Reflecting on the second quarter, we get a sense that we have been through it before, reminding us of the movie "Groundhog Day." The Fed raised rates for the second time in June, and as of this writing, the DJIA is only slightly ahead of where it was at the time of our first quarter market commentary. Throughout the second quarter, we experienced a steady stream of positive news regarding domestic & global GDP growth, unemployment figures and corporate earnings. However, the announcement of U.S. tariffs on imported steel and aluminum earlier in the year also became a reality. The hope that these tariffs would not be significant due to the issuance of temporary exemptions was dashed when the tariffs were finally implemented in May against all targeted countries.

As global markets came to grips with the first round of U.S. tariffs and retaliatory tariffs from Canada, Mexico and the EU, more news came from Washington regarding additional U.S tariffs. This time, tariffs would impact products imported from China and possibly automobiles imported from Europe. Contrary to how global markets should have reacted to the prospect of an all-out trade war, the DJIA traded within a steady range between all-time highs and fresh lows as the tug-of-war dragged out between healthy corporate earnings and the possibility of an economic slowdown.

Previous commentaries have touched on our concern regarding a combination of non-demand driven inflation and higher interest rates. With this in mind, tariffs will only add to inflation readings already influenced by higher oil prices and exchange rates. We can only hope the Fed does not react to this and raise rates at a quicker pace due to our belief that higher prices alone can stifle domestic GDP growth. This is one of the factors driving the yield down on the 10 year note to the 2.8%+ range since reaching approximately 3% after the second rate increase by the Fed. Another recent positive factor impacting bond prices has been the flight to safety due to equity downside risk concerns.

Prior to the recent implementation of tariffs by both sides of the U.S./China equation, government reports have already indicated a pullback in capital expenditures due to uncertainty driven by the beginning of a global trade war. These corporate decisions have been consistent with our extremely patient approach in the management of our client portfolios. Even though we remain bullish on the U.S. economy, the prospect of a long-term trade war is concerning.

Small & mid-cap companies lagged the S&P 500 in 2017, however our allocation to these asset classes remain intact due to their lower foreign trade exposure. For 2018, we have witnessed signs of strength in small-cap companies, and if valuation parameters are fulfilled, mid-cap companies should follow suit. We do realize that escaping the negative effect of a prolonged trade war is difficult due to an indirect impact on small & mid-cap companies via a slowdown in GDP growth.

Lastly, we are excited to announce that we have completed our transition to Black Diamond, a new reporting platform that will provide cutting edge technology for many years to come. You will notice the changes starting with the Third Quarter Performance Report and during upcoming portfolio reviews. As always, please contact your investment consultant with any questions.