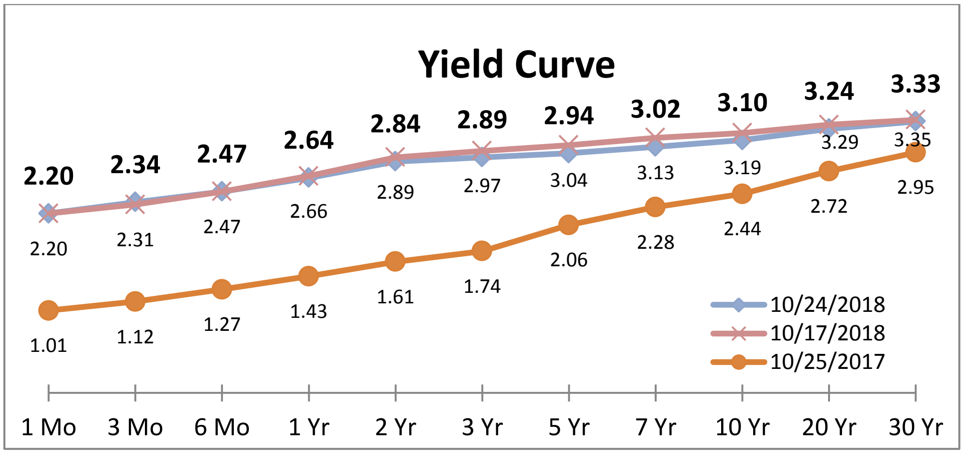
Market Update 10/25/2018

Interest Rates	10/24/2018
Bond Type	**Rate (%)**
Federal Funds	**1.95**
US Treasury : 1 Month	2.20
US Treasury : 3 Month	2.34
US Treasury : 6 Month	2.47
US Treasury : 1 Year	2.64
US Treasury : 5 Year	2.94
US Treasury : 10 Year	3.10
US Treasury : 20 Year	3.24
US Treasury : 30 Year	3.33



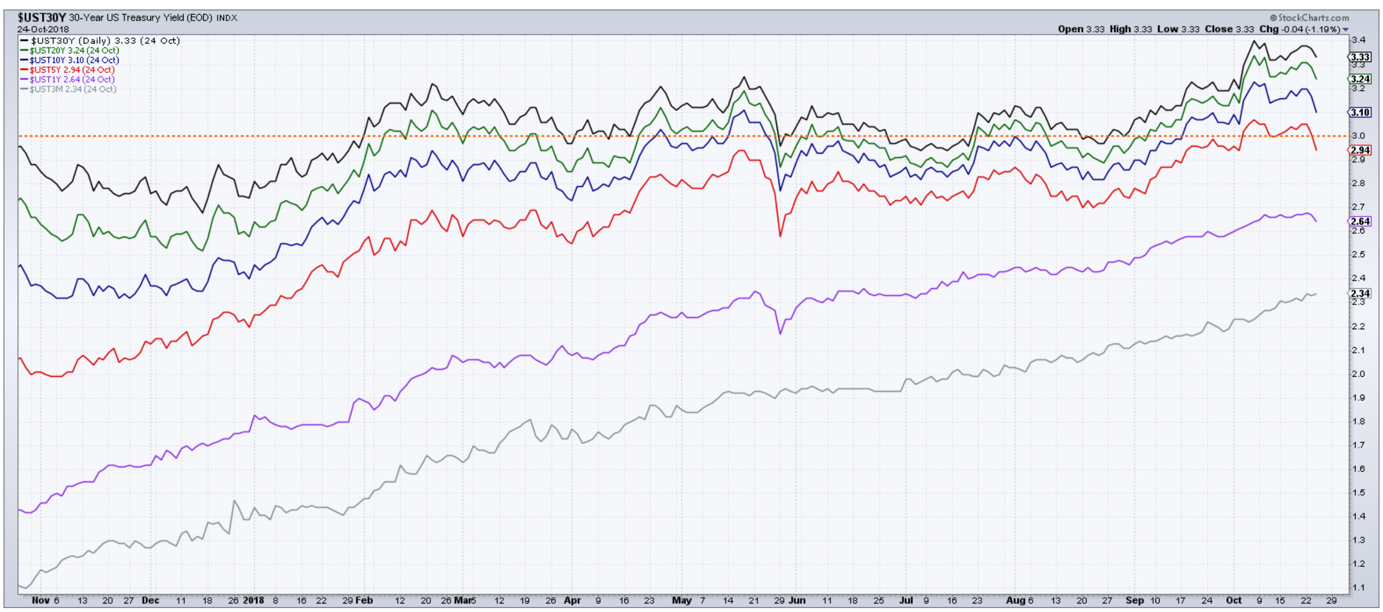
TrailWest Bank Market Rates (Floor)

Prime	TWB Mkt.	HELOC	2nd Mort.	Construction	Bare Land	Unsecured
5.25%	**5.95%**	**5.15%**	**5.15%**	**5.45%**	**5.95%**	**6.20%**

Interest Rates

Interest rates generally declined a few basis points across the yield curve this week. This is due to stock market volatility. When investors are scared, historically they rotate money out of risk assets such as equities into fixed income investments which are perceived to be much safer. Money flooding into treasuries raises prices and lowers yields (Bond prices are inversely related to yields.)

Stock markets are increasingly deteriorating, which could put a damper on the rising interest rate narrative.

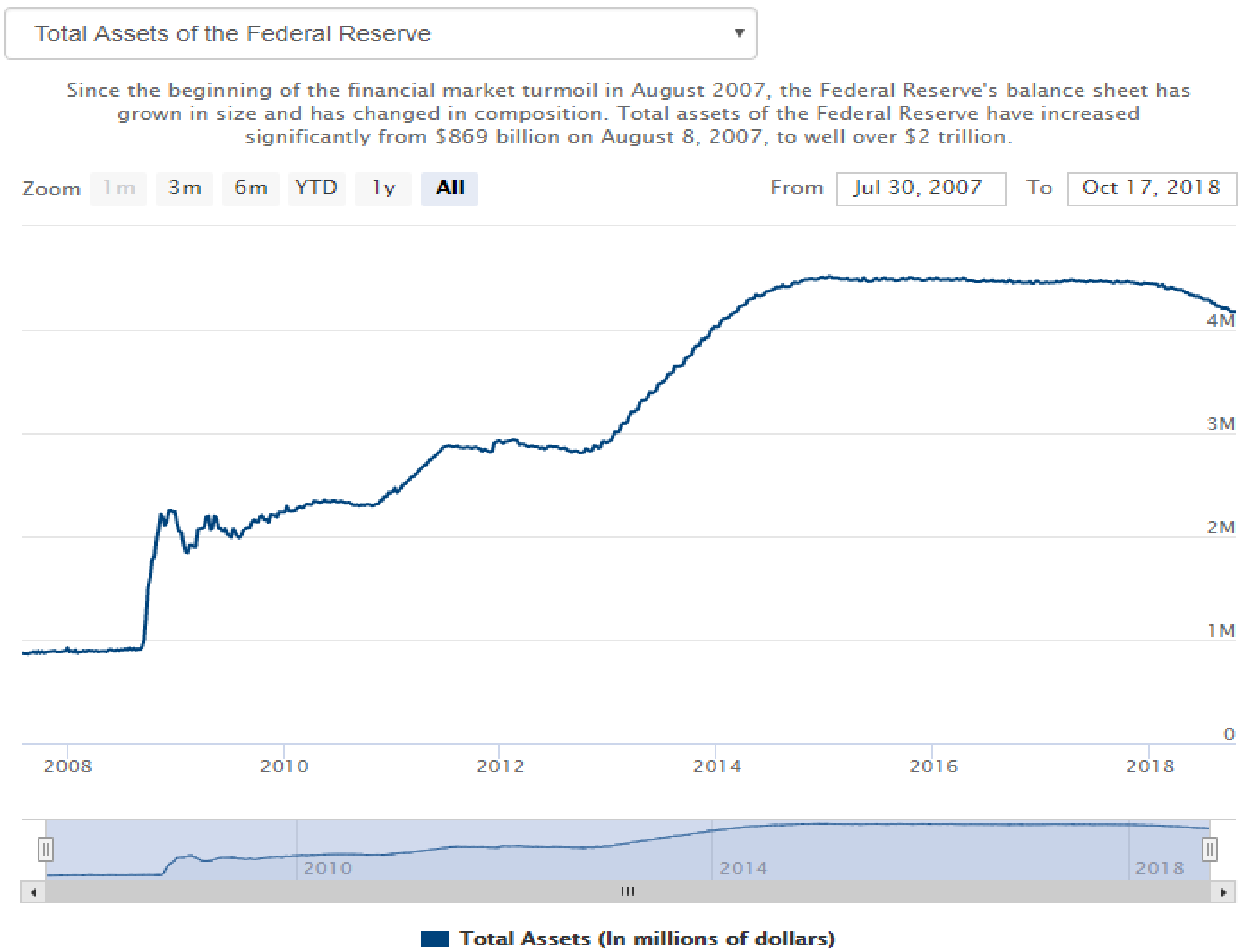


US Treasury Interest Rates, Various Maturities: (Short-term Maturity Bonds on Bottom)

US Treasury notes are bonds issued by the United States Government. Because the government effectively has the ability to print money to cover debts, these bonds are considered 'Risk-Free.'
The Yield Curve is comprised of the interest rates offered on various maturity lengths US Treasury Bonds.
These are the base interest rates that all financial securities are priced upon. Because US Treasury notes are 'risk-free', the higher the yield, the more attractive the bonds become for institutional investors.
Of all US Treasuries, the 10 year Bond is the most frequently quoted and is the maturity investor's watch closely as a measure of expected inflation.

Fed Balance Sheet

As a result of the financial crisis, the Federal Reserve initiated a program known as ‘Quantitative Easing’ (QE). The purpose of QE was effectively to suppress interest rates as a drastic measure intended to spur economic growth. This meant was the Federal Reserve was buying US Treasuries in the open-market which ballooned assets on their balance sheet. QE ended last year and since then the Federal Reserve has reversed course. Assets are now slowly shrinking. This is important in relation to interest rates. Where before, the central bank was acting as a backstop, a fixed buyer of treasuries, that backstop is no longer present. The reduction of the Feds balance sheet has been slow and will likely remain slow. The central bank is not selling their treasury holdings in the open market (an action that would likely spike interest rates) instead, they have chosen to simply let the treasuries slowly roll off the balance sheet as they mature.



QE and the incredible inflation of assets with the Federal Reserve have been highly attributed as primary driving factors of the Bull market in stocks and bonds. Therefore, it is important to note the policy reversal. The Feds Balance sheet should be watched closely moving forward.

Stocks

The S&P 500 has been increasingly under pressure lately and is trading approximately 7% below recent highs. Rising interest rates and lowered earnings forecasts are generally being attributed as the reasons. However, it is important to note severe weakness with markets in the rest of the world.

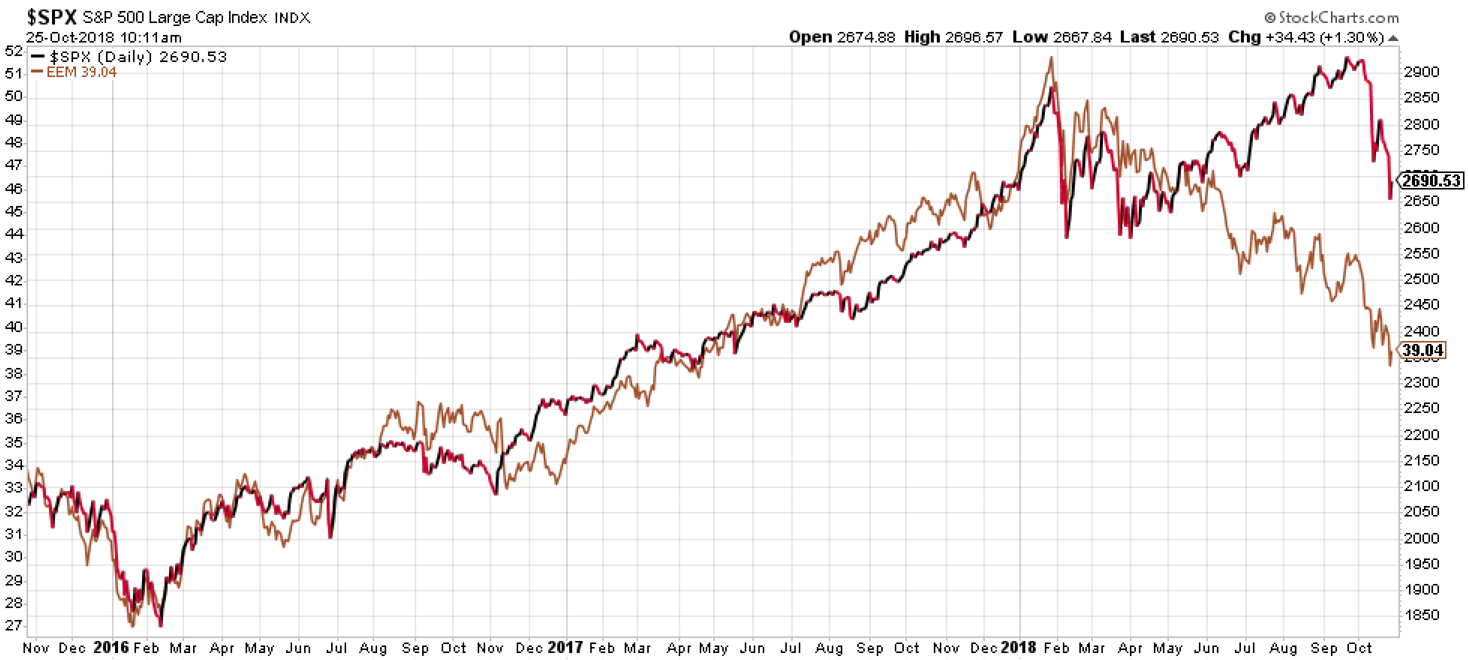
Is it rising interest rates that are negatively affecting US stocks or are American markets finally catching up to more pervasive macro trends?

Rising interest rates will put a damper on lending and economic growth. With a P/E (price-to-earnings) ratio of 22x, the S&P is currently trading expensive as compared to historical average multiple of 15x. Therefore, it is not foolish to think that there may be more downside in stock markets before things level out.

Country ETFs (Note: Total Returns, in US $)

Country	ETF	% Below All-Time High Close	Country	ETF	% Below All-Time High Close
Nigeria	NGE	-69%	South Korea	EWY	-22%
Greece	GREK	-69%	India	PIN	-21%
Turkey	TUR	-63%	Germany	EWG	-20%
Egypt	EGPT	-60%	Peru	EPU	-20%
Russia	RSX	-55%	Belgium	EWK	-19%
Colombia	GXG	-54%	Singapore	EWS	-18%
Italy	EWI	-49%	Ireland	EIRL	-17%
Brazil	EWZ	-46%	Hong Kong	EWH	-16%
Vietnam	VNM	-42%	Taiwan	EWT	-15%
Chile	ECH	-40%	Netherlands	EWN	-15%
Argentina	ARGT	-35%	Sweden	EWD	-15%
Indonesia	EIDO	-34%	United Kingdom	EWU	-13%
South Africa	EZA	-34%	Thailand	THD	-12%
Poland	PLND	-33%	France	EWQ	-12%
UAE	UAE	-32%	Japan	EWJ	-12%
Mexico	EWW	-31%	Australia	EWA	-12%
Spain	EWP	-30%	Saudi Arabia	KSA	-11%
China	FXI	-30%	Switzerland	EWL	-11%
Portugal	PGAL	-29%	Canada	EWC	-10%
Philippines	EPHE	-29%	Norway	NORW	-9%

Notable Divergence between S&P 500 (USA) & Emerging Markets (EEM - brown)

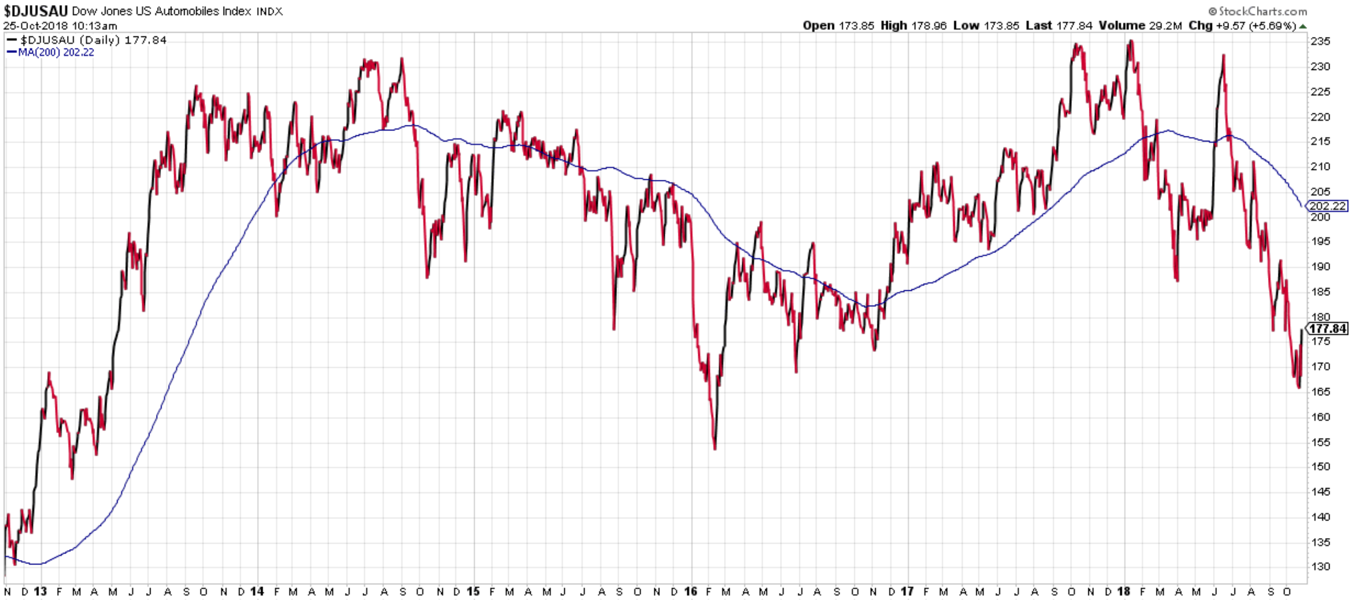


Autos

US Auto manufacturers have been under intense pressure and are trading near three-year lows. Some of the weakness is being attributed to the ongoing ‘trade war’ between the US and China. This is being compounded by an overall decline in Chinese auto sales as the country’s economic growth slows. Auto Sales are slowing domestically as well. US September auto sales were down 6% yoy. U.S. new vehicle sales fell 2% in 2017 to around 17.2 million units after hitting a record high in 2016.

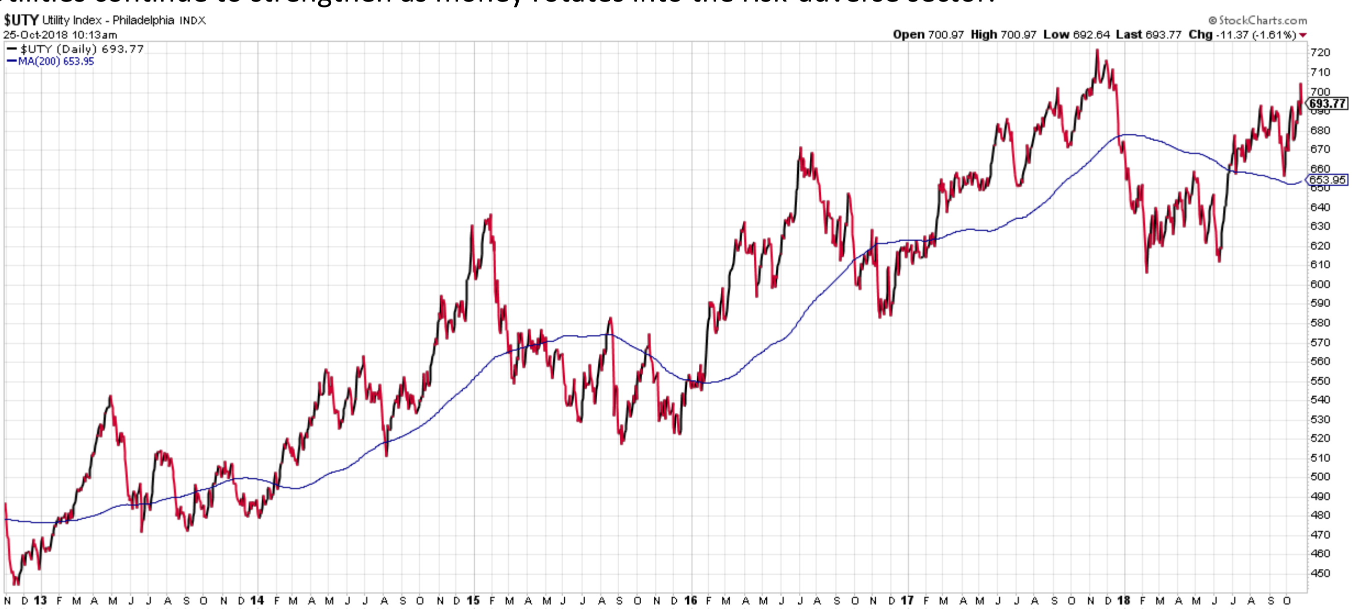
As most Americans require some sort of financing in order to purchase an automobile, higher interest rates negatively affect motor vehicle sales similar to housing.

Moving forward, it would be prudent to expect new vehicle sales to continue to slow unless prices begin to come down.



Dow Jones US Automobiles Index

Investors have been positioning themselves defensively. This is clearly illustrated by the Utilities complex. Utilities continue to strengthen as money rotates into the risk-adverse sector.

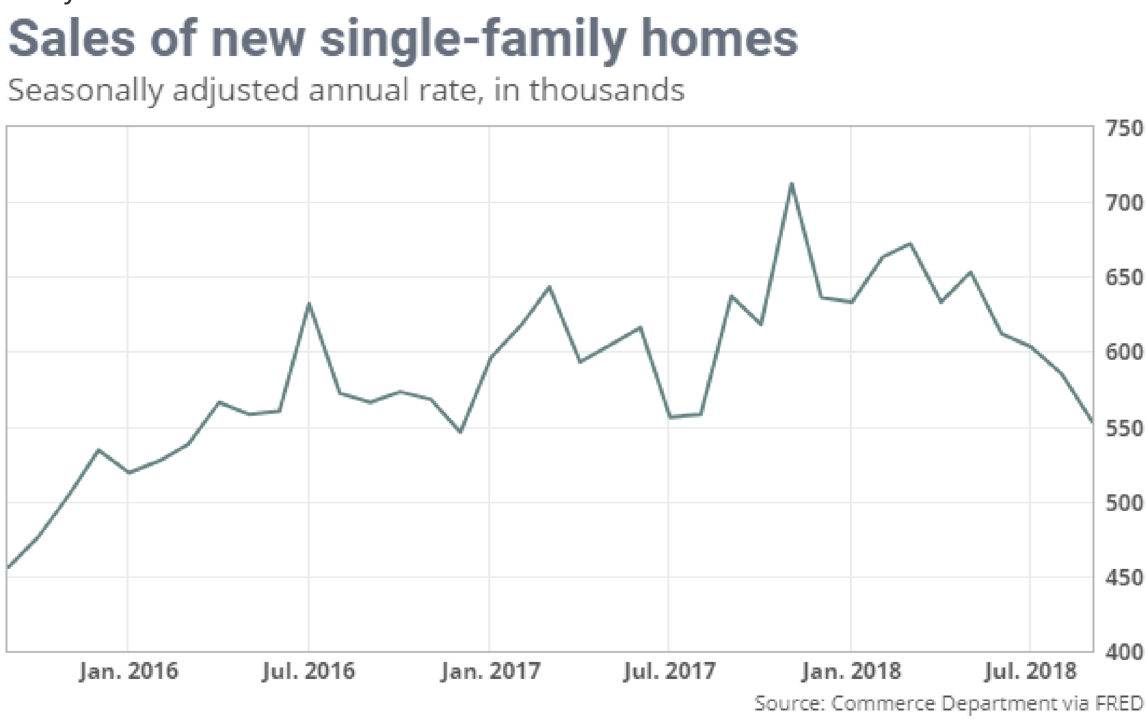


Philadelphia Utility Index

Housing

The Department of Commerce released a report on Wednesday revealing that the American housing market is slowing. New home sales are at the lowest in nearly two years.

New-home sales ran at a seasonally adjusted annual rate of 553,000 in September. The median selling price in September was $320,000, 3.5% lower than a year ago. Marketwatch.com states, *"For years, the housing story has been about strong demand, and limited supply. That dynamic may be starting to shift, however, as unrelenting price gains, higher mortgage rates, and scant choices may be nudging would-be homebuyers out of the market."*



FICO Credit Score

There has been talk about changes regarding the calculation of FICO credit scores. An article on CNBC.com elaborates:

The gold-standard in consumer lending decisions is about to get a major overhaul that could increase approvals for credit cards and personal loans, according to The Wall Street Journal.

The creator of the FICO credit score, Fair Isaac Corp., plans to unveil a new scoring system next year that considers how prospective borrowers manage their cash, the Journal reported Monday.

For decades, FICO scores were based mostly on consumers' payment histories. But the new standard, reportedly called the UltraFICO Score, is designed to give people with dings on their credit histories a process to have their banking activity factored in as well, the Journal said.

Those who don't overdraw long-established accounts with at least several hundred dollars in them could see their credit scores go up under the new framework, according to the Journal.

Conclusion

Rising interest rates have a tangible effect on markets and economic activity. It is prudent to adopt a defensive mindset at this time by focusing on wealth-preservation as opposed to hitting home-runs.

-Robert J Sullivan