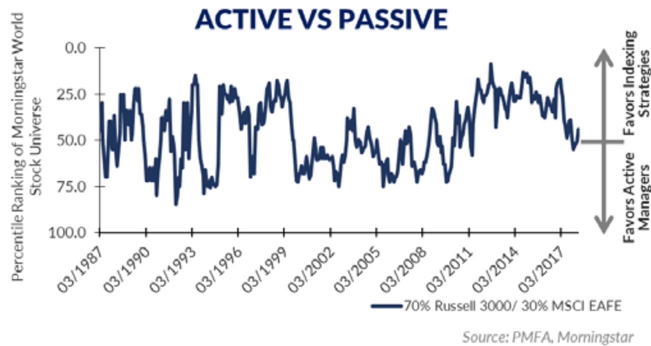
Is there still a case to be made for active management?

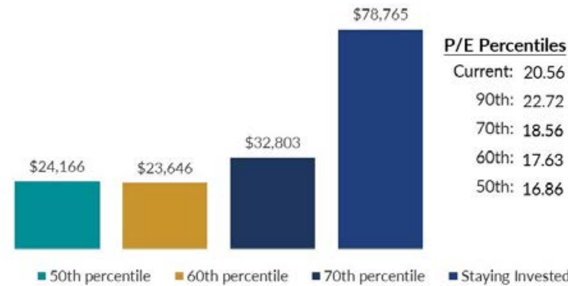


Source: PMFA, Morningstar

Active management has fallen out of favor in recent years as even managers with outstanding long-term results have struggled to outperform passive "index" funds. In fact, the index has outranked most funds within the Morningstar World Stock Universe for much of the last six years. However, the relationship between active and passive management has been cyclical over time. Active managers are beginning to find more opportunities, and may finally have their time to shine.

We continue to see merits to both active and passive management, and typically recommend a combination of both. Passive strategies deliver predictable market-like returns at a low cost and in a tax-efficient manner. Conversely, high quality active managers can outperform an index, despite higher costs. We continue to emphasize active strategies in asset classes that have proven to be less efficient over time, and where active managers have demonstrated the ability to add value after accounting for fees, tax costs, and risk.

What could the flattening yield curve mean for stocks?



Source: PMFA, Bloomberg, Morningstar, Tax Policy Center
The "Staying Invested" bar shows the value of $100 as of the end of 2017 if it was invested in the S&P 500 in 1954. The first three bars show the ending value if the position was sold whenever trailing P/E ratios reached the 90th percentile and re-invested when they reached the 50th, 60th, and 70th percentiles. Assumes the return of the 3-month T-Bill index when not invested.

History has shown that valuations are typically a good predictor of long-term returns, and investors may be wondering if they should sell out at today's high valuations and wait for a more attractive buying opportunity. However, valuations have proven to be a poor timing indicator, as stocks can remain expensive for extended periods of time before reverting to normal levels.

The chart above shows the ending value of a $100 investment in the S&P 500 beginning in 1954. The first three bars show the value if the position was sold when valuations reached the 90th percentile (most expensive), and reinvested when they fell back to the 50th, 60th, and 70th percentiles, respectively. The last bar shows the value of a portfolio that remained invested over the entire period. Due to missed performance and higher tax costs, the portfolios that sold when valuations were high significantly underperformed the portfolio that simply remained invested. The bottom line is that market timing can be costly, and has been shown to be impossible to do consistently and successfully.

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Market Perspectives
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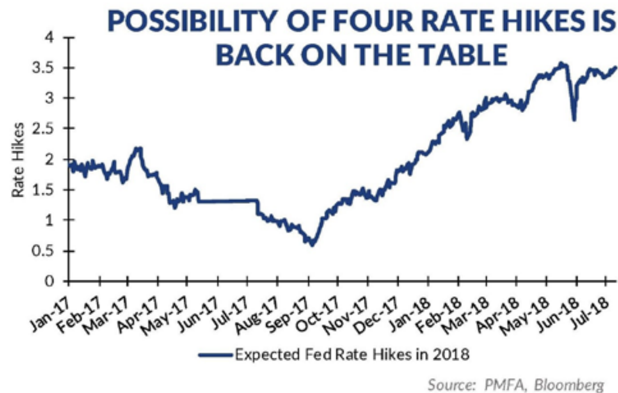
Will we see four interest rate hikes this year?



Over the past several years, the Federal Reserve has been engaged in a policy normalization process, gradually raising the federal funds rate with the goal of reaching its estimated neutral rate of 3%. With rising inflation, a tightening labor market, and a steadily growing economy, many were expecting the Fed to continue systematically raising rates for the foreseeable future to prevent the economy from overheating.

This hawkish sentiment cooled in May due to increased talk of tariffs and trade barriers that could break down global trade and disrupt supply chains. Consequently, investors began to question if the Fed would raise rates as projected. However, coming out of their June meeting, the Fed raised rates for the second time in 2018 and signaled that two more rate hikes this year is still a strong possibility. Markets will be watching closely in the coming months, as the Fed attempts to provide reassurance while maintaining transparency to avoid spooking investors.

Is the economy firing on all cylinders?

Although the transition to a service-based economy in recent decades has diminished the importance of manufacturing, it remains a key cyclical indicator on the health of the overall economy. When taken together, manufacturing and service sector data give a very clear picture of the current state of the economy.

June readings for the ISM Services and ISM Manufacturing Indexes clearly paint a positive picture, with each well above 50, indicating that both sectors are squarely in expansionary territory. The New Orders component of each index was north of 63 in June, indicating that order growth is quite strong despite the uncertainty around tariffs and potential disruptions in global trade and supply chains. Since the last contractionary reading (below 50) in late 2015, both sectors have strengthened in tandem, with the Manufacturing Index reaching its highest level since 2004 earlier this year. The recent positive momentum of both sectors points to an expansion that still appears to be on a solid footing.

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