Market Commentary October 2017

Markets have displayed remarkable resilience in 2017 and all major averages have moved solidly higher. While a long term investment strategy is still appropriate, we believe a small dose of caution is warranted here. Since it is impossible to predict the future, an asset allocation that best reflects one's risk tolerance remains the best strategy for staying the course during any market volatility. Less we sound too negative, all is not gloom and doom. Here is what else we are seeing:

Interest rates are still very low. There is no competition from bonds for stocks. You can earn more in a dividend yield in stocks than you can in bonds remembering that stocks can and do go down in price. However stocks go up in price much more often than they go down. They take the stairs up and the elevator down.

Inflation is low which keeps interest rates low. Inflation will most likely stay low for a long time given global market forces and the internet.

The job market is very strong and unemployment is down to 4.2%. Wage growth is picking up which is a very good thing. Consumers have more to spend.

ISM Institute for Supply Management Manufacturing Purchasing Managers index shot up recently and has been mostly over 50 (expanding) since late 2009. Recently it spiked to 60.8 a level this index has not seen since 2004. This index measures new orders and employment.

ISM Non-Manufacturing Index which measures Services which represents the majority of the US economy and hit 59.8 with new orders at 63.

Consumers Financial Obligations Ratio is as low as it was back in the early 80s. This measures disposable income to monthly debt service and is at 15.5%. This means 15.5% of disposable income is going toward paying off debt which includes mortgage, autos, rent, homeowner insurance and property tax. At the height of the crisis this number was over 18%.

The P/E on the S&P 500 is 17.4x using 2018 estimated earnings. This is higher but not ridiculous. When inflation is low P/E's can be higher. There is still the search for return as well. More and more investors are turning to dividends for return given that decent bonds are hard to find and taxes are a factor for taxable portfolios.

The difference between the yield on the 10 year treasury and the Fed Funds rate is still positive. Prior to the last 3 recessions this result has been negative.

Rising rates are NOT the cause of corrections. It is only when rates get too high. The market has risen while rates have been rising. Consider the 90s; rates went from 3% to 6% while the S&P 500 went from 500 to 1500. Only after the last rate hike did the market roll over and then rates began to decline again. Interest rates are the main policy tool the Fed has to either spur or slow down the economy. Right now we have had 4 rate hikes. The average is 9.

We still have higher interest rates than all of Europe. Things will not normalize until Europe stops QE and their rates begin to rise.

Earnings for the S&P 500 companies have been strong for the 3rd quarter with many companies beating on the top line as well as on earnings. This means quality of earnings are better since earnings growth is not coming just from cost cutting.

If you are listening to the news or watching CNBC, consider not watching if it makes you anxious. Bad news sells newspapers and gets people to tune in which helps ratings.

We have no control over geopolitical events and in the long run stocks go up because of earnings.

Bull markets, bear markets and corrections are all part of the investing experience. Fortunately, bull markets are far more frequent than the other two adverse events. We recognize that declines in stock prices tend to be far more painful for most people than the good feeling gains engender, however. Having a clear understanding of how you are positioned in stocks, bonds and cash can provide peace of mind next time the market corrects.

If you have any questions or concerns about your asset allocation or anything else in your financial world, please do not hesitate to give us a call.