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Q3 2017

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The market strength and resiliency in the 3rd quarter of 2017 was a continuation of the 2nd quarter, which was a continuation of the 1st quarter. Ahhh, if every year could be this way...! Despite the almost complete gridlock in Washington the US, and indeed the global economy, continues to hum along at a very healthy clip. We continue to see 2-3% annualized GDP growth while still experiencing very low inflation around the world. It doesn't get any better than that. After almost 10 years of central bank intervention to pull the economies around the world out of the Great Recession, we are finally at a point where the central banks can start to reposition their interest rate policies and tools to begin the process of diminishing their role in stimulating the global economy.

So can the stock markets continue to rise unhindered? While market indices are reaching new highs almost daily and valuations are looking stretched, what typically causes a significant correction is an economic recession and not over-extended market valuations. Right now the US economy seems to be on solid footing. With the unemployment rate under 5%, it is below the Federal Reserve's target of what they would like to see for a healthy economy. Inflation in the US is also running below the Fed's 2% target. Banks are lending money again, but not irresponsibly. Companies are making capital investments to improve productivity. So all is good...right?

The Equity Markets

The equity markets, overall, had a strong 3rd quarter. Growth stocks continued to outperform value stocks again and small cap stocks outperformed large caps. Small cap stocks gained momentum as talk out of Washington over the past couple of months has been around reducing tax rates, with the most significant cut being the corporate tax rate from 35% to 20%. Smaller companies should potentially be the biggest beneficiaries of this change. Overall, the US stock market was up almost 4.6% for the quarter and is up over 18.7% for all of 2017. International developed stocks were up over 5.6% and have returned almost 18.2% year-to-date. Emerging markets posted the strongest returns again for the 3rd quarter, returning over 7.9%, and are now up almost 22.5% so far in 2017.

The Fixed Income Markets

The bond markets experienced positive returns for the quarter despite a slight increase in yields. Over the quarter the 10-year bond yield increased by 2 bps, starting the quarter at 2.31% and ending it at 2.33%. The US bond market, overall, had a positive return of .85% for the quarter and has returned over 3.1% so far in 2017. The municipal bond market performed in line with the taxable bond market for the quarter, and has returned over 4.6% so far this year. The high yield markets continue their run with positive returns of almost 7% so far in 2017.

So what did all of this mean for investors? Once again, it was a quarter of positive returns across the board. For a diversified portfolio, depending on an investor's asset allocation, returns for the quarter were up somewhere in the range of 2% and 4%.

Looking Ahead

As we move into the 4th quarter there is still cause for optimism for the global economy and the capital markets. Corporate earnings continue to show strength and if the tax reform being discussed in Washington becomes a reality this would be a big boost for corporate profitability. Inflation remains subdued and interest rates are still at historically low levels.

A potential disruption to the complacency the markets have been experiencing would be a decision from the Trump administration to replace Janet Yellen as head of the Federal Reserve. Given the significant influence and impact the Fed has had on the stock and bond markets, stripping away the calm that Janet Yellen brings to the table, given her very thoughtful and patient approach to Fed policy, could be very unsettling to the markets.

There is no doubt that there is something else out there that is brewing to create market volatility once again. There always is, and most of us only see it in hindsight. It is unlikely to be whatever it was that tripped up the markets before. We do get smarter and wiser, but there is always something new to learn. Staying focused on a long-term strategy that is aligned with one's goals and objectives is what allows us to ride out whatever it is that is going to throw us for the next loop and not react to short-term market movements. It is important to remind ourselves of this when times are good so we can reflect on it when times aren't so good.

As always, we would love to hear from you, so feel free to contact us at any time.

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