ROCKLAND TRUST

Where Each Relationship Matters®

July 2018

Dear Investors:

Over the summer, I spend every weekend I can out on the water. As my family gets older, I've come to realize that the boat helps bring my kids home. It's the one place where we can all come together for relaxation or adventure depending on where the waves carry us.

Throughout the second quarter, it was rare for investors to hear the word "market" without the word "volatility". After an unusually complacent market in 2017, it can be easy to forget that market volatility is normal. Volatility, much like waves, can make the ride uncomfortable, but is an expected part of the journey.

Despite the volatility that has crept back into the market, U.S. stocks were still slightly up at the end of the quarter. Let's take a look at the economy that carried us through the first half of the year.

U.S. Economy

In its tenth year of economic expansion, the second-longest on record, the U.S. economy continues to chug along at a sluggish pace. For the first time in three years, it's a possibility that we could see economic growth in the second quarter reach three percent year over year. Fiscal stimulus remains strong and the tax cuts leading into 2018 continued to increase business and consumer spending through June.

The U.S. Labor market continues to tighten and the unemployment rate remains extremely low at 4.0%. In May, the unemployment rate fell to 3.75% which was the lowest since December of 1969.

The corporate tax rate cut from 35 percent to 21 percent led to higher profits in the first half of the year. In addition, a weaker dollar increased the value of foreign revenues and oil prices were up year over year which helped U.S. energy companies. Both the stronger labor market and higher energy prices contributed to an uptick in inflation in the second quarter.

Traditional Asset Class Returns Q2:2018			
Asset Class	**Benchmark**	**Q2**	**YTD**
US Stocks	S&P 500	3.43%	2.65%
US Gov't Bonds	BbgBarc US Govt Intermediate	0.01%	-0.97%
Cash	BbgBarc US Treasury Bill 1-3 Mon	0.44%	0.77%

U.S. Stocks

Investors were cautious in quarter two. Among their major concerns were: the impact of the two rate increases in the first half of the year, the possibility of trade wars, and the potential for rising inflation. All in all, U.S stocks performed slightly better than their international counterparts to close the first half of the year.

2018 marks the eighth consecutive year the S&P 500 rose in the first half of the year. The Russell 2000, which largely consists of smaller-capitalization domestic companies, has benefited from the continued strength in the U.S economy as well as the domestic corporate tax overhaul. It remains the best performing index so far this year.

Year-to-date, the S&P 500 has risen +2.65%, led by the Consumer Discretionary (+11.52% YTD) and Technology (+10.87%) sectors. The technology sector continued to rally with the help of tech giants Apple, Facebook, Google, and Microsoft. These four tech stocks alone have accounted for 43% of the S&P 500's return YTD. Stocks in the industrials, financials and telecommunication services sectors lost ground this quarter due to concerns around trade sanctions, rising interest rates, and a flattening of the yield curve. The Consumer Staples (-8.55% YTD) and Telecom (-8.35% YTD) sectors continued to underperform and remain the worst performing U.S. equity sectors through the first half of the year.

U.S. Bonds

During the second quarter of 2018, interest rates rose across the yield curve with larger increases in the short and intermediate maturities; driven by the Federal Reserve proceeding with their plan to tighten monetary policy. Strong economic data including robust GDP growth and record low unemployment, contributed to the Fed raising rates at their June meeting. Interest rate increases on the longer end of the curve were muted during the quarter and the yield curve continued to flatten. Both investors and the Federal Reserve will closely monitor the shape of the yield curve as many view it as an indicator of economic sentiment and future inflation.

Several times throughout the quarter we saw the U.S. 10 year treasury yield top 3% for the first time since 2014. These spikes in yield came with increased Treasury supply to pay for Tax Plan initiatives, geopolitical tensions post announcement of the U.S. withdrawal from the Iran deal and briefly after the June Federal Reserve meeting which was viewed to contain a more hawkish tone. Ultimately, we saw yields retreat each time as escalating trade tensions had investors seeking safety in U.S. treasuries, sending yields lower.

The 10 year treasury finished the quarter at 2.86%, higher than where we ended Q1 2018 at 2.74% and the beginning of the year at 2.41%. Overall, the investment grade bond market was slightly positive for the quarter but remains generally negative year to date.

Diversifying Asset Classes

In Q2, the rising US dollar was a headwind for non-US assets which caused emerging market securities to sell off. MLPs rallied in the quarter due to a double-digit increase in the price of crude oil. US Real Estate Investment Trusts (REITs) posted their fourth consecutive monthly gain in June, resulting in strong Q2 performance that put the asset class into positive territory for the year.

Asset Class	Benchmark	Q2	YTD
Foreign Stocks	MSCI EAFE	-1.24%	-2.75%
Emerging Markets Stocks	MSCI Emerging Markets	-7.96%	-6.66%
US Mid Cap Stocks	Russell Mid-Cap	2.82%	2.35%
US Small Cap Stocks	Russell 2000	7.75%	7.66%
REITs	MSCI US REIT	10.10%	1.19%
Commodities	Bloomberg Commodity	0.40%	0.00%

MLPs	Alerian MLP	11.80%	-0.63%
Managed Futures	Morningstar US Managed Futures	-1.37%	-3.96%
Foreign Bonds	FTSE WGBI Non-USD	-5.11%	-0.92%
Emerging Market Bonds	JPM EMBI Global	-3.51%	-5.23%
US Inflation Protected Bonds	BbgBarc US Treasury TIPS	0.77%	-0.02%
Floating Rate Loans	Credit Suisse Leveraged Loan	1.58%	2.38%
US High Yield Bonds	BbgBarc US Corp High Yield	1.03%	0.16%
Convertible Bonds	ICE BofAML Convertible Bonds	3.77%	6.26%

Conclusion

It is likely we will continue to ride the wave of market volatility in the second half of the year. The market, like the ocean, is rarely still.

While volatility can bring discomfort, it is a necessary part of the investment process. Our portfolios are designed to withstand the stormy waters. Our focus has always, and will continue to be, helping you reach your destination safely.

Thank you for your continued confidence.

Sincerely,

David B. Smith, CFA
Chief Investment Officer
Investment Management Group

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NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY • NOT GUARANTEED BY THE BANK