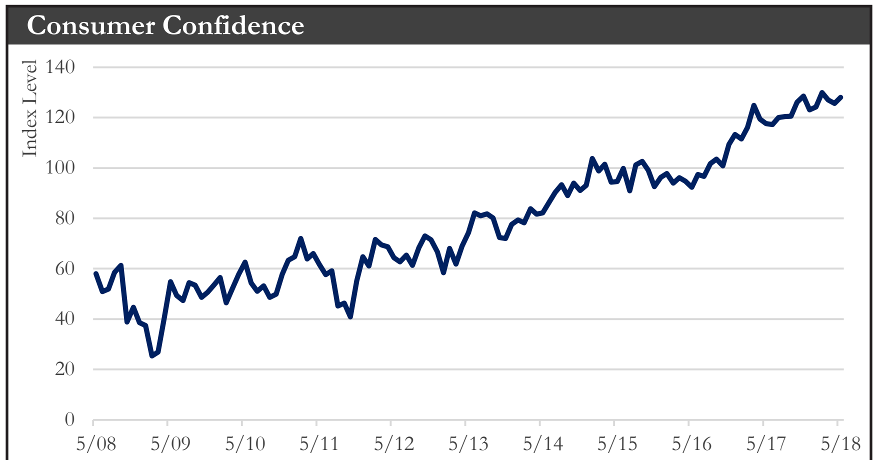
Old Dominion
Capital Management, Inc.

MONTHLY UPDATE AND COMMENTARY
JUNE 2018

Recap: The American economy grew by 2.2% (annualized) in the first quarter. This slight downward revision to growth in Q1 has not changed the basic story for the economy, which involves some early year seasonality holding back growth followed by quarterly growth of close to 3% through the remainder of the year. The U.S. economy grew at 2.8% on a year-over-year basis in the first quarter – well above its potential, and a marked acceleration from 2% at the beginning of 2017. The US economy has been doing very well.

The Fed discounted the somewhat slow start to the year. And, barring some dramatic unforeseen event, all indications at this point have been that an interest rate hike is likely on June 13th. Beyond June, the Fed is likely to raise rates at least one more time this year and maybe two. While the recent improvement in inflation biases to an upside risk on rates, that view must be tempered with the decision on the part of the Administration to impose import tariffs. These would likely have negative consequences for business confidence and future investment.

Consumer Confidence: Consumer confidence in the economy remained buoyant heading into summer, with the Conference Board's measure rising 2.4 points. Households viewed both current and future economic conditions more favorably, while the labor differential—the share of house-holds reporting jobs as "plentiful" minus the share reporting "hard to get"—pointed to an increasingly tight labor market.



Source: The Conference Board

Personal Income: Americans' spending gathered further momentum in April as incomes continued to rise which should be viewed as a signal that consumers could drive stronger economic growth in the second quarter. Personal income rose 0.3% in April. Personal spending rose by a robust 0.6% in nominal terms in April. Prices increased by 0.2% on the month, lifted by both energy and food prices. On a year-over-year basis, headline inflation remained unchanged at 2% while core PCE inflation – the Fed's preferred measure – remained unchanged at 1.8% on a year-over-year basis. The personal saving rate fell by 0.2 percentage points to 2.8% - the lowest level since December 2017.

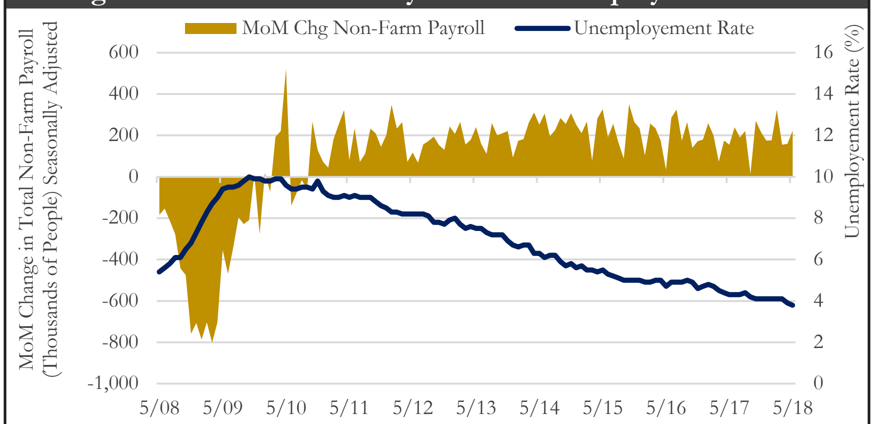
Rising incomes, decreasing unemployment, and lingering money from last year's tax cut helped propel spending on both goods and services in April, which suggested consumers' momentum has been rebuilding after a slowdown earlier this year. As a result, after expanding by just 1% (annualized) in the first quarter of the year, consumer spending has been on track to surpass the 3% mark in Q2. This bodes well for GDP growth, which is also likely to come higher than 3%.

With core inflation still running below 2%, there have been few signs that the economy is overheating, which has allowed the Federal Reserve to continue with their gradual pace of interest rate normalization.

With that said, the risk of trade wars due to the tariffs imposed on steel and aluminum has muddied the water on the inflation outlook. The tariffs should lead to higher prices for American consumers. As such, trade developments will be closely followed by the Federal Reserve in the coming months.

Labor Market: U.S. non-farm payrolls increased by 223,000 in May. Services sector hiring was the driving force behind the acceleration, although goods sector hiring also held up relatively well. Perhaps even more surprising was the unemployment rate falling to 3.8% – the lowest reading in 18 years. The labor force rose by a modest 12,000 people, and the participation rate dropped to 62.7%, highlighting that structural challenges to bringing more workers back into the labor force have persisted. Wage growth accelerated in May, rising 0.3% on the month. On a year-on-year basis, growth in average hourly earnings picked up to 2.7%.

Change in Total Non-Farm Payrolls and Unemployment Rate

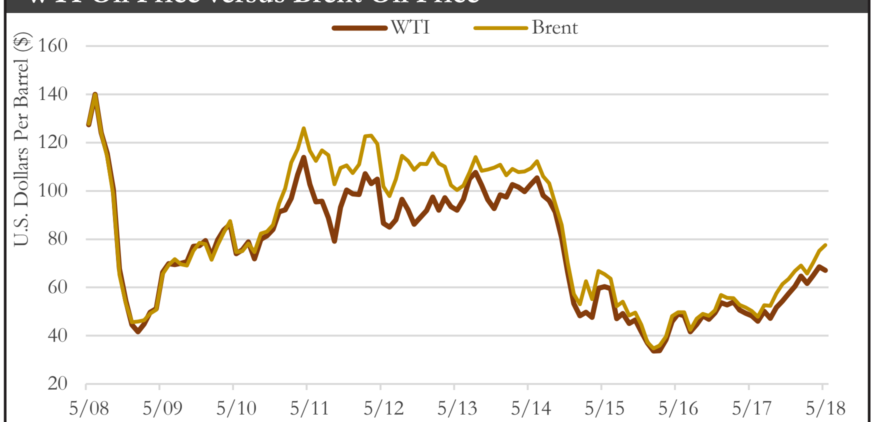


Source: U.S Bureau of Labor Statistics

May's healthy hiring tally in part represented a catch up from some weather-related weakness in recent months. Monthly payroll tallies were expected to slow in line with a maturing expansion as the economy ran out of people to pull back into the labor force. With wage pressures picking up and the unemployment rate falling again, the Federal Reserve will likely raise interest rates on June 13th.

Oil Price and Inflation: Oil prices have been rising steadily over the past month, with implications for the domestic and global economy. Higher energy prices should help support domestic investment and overall economic activity in oil exporting countries such as Saudi Arabia, Canada, and increasingly the United States. However, consumers will likely begin feeling the pinch from higher gas prices. The pass-through to consumers from rising energy prices has usually been quite brisk, and this time is no exception. The U.S. CPI report for April saw prices rise 2.5% over the past twelve months, largely owing to a strong upward move in the price of gasoline (+13.4% y/y).

WTI Oil Price versus Brent Oil Price

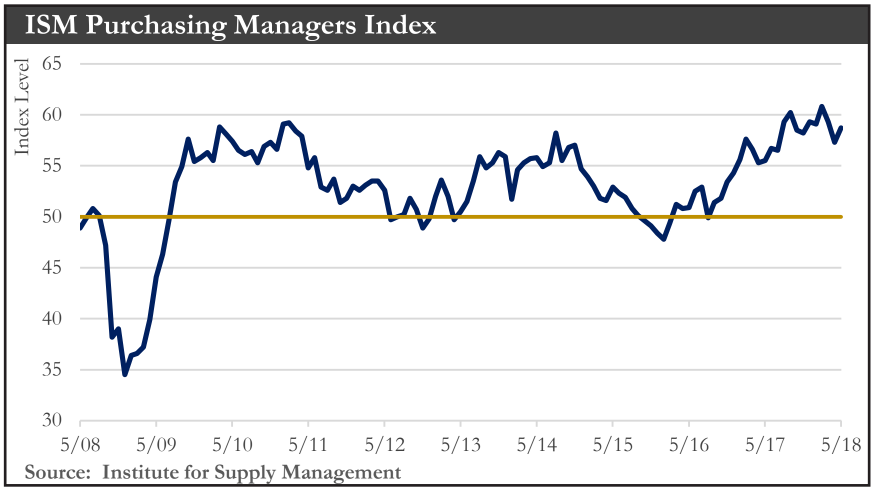


Source: Bloomberg

That said, inflationary price pressures overall have remained fairly subdued, despite strong economic activity and tightening labor markets. Inflation should hold near the Fed's 2% target for the remainder of the year, with the economy running just hot enough to warrant as many as two more rate hikes this year.

Housing: Higher interest rates will certainly have an impact on the housing market. After declining by 6% in the first quarter, existing home sales have started the second quarter on weak footing as activity fell 2.5% in April. Sales of new homes also took a break in April, declining by 1.5%. Since the start of the year, the average rate on a 30-year mortgage rose by 0.70% basis points. Rising rates alongside brisk growth in home prices have dented affordability; however, this has only been part of the story behind relatively tepid home sales. Low inventory levels of existing houses on the market have been the most important factor restraining resale activity. The pace of new construction has remained modest and will likely be constrained by labor shortages and rising housing component costs. The overall pace of activity in the housing market will likely once again remain modest this year.

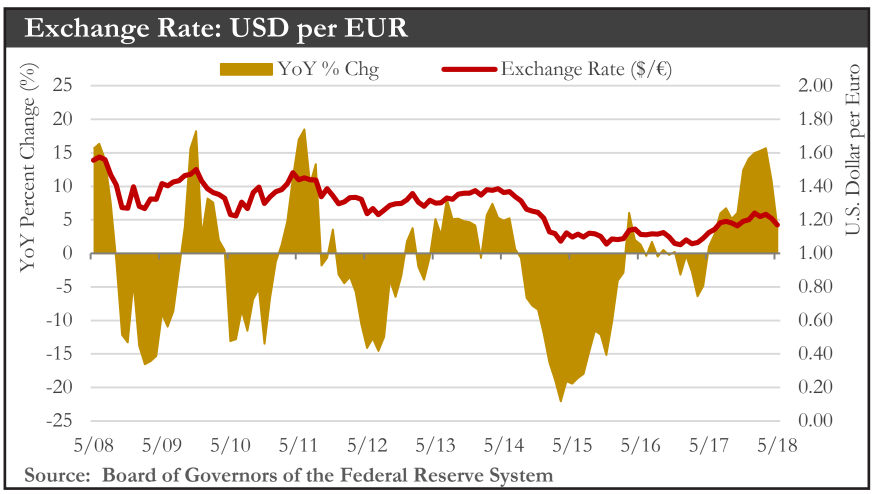
Manufacturing Index: The Institute for Supply Management (ISM) manufacturing index rose by 1.4 points to 58.7 in



May, marking the first increase since February. Consistent with anecdotal evidence found in the Fed's latest Beige Book, the pace of U.S. manufacturing picked up in May. Still, capacity constraints have continued to be a concern.

The impact of trade tensions and uncertainty was also apparent in this release. Trade subcomponents declined for three consecutive months, and survey respondents expressed concerns about rising prices of steel and aluminum, and experienced large degrees of uncertainty due to trade disputes. With steel and aluminum tariffs taking effect, and retaliatory trade actions from other countries on the horizon, it appeared that those worries would only intensify for U.S. businesses in the coming months.

Euro Zone: The eurozone's May annual rate of inflation was 1.9% higher than in 2017, a jump from the 1.2% rate of inflation recorded in April, the highest level since April of last year. Much of that pickup was due to rising energy prices. But slower economic growth and political turmoil in Italy suggests the path ahead remains uncertain for policy makers.



The pickup could fade if volatile energy prices give up their gains, or a first-quarter economic slowdown proves more durable than expected. Political upheaval in Italy threatens the stability efforts the ECB has worked hard to contain over the past six years.

While the ECB has targeted a headline inflation rate of just under 2%, it has tended not to react to changes that were primarily driven by volatile energy costs, in common with most other central banks. For an energy importer such as the Euro zone, higher prices have crimped growth, since they could force consumers to cut back on purchases of other goods and services produced inside the currency area. Economic data releases and business surveys released since the end of the first quarter have not pointed to a rebound in growth across the zone.

The wild card for policy makers is Italy, where the President blocked the formation of a euro-skeptic government, prompting a jump in government borrowing costs and a weakening of the euro. In the wake of Italy's political and bond market turbulence, there is a likelihood that the ECB will soon signal that the program of bond buys will carry on at least until the end of the year, and possibly beyond. This turmoil has reinforced the view that the bank will extend the asset-buying program into 2019 and that the likelihood of rate hikes will now be pushed out much further into the future.

Emerging Markets: Elsewhere, India's economy accelerated for the third consecutive quarter, rising 7.7 percent year over year. The data were supportive of the view that India's economy has turned the corner after an economic slowdown driven by structural reforms surrounding demonetization and the rollout of the goods and services tax. The Reserve Bank of India (RBI), which had been cutting its main policy rate over the 2015-2017 period to combat a slowdown in growth and inflation, has been on hold since last summer. With inflation in check and economic growth gaining momentum, the Reserve Bank of India would seem content to assess the incoming data and let the recovery continue unperturbed.

Tariffs: The U.S. administration imposed a 10% ad valorem tariff (proportional to price) on aluminum imports and a 25% ad valorem tariff on steel imports from the European Union as well as Canada and Mexico. The amount of trade actually effected by this change has been quite small: about 0.8% of annual Canadian output, 0.3% of Mexican output, and 0.04% of EU output. As such, these tariffs are likely to have a very minor direct effect on economic activity, jobs, and consumer price inflation in these regions. However, there is a chance of a more outsized negative impact on economic activity if the imposition of these tariffs should dent confidence and therefore results in the delay or cancellation of new investment in these regions.

Moreover, the policy risks higher prices on imports, painful retaliation against U.S. exports and longer-term strife with allies. Consumer price inflation should be increased by at least 0.1 percentage points this year and next from these tariffs. However, equivalent tariffs announced by affected regions and the potential for further tariff escalations could amplify the estimated drag on economic growth and lift to consumer price inflation.

Outlook: Recent U.S. economic data has been broadly positive. American consumers were back in full force in April, with personal spending rising by a robust 0.4% in real terms, building on a solid March performance. The back-to-back gains have pointed to a 3.5% rebound in second quarter consumer spending after a soft first-quarter print (1% Q/Q annualized). This narrative has been further reinforced by a strong labor market. In May, payroll gains beat expectations, the unemployment rate fell to an 18-year low and wage growth accelerated. The latest data has cemented the case for a Federal Reserve interest rate hike on June 13th.

With manufacturing activity slowing from a very strong pace of expansion in Europe, observers are worried that global economic momentum may be starting to slip. Still, global growth is expected to expand by 3.8% in 2018 though momentum has clearly slowed in Europe and some other regions.

Escalation of trade tensions poses a clear downside risk to global growth by elevating economic policy uncertainty and denting business confidence both domestically and abroad. Although they have had limited impact thus far, these types of feuds can quickly escalate. Add to this the Iran sanctions and the uncertainty of any fruitful results from talks with North Korea adds to the reservoir of downside risks.

Sources: Department of Labor, Department of Commerce, Institute for Supply Management, Indian Ministry of Statistics and Programme Implementation, Eurostat, Yahoo Finance, Bloomberg, the Conference Board.

Index Performance as of 5/31/18

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Russell								
3000 Value	-1.07	0.99	1.43	-0.14	-1.43	8.85	7.71	10.15
3000	-0.61	2.82	3.21	1.14	2.55	15.06	10.71	12.85
3000 Growth	-0.19	4.53	4.88	2.32	6.43	21.32	13.68	15.51
1000 Value	-1.17	0.59	0.93	-0.85	-1.93	8.25	7.44	10.10
1000	-0.69	2.55	2.90	0.57	2.19	14.60	10.70	12.92
1000 Growth	-0.26	4.38	4.75	1.88	6.23	21.02	13.93	15.70
Mid Cap Value	-0.81	1.09	1.59	1.84	-0.96	8.32	7.57	10.83
Mid Cap	-0.76	2.27	2.11	2.18	1.64	12.67	8.57	11.80
Mid Cap Growth	-0.69	3.74	2.76	2.59	4.99	18.42	9.99	13.01
2000 Value	0.05	5.82	7.65	8.98	4.81	16.35	11.04	10.96
2000	0.36	6.07	6.99	8.37	6.90	20.76	10.97	12.19
2000 Growth	0.64	6.30	6.40	7.83	8.85	25.08	10.81	13.33
Standard & Poors								
S&P 500	-0.77	2.41	2.80	0.19	2.02	14.38	10.97	12.98
Consumer Disc	-0.20	1.99	4.40	1.97	7.63	17.82	13.33	15.35
Consumer Staples	-0.26	-1.53	-5.78	-6.61	-12.49	-10.14	3.35	7.17
Energy	-0.72	3.04	12.68	14.55	6.05	19.93	2.25	1.67
Financials	-2.72	-0.90	-1.27	-5.53	-2.21	18.97	13.08	13.19
Health Care	-0.83	0.22	1.44	-1.67	0.20	10.26	5.01	13.25
Industrials	-1.97	3.01	0.13	-2.55	-1.43	10.46	11.59	13.13
Information Technology	0.10	7.37	7.47	3.27	11.26	28.20	20.94	21.10
Materials	-1.93	2.07	2.22	-2.11	-3.42	11.55	6.93	9.83
Real Estate	1.73	2.26	1.62	5.46	-3.47	2.49	5.61	7.51
Telecom Services	-1.70	-2.28	-3.24	-4.20	-10.48	-3.85	2.25	3.62
Utilities	1.43	-1.13	0.95	4.75	-2.38	-2.09	8.41	10.18
Other U.S. Equity								
Dow Jones Industrial Avg.	-1.51	1.41	1.76	-1.90	-0.24	18.91	13.46	12.78
Wilshire 5000 (Full Cap)	-0.53	2.80	3.35	1.20	2.63	15.10	10.58	12.69
International Equity - Broad Market								
MSCI EAFE	-1.73	-2.25	-0.02	-1.82	-1.55	7.97	4.33	5.93
MSCI EM	-1.19	-3.54	-3.97	-5.76	-2.61	14.03	6.17	4.52
MSCI Frontier Markets	-1.71	-9.22	-12.08	-11.28	-7.59	6.08	3.35	4.11
MSCI ACWI	-1.12	0.12	1.08	-1.08	0.11	11.84	7.52	8.88
MSCI ACWI Ex USA	-1.54	-2.31	-0.75	-2.50	-1.92	9.67	4.74	5.46
MSCI AC Asia Ex Japan	-0.57	-1.32	-0.62	-2.12	0.04	17.27	7.42	7.96
International Equity - Country Region								
MSCI Brazil	-5.98	-16.37	-19.71	-21.19	-9.78	6.86	7.44	-3.43
MSCI BRIC	-0.63	-1.82	-2.29	-5.38	-0.12	22.04	7.21	6.24
MSCI China	-0.47	1.84	1.81	-1.54	3.66	30.85	6.93	11.68
MSCI Europe	-2.17	-3.28	-0.61	-1.80	-2.58	4.83	3.37	5.30
MSCI India	3.00	-3.59	0.37	-3.23	-6.61	6.68	5.79	7.71
MSCI Japan	-1.13	-0.99	-0.32	-2.43	0.51	14.57	6.53	8.29
MSCI EM Latin America	-4.48	-14.06	-15.15	-15.96	-8.34	3.67	3.40	-3.62
MSCI Russia	-0.46	1.13	-6.39	-9.89	2.39	20.74	9.86	0.37

Index Performance as of 5/31/18

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Fixed Income								
Barclays U.S. Aggregate	0.75	0.71	-0.04	0.61	-1.50	-0.37	1.39	1.98
ICE BofAML US 3M Trsy Bill	0.03	0.15	0.28	0.42	0.64	1.28	0.62	0.39
Barclays U.S. Gov't	0.90	0.89	0.08	1.01	-1.07	-0.80	0.72	1.25
Barclays U.S. Credit	0.66	0.50	-0.41	-0.10	-2.53	0.08	2.41	2.87
Barclays High Yield Corp.	-0.06	-0.03	0.62	0.01	-0.24	2.35	4.86	4.87
Barclays Municipal	0.60	1.15	0.78	1.16	-0.33	1.11	2.79	2.92
Barclays TIPS	0.84	0.43	0.37	1.42	-0.42	0.74	1.46	0.86
Barclays Gbl Agg Ex USD	0.03	-1.87	-4.10	-2.72	-0.62	3.40	3.50	0.85
Barclays Global Aggregate	0.34	-0.76	-2.35	-1.31	-1.02	1.72	2.58	1.34
JPM EMBI Global Div	-0.28	-0.94	-2.38	-2.10	-4.08	-0.56	4.50	4.34
Alternative Investments								
Alerian MLP	1.41	5.05	13.55	5.67	0.93	-3.71	-8.13	-3.20
Bloomberg Commodity	-0.83	1.42	4.04	3.39	3.62	11.02	-2.84	-6.64
FTSE NAREIT Equity REIT	1.99	3.95	5.44	9.45	-3.21	1.34	4.88	6.97
S&P Global Natural Res.	-1.20	1.47	6.54	4.89	4.78	26.09	7.99	4.40
S&P N. Amer Natural Res.	-1.03	3.02	11.09	13.10	4.38	18.10	1.42	0.77

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