

2017 Third Quarter Investment Report

The U.S. stock market continues its remarkable positive run despite some contrarian news headlines. While market uncertainties always exist, if you look past the headlines, the underlying fundamentals of our economy are still remarkably solid this deep into our long, slow economic expansion since one of the worst market downturns back in 2008-2009. The unemployment rate dropped further to 4.2% in September, corporate earnings came in better than expected, and anticipation of corporate tax cuts continues to fuel the rise in equity markets.

Stock Market

A breakdown shows that just about everything gained at least modestly in value these last three months. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—rose 4.59% for the most recent quarter, finishing the first three fourths of the year up 13.72%. The comparable Russell 3000 index is up 13.91% for the year so far.

Looking at large cap stocks, the Wilshire U.S. Large Cap index gained 4.50% in the third quarter, to stand at a 14.19% gain so far this year. The Russell 1000 large-cap index finished the first three quarters with a similar 14.17% gain, while the widely-quoted S&P 500 index of large company stocks gained 3.96% for the quarter and is up 12.53% in calendar 2017.

Meanwhile, the Russell Midcap Index has gained 11.74% so far this year.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies posted a 5.39% gain over the third three months of the year, to stand at a 9.55% return for 2017 so far. The comparable Russell 2000 Small-Cap Index is up 10.94% this year, while the technology-heavy Nasdaq Composite Index rose 5.79% for the quarter and is up 20.67% in the first three quarters of the year.

As nice as the returns have been domestically, international stocks this year have been even kinder to investment portfolios. The broad-based EAFE index of companies in developed foreign economies gained 4.81% in the recent quarter, and is now up 17.21% in dollar terms for the first nine months of calendar 2017. In aggregate, European stocks have gone up 19.87% so far this year, while EAFE's Far East Index has gained 12.31%. Emerging market stocks of less developed countries, as represented by the EAFE EM index, rose 7.02% in the third quarter, giving these very small components of most investment portfolios a remarkable 25.45% gain for the year so far.

Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted a meager 0.61% gain during the year's third quarter, and is now up 2.44% for the year so far. The S&P GSCI index, which measures commodities returns, gained 7.22% for the quarter but is still down 3.76% for the year. By far the biggest component is the ever-unpredictable price of oil. Since the bottom on February 11, 2016, crude oil prices have actually risen by 50%, but the trajectory has been choppy and unpredictable.

Fixed Income

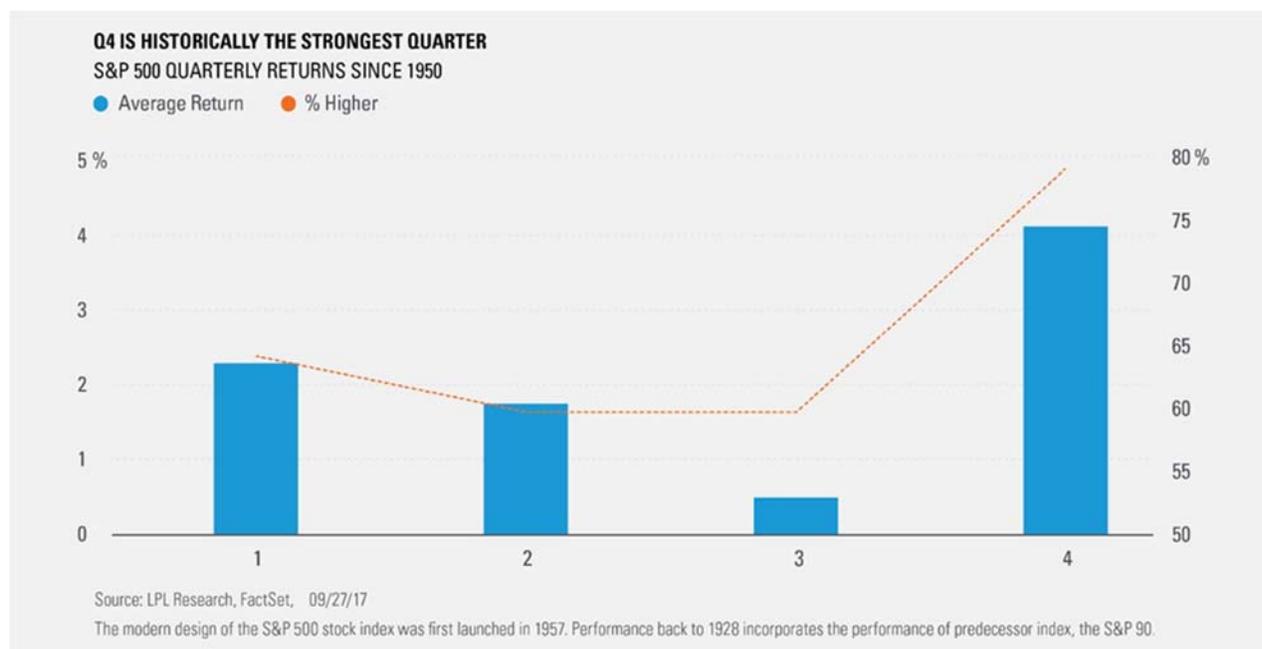
In the bond markets, coupon rates on 10-year Treasury bonds have risen incrementally from 2.30% at this point three months ago to a modest 2.33%, while 30-year government bond yields have also risen incrementally, from 2.83% to 2.86%.

Summary

One might imagine that the uncertainties around government policy and fundamental economic issues (failed attempts to repeal the Affordable Care Act and a new promise to write a new tax code, for example) would nerve investors, and if those weren't nervous enough, there's the ongoing drama from North Korea. Hurricanes have disrupted economic activity in Houston and large swaths of Florida, while Puerto Rico lies in ruins. Yet the bull market sails on unperturbed.

How can this be? Because if you look past the headlines, the underlying fundamentals of our economy are still remarkably solid this deep into our long, slow economic expansion. Corporations reported a better-than-expected second quarter earnings season, with adjusted pretax profits reaching an annualized \$2.12 trillion—which means that American business is still on sound footing. Unemployment continues to trend slowly downward- hitting 4.2%, the lowest percentage since the year 2001- and wages continue to trend slowly upward. The economy as a whole grew at a 3.1% annualized rate in the second quarter, which is at least a percentage point higher than the recent averages and marks the fastest quarterly growth in two years. There is hope that the new tax package will prove as business-friendly as the Trump Administration is promising.

Meanwhile, as you can see from the accompanying chart, fourth quarters have historically been kind to investors—much kinder than third quarters.



Economists tell us that the multiple whack of hurricane damage will slow down economic growth figures for the third quarter, although the building boom fueled by the destruction will mitigate that somewhat. There are no economic indicators that would signal a recession on the near horizon, and one of the potential panic triggers—a Federal Reserve Board decision to recklessly raise interest rates—seems unlikely given the Fed’s extremely cautious approach so far.

There are still potential speed-bumps down the road. The Trump Administration has publicly mentioned his intention to enter trade renegotiations with America’s major trading partners: the NAFTA members Canada and Mexico, and with China. Tight immigration rules could lead to limited labor supplies.

The current 12-year stretch of economic growth below 3% a year is America’s longest on record. But if the U.S. charts a prudent economic course, it’s possible that the current expansion could at least set new records for longevity. This current expansion just turned 99 months old. The all-time record is 120 months, from 1991 to 2001. Despite the unknown of the markets, we remained committed to not trying to time the market but instead putting you in the right asset allocation according to your time horizon and risk tolerance to help you meet your goals.

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This article was adapted from the original article written for Financial Planning Office by Bob Veres, Financial Commentator.