stock represents. For example: Bank of America is in the Financial Sector. Over 95% of the world's listed stocks are classified by the GICS. By categorizing stocks into sectors, it allows a common framework from which to make proper comparisons and asset allocation decisions.



However, not all stocks fit neatly into just one sector category. A great example of that is Amazon. As a retail juggernaut, Amazon is classified in the consumer discretionary sector. However, Amazon's Whole Foods division, Amazon Prime Video, and Amazon Web Services' (AWS) cloud computing platform, make a case for it to be considered in the consumer staples, media, and/or technology sector.

Gone are the days where companies fit neatly into their originally assigned category. Therefore, a major reshuffling needed to take place. Two weeks ago, those adjustments occurred.

As you can see from the chart above, there are still 11 sectors. The telecommunication sector has been removed and was replaced with the new "Communication Services Sector". In it are names like Twitter, Netflix, Alphabet (Google), AT&T, Disney, and Facebook. These stocks were taken from the technology sector, consumer discretionary, and telecommunication sectors and reclassified to better align with their primary source of business revenue. Although I used Amazon in the example above as a company spanning multiple sectors, Amazon's online retail business is still its largest revenue stream, so it will stay in the consumer discretionary sector.....for now.

For investors owning the entire market, the change is negligible. The same stocks are on the bus, just in different seats. However, for those who invest in sector specific mutual funds and ETFs, the shifting of stocks and weighting of each sector will create big, big changes. For example: if you previously owned a technology sector fund to get exposure to Alphabet (Google), that technology fund may no longer even own Alphabet (Google). Now, if you want to own it, you need to buy the Communication Services Sector fund.

Another big change is risk. Previously, the telecommunication sector was considered defensive value and paid a high dividend of 5.4%. Many investors used to buy the telecommunication sector for monthly income and low volatility. The new Communication sector is more growth oriented and pays a lower dividend of roughly 1.7%.

These recent changes can greatly alter the make-up of a portfolio. According to Credit Suisse, an estimated \$60 billion in ETF assets could be impacted. That is why it is always important to know what you own and why you own it. We at **Forward** are conducting a careful review of your investments to make sure that your portfolios do not deviate from their intended risk level due to these adjustments.

## Household Debt: Trillions of dollars of IOU's

Americans are trillions of dollars in debt. Yes, Trillions with a T. According to the Federal Reserve data, total household debt is now \$13.29 trillion. That's more than half a trillion more than in 2008! Mortgage debt makes up the bulk of that debt at \$9 trillion followed by student loans, auto loans and revolving credit (primarily credit cards), as the chart at the right shows.

Large debts significantly impact future growth potential. While not yet at a tipping point, the increase of debt both domestically and around the world is creating precarious scenarios. Trade wars, tariffs, rising interest rates, and inflation will negatively affect this problem going forward. We have been watching it closely for years and urge everyone to reduce debt where and when they can. Contact us if you'd like help devising a debt reduction plan.

