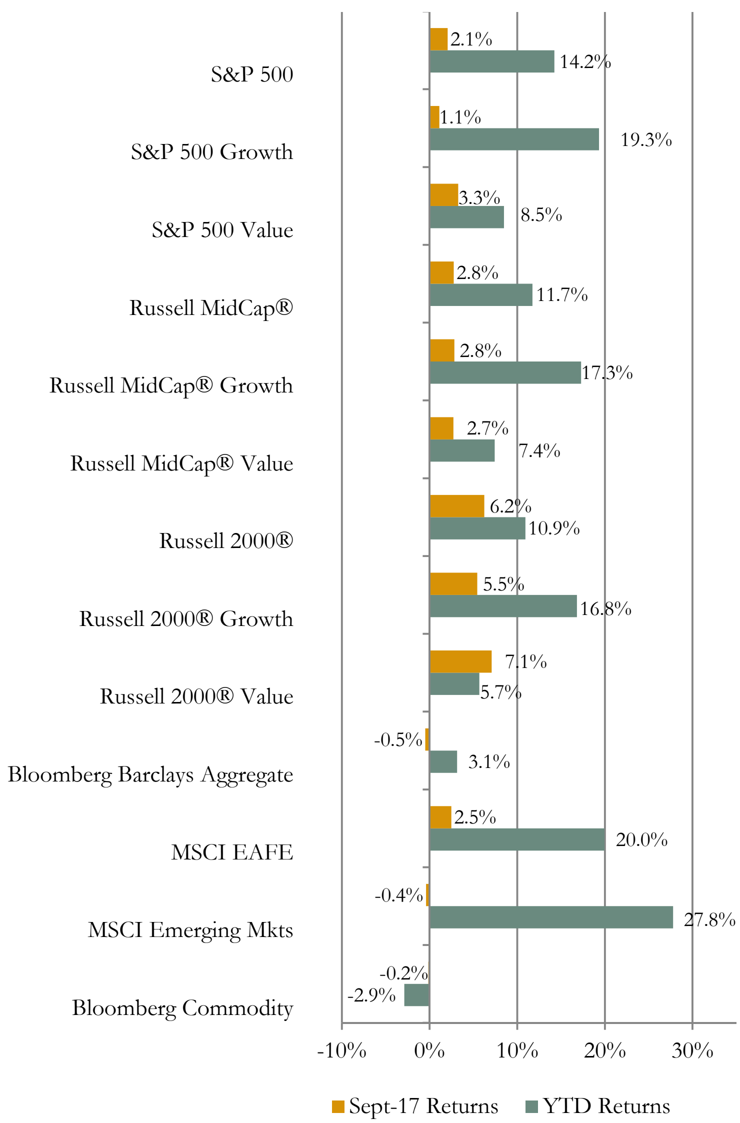
Monthly Market Summary – September 2017

September was another record breaking month for equity markets. The S&P 500 index ended the month at a new all-time high which was the ninth record high for that index for the month. The Nasdaq Composite and the Russell 2000 indices also closed at new highs on the last trading day of the month. The Nasdaq hit five new highs during September and the Russell 2000 had six new highs. The Dow Jones Industrial Average was one major index that did not hit a new high on the last day of September, but the index recorded seven new highs during the month. Several stock markets outside the U.S. had strong gains as well. For example, the Japan Nikkei index and the Stoxx Europe 600 indices were each up almost 4% and the Brazil equity market reached a six-year high. Solid earnings growth, strong consumer and business sentiment, and improving economic fundamentals have been supportive to higher stock prices in the U.S. and other regions.

Market Indices – September 2017



Policy plan announcements also had a significant impact on financial markets during the month. Prospects for higher interest rates lifted certain stocks like banks, while cyclical and small-capitalization (cap) stocks gained as the reflation trade made a comeback. These same influences led to declines for more defensive assets like Treasury bonds and high income stocks such as REITs and utilities. One of the key announcements during September was made by the Federal Reserve Open Market Committee (Fed). The Fed said it will begin its balance sheet wind-down in October and signaled one additional hike in the fed funds rate in 2017 followed by three in 2018. The other key announcement during September was the introduction of the Republican tax reform framework. Investors reacted positively to the plan to lower the corporate tax rate to 20% from 35%, reduce the number of tax brackets for individuals to three along with lowering the top rate to 35% from 39.6%, eliminate the alternative minimum tax and inheritance tax, and treat foreign profits accumulated overseas as already repatriated.

In U.S. equity markets, small-cap stocks, which are seen as the most sensitive to the proposed tax reform, outperformed mid-cap stocks and both outperformed large-cap stocks. Value stocks outperformed growth stocks in the large and small-cap indices but growth outperformed value by a small margin in the mid-cap index.

Industry sector returns were mixed. In a change from most of this year, the energy sector was the best performing sector among large, mid, and small-cap stocks. After hurricanes Harvey and Irma, devastating floods in South Asia, and an earthquake in Mexico oil prices rose sharply and drove energy stocks higher. Cyclical stocks, such as banks and industrials, were also top performers driven higher by Fed comments about economic strength supporting their forecasts for further rate hikes, expectations for a boost to housing, auto, and infrastructure spending to rebuild after the hurricanes, and optimism about the potential impact of the tax reform plan on corporate earnings. Defensive sectors such as consumer staples and interest rate sensitive utility and real estate stocks declined and had the weakest returns as investors rotated into stocks that are expected to benefit from higher interest rates and strengthening economic activity. The information technology sector posted modest positive returns but was one of the weakest performing sectors as the sharp rally in the sector for most of the year cooled. Healthcare sector returns varied by market cap. Strength in biotechnology stocks drove the healthcare sector to a strong positive return in the small-cap index and a small positive return in the large-cap index. However, the sector posted a negative return in the mid-cap index.

In another change from prior months, emerging markets stocks underperformed both U.S. and developed international stocks. The MSCI Emerging Markets (EM) index posted a return of -0.4%. The MSCI EAFE index of developed international stocks had a return of 2.5%. Currency movements did have a negative impact on returns for U.S. based investors as the U.S. dollar strengthened against many currencies. On a local currency basis, returns for the EM and EAFE indices were 0.4% and 2.7% respectively. The higher U.S. dollar contributed to the weakness in EM, particularly the materials sector, since the higher dollar pressured industrial metals prices. The cool down in the technology sector also contributed to the weakness in the EM index since technology heavy country indices such as Taiwan declined for the month. On a geographic basis, in emerging markets regions, Brazil continued its rebound after the central bank cut interest rates again. Brazil was one of the top performing emerging markets countries with a return of over 4%. Russia also had a return over 4% boosted by higher oil prices and a cut in a key interest rate. On the other end of the spectrum, India and emerging European countries were the weakest performing emerging markets countries with negative returns for the period. Stocks in India declined on an unexpected drop in second quarter gross domestic product. The economy in India is still feeling the impact of reform policies such as the demonetization policy implemented last year and the new goods and services tax. In developed international markets, the euro zone index had the best return of almost 4% on improving economic data. For example, the euro zone composite purchasing managers' index reached a four-month high, the unemployment rate in Germany dropped to a record low, and a report showed that wages in the euro zone rose 2% in the second quarter compared to the prior year, which was the fastest pace of growth in two years. In contrast, the Pacific ex Japan index posted a negative return with Australia and New Zealand declining due in large part to lower industrial metals prices hurting the mining sector.

U.S. bond market returns were mostly negative for the month leading the Bloomberg Barclays U.S. Aggregate Bond index to post a return of -0.5% for September. The yield on the benchmark 10-year Treasury bond rose slightly during the month to 2.3% from 2.1% at the end of August. Bond yields moved higher, and prices lower, after the Fed signaled further interest rate increases likely in 2017 and 2018. Prices for longer maturity bonds declined more than for shorter maturity bonds. The high yield corporate bond index was the top performer for the month with a return of 0.9% helped by higher oil prices since energy companies make up a large portion of the index.

The Bloomberg Commodity index had a return of -0.2% for September. A gain in the oil sub-index was not enough to offset declines in the industrial and precious metals sub-indices. The price of oil advanced during the month about 9% from $47 per barrel to about $51. Industrial metals prices fell due to the rising value of the U.S. dollar and slower demand from China. The price of gold retreated as geopolitical concerns calmed somewhat.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

Global economic growth momentum remains positive since most economic data continues to be solidly in expansionary territory and inflation remains muted. Global economic conditions are likely to be generally supportive for corporate earnings. However, with the strong equity markets over recent months, valuations are not cheap. Therefore, we continue to have a neutral view on global equities. Our tactical allocation recommendation remains as an equal weight to the long-term target allocation for U.S., international developed, and emerging markets stocks as well as to U.S. large-cap, mid-cap, and small-cap stocks. We continue to favor equities over bonds so retain our underweight recommendation for fixed income investments. Our underweight recommendation is because the return expectation for bonds is modest due to the low level of yields and the prospects for yields to move higher (and prices lower) if inflation picks-up and the Fed continues to hike its policy rate as it has suggested. Within fixed income we continue to recommend a focus on short to intermediate term bonds. We also continue to favor non-Treasury bonds for the yield advantage they provide. We continue to favor hedge fund strategies over fixed income for the lower expected volatility portion of portfolios but also recommend an underweight allocation to hedge funds. Since our expectation is for a moderate rate of inflation to continue, we recommend an equal weight to real assets. We would not be surprised if financial markets experience bouts of volatility as more details emerge about any fiscal, monetary, or political policy changes or if there are delays in implementing these actions. Therefore, we continue to recommend using periods of market strength to raise any cash needed to support spending needs over the coming 12-24 months.