COMPASS WATCH

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Mark S. Halverson
Christopher C. Kelley, CFA, CAIA
Jay M. Jackley, CIMA
Leigh E. Niebuhr
Charles M. Kelley, CFA
Mark A. Vitelli, CFA

The Ongoing Divergence Between U.S. & International Markets

It's almost impossible to avoid international exposure in today's globally interlinked economy. Nearly one-third of the revenues of U.S. companies in the S&P 500 Index come from outside the United States. The trends influencing demographics and technology have made the world flatter. However, we continue to see a divergence between the U.S. and most of the rest of the world in economic momentum and central bank policy. Despite the promiscuous monetary policy by central bankers worldwide, many non-U.S. markets have lagged significantly behind the S&P 500 Index in the long term. This is the case even though *emerging* markets, with favorable conditions, have accounted for two-thirds of global growth over the last seven years.

INDEX	DESCRIPTION	3-YEAR	5-YEAR	10-YEAR	20-YEAR
S&P 500	**U.S.**	**11.41%**	**15.79%**	**8.49%**	**7.19%**
CAC 40	France	10.86%	9.38%	1.23%	6.45%
DAX	Germany	9.22%	9.05%	2.72%	6.22%
FTSE 100	U.K.	4.53%	5.54%	1.74%	4.57%
Hang Seng	Hong Kong	12.01%	9.53%	4.30%	8.83%
Nikkei 225	Japan	13.52%	12.84%	6.00%	4.19%

Source: Bloomberg, as of 12/31/17. Returns are in US Dollars, annualized.

The U.S. was the first major market to recover from the global crisis after 2008. It also remains ahead of other regions in moving from an accommodative monetary policy, which was meant to spark growth, to a neutral policy stance, which is reflected by three consecutive years of interest rate increases. Europe, Japan, and the rest of developed Asia, meanwhile, have maintained easy monetary policies to keep their recoveries on track or to avert recession.

Economists generally believe low barriers to trade and investment are positive attributes to reduce consumer prices and allow capital to flow to the most productive companies and industries, fueling rising prosperity. However, many astute investors believe that the current U.S. administration's unfunded tax-cuts, tariffs, trade wars, and higher spending will force the U.S. to raise interest rates faster and out-of-step with Europe and Asia. Global debt has risen from 179% of GDP on the eve of the Lehman crisis (September 2008) to 217% of GDP today, as emerging markets join the credit binge.

Many emerging markets have borrowed in foreign currencies (mainly U.S. dollars). As the dollar strengthens, it becomes more expensive to repay loans, which then raises the issue of credit defaults. Famed Austrian economist Ludwig Von Mises once stated, "When Central Banks raise rates, the misallocation of credit is revealed and must be unwound." The risk-reward calculation has changed.

Thus, the strengthening dollar and rising U.S. interest rates act together as a tightening tourniquet on world liquidity. To defend against capital flight as the dollar strengthens, emerging market economies must also raise interest rates, curbing their own growth.

The larger question is: Why are longer-term interest rates stubbornly low? A year ago, the consensus expectation was that the 10-year US Treasury would be well above 3% today. But the reality is that the spread (or difference) between two-and ten-year US Treasury yields is below 20 basis points[1], its lowest reading since August 2007. On a global basis, prospects for robust economic growth might not be so promising, and this could be the reason that longer-term rates aren't at levels where investors thought they would (or should) be.

Another key component that investors often overlook when investing directly overseas is *currency*. When U.S. investors buy foreign domiciled stocks, they are essentially making two investments, often without realizing it: first, the direct investment in the company itself, and second, the less obvious investment in the currency in which the foreign company is denominated. Domicile still matters some. Aside from renewed concerns about tariffs and trade wars, not every foreign country has laws in place (i.e., governance, accounting standards) to protect investors to the same extent as the U.S.

For 30 years, our responsibility at Compass has been to manage client portfolios, applying sensible, time-tested disciplines. High-quality, U.S. exchange-listed multinational growth companies (like we own) still appear to be a sensible choice for building and sustaining future wealth.

[1] Source: Bloomberg as of 8/27/2018. The 10-year US Treasury=2.84%; 2-year US Treasury=2.65%.

Compass Capital Management • 706 Second Ave S, Suite 400 • Minneapolis, MN 55402
Phone (612) 338-4051 • compasscap.com • Fax (612) 339-1304

Quality Relationships. Quality Investments.

A Guide for Your Journey

Navigating your financial journey lacking a guide is like driving to an unfamiliar destination without a compass, map or GPS. You may reach your goal, but not without some stress and setbacks. Avoid the financial road construction, traffic backups and speed traps—let Compass help navigate.

Life unfolds differently for everyone. By planning ahead, you can make well-informed decisions that will positively impact your life. Ask us how we may help address your specific needs.

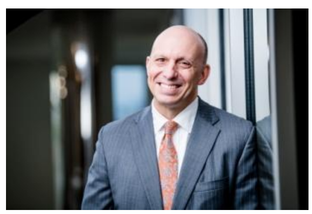
For a review of your financial assets or other investment advice, do not hesitate to contact the seasoned and experienced Compass Investment Team.

Leigh Niebuhr
612.338.7216
leighn@compasscap.com

Charles Kelley, CFA
612.338.4077
kelley@compasscap.com

Mark Halverson
612.338.4250
markh@compasscap.com

Jay Jackley, CIMA
612.767.4202
jayj@compasscap.com



Mark Vitelli, CFA
612.338.4358
markv@compasscap.com

Chrisopher Kelley, CFA & CAIA
612.338.4133
chris.kelley@compasscap.com

Market Commentary

Within the S&P 500 index, Energy and Consumer Discretionary were the strongest sectors in the second quarter, while Financials and Consumer Staples were the weakest.

Bond prices moved slightly lower in response to emerging signs of inflation in the economic data. The 10-year U.S. Treasury yield increased to 2.86% from 2.74% during the quarter.

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Market Indexes

(Total Return as of 6/30/18)