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The good news on the economy has been overshadowed in recent months by the escalating trade tensions with China and our other trading partners. The DJIA is still negative for the year as the possibility of higher tariffs have pulled down its large multinational industrial companies. The S&P 500 was up 2.9% for the second quarter, and the Nasdaq index was the strongest performer up 6.3% due to its much larger component of technology stocks. The CBOE Volatility index, the VIX, is up 40% year-to-date as money has come out of equity mutual funds and exchange traded funds and gone into U.S. Treasuries. The 10 year Treasury yield dropped back from its high of 3.10% in May to 2.84% at quarter end.

While further volatility due to ongoing trade negotiations is a strong possibility, the uncertainty is offset by the outlook for continued strong earnings combined with a moderate pace of monetary tightening. In addition to lowering the corporate tax rate, tax reform dramatically lowered the tax rate on bringing overseas profits and cash back onshore from 35% to 15.5%. J.P Morgan estimates that out of $2 trillion in profits held overseas, only $217 billion has come back into the U.S. during Q1. This money will be used by corporations to pay down debt, to strike deals, and to invest in their own businesses. Capital spending is up 20% this year, and the market saw a record high amount of buybacks in the first quarter of $756 billion. M&A activity globally has also been strong in 2018, up 57% year over year.

While the synchronized global expansion that drove markets to highs last year has slowed a little, particularly in Europe and Japan, the U.S. economy continues to do well. This is the second longest expansion in history, and Q3 GDP is estimated to be around 3.8%. Unemployment at 3.8% is as tight as it was during the late 1990s. Besides a prolonged trade war, there are several risks to earnings growth that we are monitoring. The price of WTI oil was up 14.2% in the second quarter as OPEC cut production and Venezuela output declined. Higher energy costs combined with higher healthcare costs could begin to impact profit margins even with lower corporate tax rates.

Around the world, recent elections in Italy, Mexico, and Germany show that voters are not happy with the status quo. The Brexit vote two years ago was an early warning sign of this. The global migrant crisis is a symptom of the ongoing humanitarian and economic crisis in many of the poorer parts of the world, and it is our hope that the combined efforts of the developed world can find a workable solution to these complex issues. If not, the political turmoil will continue to overshadow good economic news both here and abroad.

Thank you for your confidence in us, and we look forward to visiting with you in person or by phone conference at your convenience.

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