Monthly Market Commentary
June, 2018

US Economy

Typically, late in the economic cycle, we see consumer, investor, and business sentiment becoming increasingly positive. In past cycles, investor confidence rose even as market volatility began to increase. As previous economic cycles transitioned into recession, complacent investors were taken by surprise when market downturns proved to be more than temporary. The current US economic cycle does not appear destined for a recession in the near term; however, we estimate that the cycle is in its final third. Yet, institutional and individual investor confidence has been unable to mount a sustained recovery after a decline in 2015 – stemming from the beginning of Federal Reserve (Fed) monetary tightening and fears of a Chinese economic downturn.

Intensifying political and policy risks in the US and abroad, along with concerns that global monetary policy will tighten too quickly and stall economic growth, likely have left investors unsure about the prospects for future economic growth. In addition, global growth has lagged previous recoveries and investors may be cautious in light of rising interest rates – many are wary that the aging bull market in US equities will come to an end at some point. Despite these uncertainties, households have remained willing to increase their spending. This is a potential bright spot for future corporate earnings and one potential catalyst for higher US equity prices by year-end.

US Markets

US equity markets trended sideways during the month of June. We believe concerns surrounding tariffs and trade wars likely contributed to the market volatility, as investors digested news coming out of Washington. As we have mentioned in the past, we anticipate that the markets could remain range-bound throughout the summer (not unusual during the summer). While there are legitimate concerns about a negative impact from tariffs on global markets; in the near-term, we continue to be encouraged by a strong US economy, a strengthening labor market, increased consumer spending, and a robust housing market. As such, despite the potential for near-term volatility, we anticipate the markets could trend higher into year end.

Fixed Income

During their June meeting, the Federal Open Market Committee (FOMC) decided to increase the range for the federal funds target rate from 1.50% - 1.75% to 1.75% - 2.00%. The FOMC reiterated that it expects economic conditions to evolve in a manner that will warrant gradual increases in the federal funds rate. In addition, the Fed will continue reducing its balance sheet by $30 billion this month and plans to increase its month reduction to $40 billion next month.

The FOMC's reasoning behind the rate hike includes a strengthening labor market, a strong US economy, along with the unemployment rate remaining low. Household spending has increased, while business fixed investment continues to grow strongly. Looking forward, the FOMC anticipates that inflation (excluding food and energy prices) should continue to remain close to the Fed's 2% objective over the medium term. The FOMC expects that further gradual rate increases will be consistent with sustained expansion of economic activity and strong labor-market conditions.

International Markets

US trade policies have recaptured headlines throughout the month of June. The Trump administration decided to move ahead with imposing tariffs on steel (a 25% tariff) and aluminum (a 10% tariff). While the risk of a full-blown trade war may be higher, a trade war is not likely yet – as a potentially deeper conflict would involve tariffs that are larger in magnitude than what has been implemented so far. Since emerging market (EM) economies are expected to contribute significantly to global growth in 2018, there are concerns that export disturbances could affect the investment outlook of EMs and derail the positive pace of global growth.

We believe that the direct EM economic-growth impact of the latest US-imposed tariffs on aluminum and steel will be minimal overall – as they comprise a small portion of EM economies' total exports. Yet, financial-market uncertainties are being fueled by concern over potential deterioration in global trade conditions that could result from escalating retaliation – and by direct impacts on businesses, such as increased input costs, the time required to switch suppliers, or delayed production.

The top suppliers of steel and aluminum to the US – China, Brazil, Russia, South Korea, Mexico, and the United Arab Emirates – will likely experience industry specific impacts, as price increases stemming from tariffs likely would cause US companies to seek supply domestically. However, given the size of these large EM economies and the volume of their exports, we believe that the direct impact of steel and aluminum tariffs may only have a minimal impact on global growth.

Commodities

The Permian basin is a US shale-oil basin that is responsible for a large portion of the oil-production growth that the US has witnessed recently. Earlier this year, a problem surfaced in the area – as oil production started to exceed pipeline "takeaway" capacity. In other words, there was "too much oil in the Permian basin for the existing pipelines to handle. This dynamic had the same effect as putting a kink in a garden hose, as it restricted the full potential flow of oil.

Some market observers have pointed to this supply constraint as being supportive of oil prices – and they are likely correct – in the short term. But in the intermediate term, the kink in the hose is likely to be fixed, and Permian oil should then be flowing at full force. The fix is expected in 2019 as additional pipelines come online. At that time, the issue of "too much oil in the Permian basin" may change to just "too much oil."

What Does This Mean To Me?

The recent market volatility and disconcerting trade language that has been emanating from Washington has likely weighed on investor sentiment. Nonetheless, we believe investors should continue to follow their long-term investment plan during times of political uncertainty – and focus on the underlying fundamentals that traditionally drive economic growth, such as a strong labor market, healthy household spending and borrowing, and a pickup in business investment.

If you have any questions or concerns, please do not hesitate to reach out to us at any time.

Sincerely,

Chad E. Mickelson, CRPC®, CFP®
Senior Vice President – Investments
Financial Advisor

Clint A. Markin, CRPC®, CFP®
Senior Vice President – Investments
Financial Advisor

This letter has been prepared for informational purposes only and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Investing involves risk including the possible loss of principal. The opinions expressed in this letter are those of the author(s), are subject to change without notice and are not necessarily those of Wells Fargo Advisors or its affiliates. Statistical information has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed. Past performance is not a guarantee of future results and there is no guarantee that any forward looking statements made in this letter will be attained.

Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. An investment in the stock market should be made with an understanding of the risks associated with common stocks, including market fluctuations.

Investing in commodities is not suitable for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. The prices of various commodities may fluctuate based on numerous factors including changes in supply and demand relationships, weather and acts of nature, agricultural conditions, international trade conditions, fiscal monetary and exchange control programs, domestic and foreign political and economic events and policies, and changes in interest rates or sectors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks, including futures roll yield risk.

There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied economic conditions.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. Investing in emerging markets accentuates these risks.

Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC, Member SIPC.
CAR# 0718-00967

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC, Member SIPC.