Market Update

September 2017

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Summer Shake

August was a month of intrigue and volatility in the financial markets. The eerie calm which had pervaded global bourses for much of the year gave way to tumult in the last full month of summer. Corporate earnings, Hurricane Harvey, and geopolitical tensions with an increasingly strident North Korea were among the causes, as was political uncertainty stemming from Capitol Hill and the Trump administration.

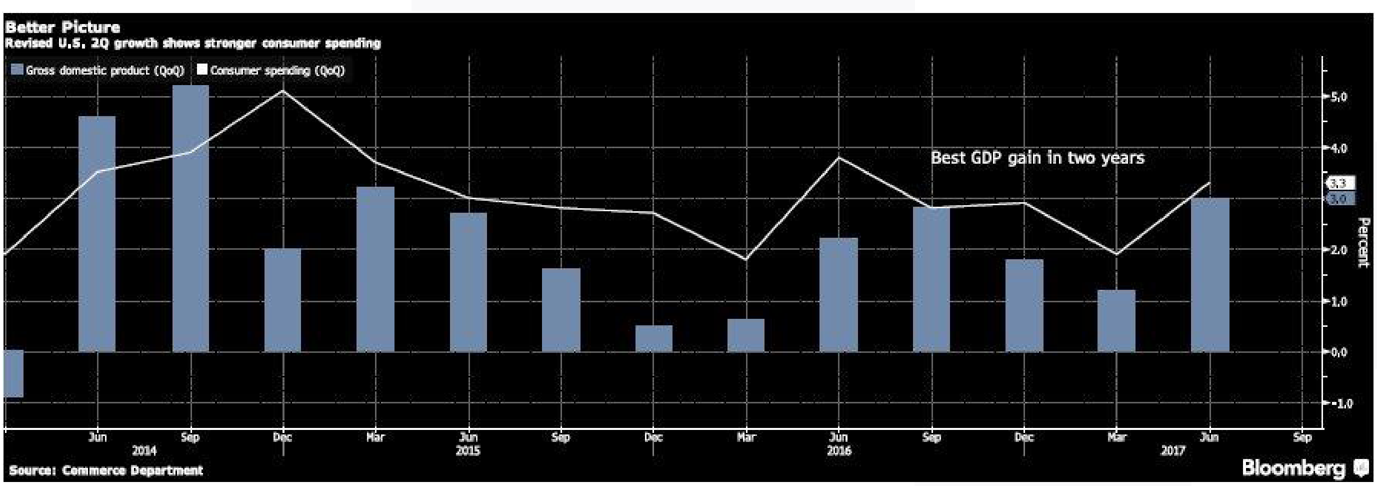
The S&P 500 closed the month at 2,471 and the Dow Jones Industrial Average wound up at 21,948. Fear and uncertainty drove yields on US Treasuries lower, as investors bid up the price of safe haven assets. The yield on the 10 year U.S. Treasury bond started August at 2.25%, but ended at 2.12%. Industrial metals rose in price as global demand strengthened. International equities were mixed, and developed equities eased slightly and emerging markets displayed strength. The dollar continued its trend lower against other major currencies.

S&P 500	0.31% (including dividends)
DJIA	0.65% (including dividends)
NASDAQ	1.43% (including dividends)
EAFE	-0.31% (developed international equity index)
MXEF	2.01% (emerging market equity index)

Source: Bloomberg

What does it mean?

The U.S. economy picked up steam throughout the summer, as second quarter GDP was revised upward to 3.0% on the strength of consumer spending (up 3.3%) and business investment (up 6.9%). It was the fastest pace in two years, and a welcome signal that economic activity in the U.S. is broadening beyond increasingly debt-laden households.



Source: Bloomberg

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The latest figures, combined with upward revisions to previous quarterly data, suggest that the American economy is gaining momentum heading into the second half of the year. Corporate pretax earnings were up 1.3% from the prior quarter and 7.0% over the previous year.

Drivers

Backed by a strong labor market, the American consumer is feeling optimistic. Even though wage growth has been lackluster, the combination of low unemployment (4.4%), subdued inflation (1.9% CPI year over year) and attractive borrowing costs have made for a favorable backdrop. Corporations increased spending on software, structures and equipment, all of which suggest confidence in the outlook ahead. The ISM manufacturing index increased from 56.3 in July to 58.8 in August. And large companies with global operations and international customer bases benefitted from the weakening dollar. Even though stock prices have broadly gained through the end of August (the S&P 500 was up 10% since January), the dollar has declined 8.4% against major foreign currencies. Digging deeper into the numbers, The Wall Street Journal notes that shares of American companies which derive more than half their revenue outside of the U.S. are up an average of 13%. Conversely, S&P 500 companies which derive less than half their income from abroad are up only 5.9% from January 1 through the end of August. And the "least" international firms (those in the bottom 20%) saw their stock prices increase only 2%.

The Fed

The Federal Reserve appears to remain on target to start reducing the size of its balance sheet, starting at its September meeting. This will mark a shift to quantitative tightening, as the central bank uses another lever besides interest rates to "normalize" monetary policy. Wall Street expects the Fed to move slowly to avoid spiking interest rates and causing market disruptions. The current plan calls for the balance sheet to initially shrink by only $10 billion per month, and with the pace gradually increasing by $10 billion every quarter up to a maximum of $50B per month. Since other central banks around the world are still buying assets, the Fed's maneuvers are not expected to have a meaningful impact on interest rates for at least a year. When all is said and done, and the Fed has extricated itself from the QE (Quantitative Easing) business, we would expect to see interest rates modestly higher. JPMorgan's estimate of a post-unwind 10 year U.S. Treasury yield in the 3.2 – 3.5% range seems reasonable to us.

Disappointing sign of the times:

The recent security breach at Equifax and the company's subsequent mishandling of the crisis is a serious concern which affects most American households. We encourage all of our clients to consider the safest subsequent course of action, a CREDIT FREEZE, even though it does involve some inconvenience and modest expenditures.

A credit freeze effectively seals your credit reports and prevents thieves from establishing new credit in your name, even if they have obtained your personal information. Consumers can temporarily un-freeze, or "thaw" their credit when they legitimately apply for new credit in the future. Existing credit lines are not impacted by a credit freeze. You can continue to use your credit cards and access existing lines as per usual. It's important to note that ALL THREE of the credit reporting bureaus must be contacted. And they may each charge a small fee (up to $10, depending on the state where you live) to freeze your file. Importantly, Pennsylvania is one of four states where such a freeze is in effect for only seven years. Other states maintain the freeze permanently until you request removal.

Please consider reaching out directly to the major credit reporting agencies, either online or using the phone numbers listed below:

TransUnion: (888) 909-8872

Equifax: (800) 685-1111 ; New York residents call (800) 349-9960

Experian: (888) 397-3742 – press 2 and follow the prompts for a security freeze

Putting it all together:

As a fiduciary firm, we put our clients first. Whether selecting investments on your behalf or providing unbiased advice on matters of financial import, our focus remains on you. We continue to emphasize quality in our equity selection process, favoring companies with strong balance sheets and healthy dividends. Such characteristics tend to put a firmer base under their respective stock prices, so we expect them to be less volatile in periods of market stress. We continue to look for opportunities to rebalance portfolios, seeking to trim equity positions which have swelled toward the upper range of their allocation targets. In so doing, we are paring back on stocks and equity funds and deploying those proceeds in shorter duration fixed income investments. We are comfortable building modest cash cushions at these levels, positioning us well to be opportunistic when the markets retreat, as they inevitably will.

As always, we appreciate the confidence you have placed in us as your advisor. We welcome your thoughts and look forward to any feedback or information that may help us to be even more effective on your behalf.

Very best.

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