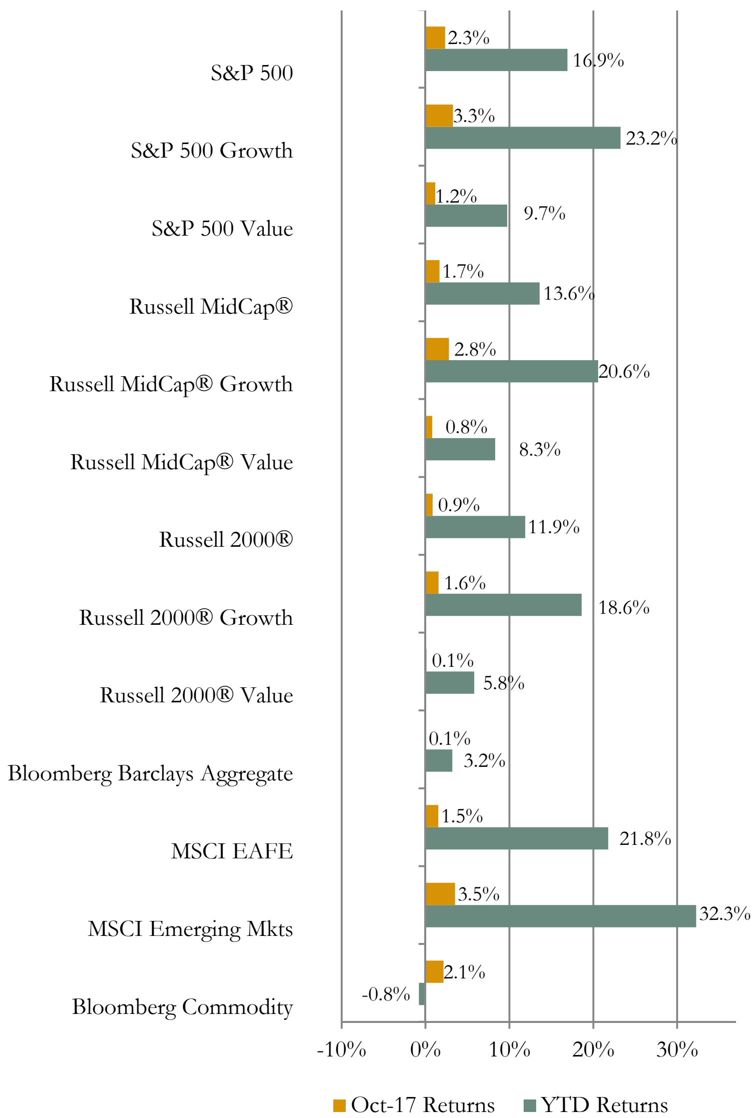
Monthly Market Summary – October 2017

Robust corporate earnings reports and positive economic data drove major global equity indices to new record highs during October. In the U.S., the Dow Jones Industrial Average, S&P 500, and Nasdaq Composite each set multiple new highs. In Europe, the German DAX 30 and the U.K. FTSE 100 hit new highs. In Japan, the Nikkei 225 did not set a new record high, but did advance to the highest levels since 1996. The strong economic data along with comments by the Federal Reserve (Fed) hinting at a December rate hike pushed Treasury bond yields higher which drove the U.S. dollar higher. In the commodity markets, strong data on industrial production, particularly in China, drove prices for industrial metals higher. Also, crude oil prices rose due to stronger demand and talks of an extension of the Organization of Petroleum Exporting Countries' (OPEC) production cut agreement.

Market Indices – October 2017



Third quarter earnings reports have been generally good across various industries globally. In the U.S., very strong earnings were reported by Amazon, Caterpillar, General Motors, Intel, IBM, 3M, Microsoft, UnitedHealth Group, and United Parcel Service. According to a report by Bloomberg, with half of the S&P 500 companies having reported, earnings are up 8% and sales are up 6%. In Europe, earnings for STOXX 600 index companies that have reported are on average up 8%. Many of the largest companies in Asia are also reporting higher sales and earnings.

Improving economic fundamentals have been supportive to higher actual earnings as well as the outlook for future earnings. The first reading on third quarter U.S. gross domestic product (GDP) growth came in at a 3% rate. Since second quarter GDP growth was 3.1%, this was the first period of back-to-back quarters of 3% or more growth since 2014. The manufacturing sector has been an important part of the GDP growth. Several U.S. regional manufacturing reports rose to multiple year highs. For example, the MNI Chicago Business Barometer and the Kansas City Fed's measure each rose to the highest level since March 2011. A key to the strength in the manufacturing sector has been robust new orders. The October durable goods orders report showed an 8.3% increase over the prior year. The services side of the economy has been improving as well.

The Institute for Supply Management's non-manufacturing index rose to 59.8%, which was the highest level since August 2005. The strength in business conditions continues to provide a boost to the labor market. The October jobs report showed that wages rose 2.9% over the prior year, which was more than expected, and the unemployment rate fell to 4.2%. Higher stock prices, improving business conditions, and low unemployment lifted consumer confidence. The Conference Board's reading on U.S. consumer confidence in October rose to the highest level in 17 years. In addition, the University of Michigan consumer sentiment index rose to the highest level since 2004. Strong consumer sentiment is a positive for consumer spending which is the largest component of the U.S. economy. Economic data has been positive outside the U.S. as well. For example, in the U.K. third quarter GDP came in better than expected and unemployment dropped to 4.3%, the lowest level in 42 years. In the euro-area, the unemployment rate declined to the lowest level since January 2009 and industrial production rose 1.4% to a nine-month high. In China, industrial production increased 6.6% over the prior year which was better than expected.

In U.S. equity markets, large-capitalization (cap) stocks outperformed mid-cap stocks and both outperformed small-cap stocks. Growth stocks outperformed value stocks across the market cap spectrum. The level of dispersion between growth and value stock indices has grown to be significant this year. For example, the year-to-date return for the S&P 500 growth index is 23% compared to the return for the S&P 500 Value index of 10%. The growth indices outperformed again in October primarily due to the strength of the information technology (tech) sector. The tech sector had the highest returns in the large, mid, and small-cap indices propelled by very strong earnings reports from numerous industry members. Interestingly in a month dominated by positive economic data and strong earnings reports, the normally more defensive utility sector had the second highest returns in each of the market cap indices. Materials was another top performing sector on higher demand and higher commodity prices. After posting strong gains in September, energy company stocks declined in October despite higher crude oil prices. The consumer staples sector continues to be weak. The sector had a negative return in the large, mid, and small-cap indices as consumer staples producers grapple with lack of pricing power, higher commodity costs, and changing consumer tastes.

Emerging markets stocks outperformed both U.S. and developed international stocks. The MSCI Emerging Markets (EM) index posted a return of 3.5% and the MSCI EAFE index of developed international stocks had a return of 1.5% on a U.S dollar basis. Currency movements had a negative impact on the EAFE index return for U.S. based investors as the U.S. dollar strengthened against the euro and yen. On a local currency basis, the return for the EAFE index was 3.0%. Currency had only a minor impact on the EM index return. Just as in U.S. equity markets, growth stocks outperformed value stocks in the EAFE and EM indices on the strength of the tech sector. The tech sector had the best return in both the EAFE and EM indices. Other cyclical sectors such as industrials and materials also had strong returns. Healthcare was another top performing sector in the EM index. The more defensive sectors, such as consumer staples, telecom, and utilities had the lowest returns in international markets. On a geographic basis, Japan had the best return among developed international countries on several strong economic reports and the reelection of Prime Minster Abe which investors interpreted as positive for the continuance of accommodative monetary policy and structural reforms. Returns in the European region were mixed with strong economic and earnings news boosting equity markets in Germany and France while political issues pressured equity prices in Italy, Spain, and the U.K. In the emerging markets index, Korea and Taiwan had among the highest returns on the strength in the tech sector. India was the top performer as investors reacted positively to a bank recapitalization plan announced by the government which is expected to aid credit growth. The Latin American region had the lowest return since Brazil and Mexico had sizeable negative returns due to negative currency moves and some weaker economic data.

U.S. bond market returns were mixed for the month leading the Bloomberg Barclays U.S. Aggregate Bond index to post a return of 0.1% for October. Treasury bond yields rose (and prices declined) across the maturity range due to solid economic data and on expectations for less accommodative monetary policies going forward. The yield on the benchmark 10-year Treasury bond rose slightly during the month and closed at 2.4% up from 2.3% at the end of September. In a more striking move, the yield on the two-year Treasury bond rose to a nine-year peak of 1.6%.

Corporate and municipal bond prices advanced on strong demand for income coupled with limited issuance of new bonds. The high yield corporate bond index was the top performer for the month with a return of 0.4% helped by higher oil prices since energy companies make up a large portion of the index.

The Bloomberg Commodity index had a return of 2.1% for October. The livestock sub-index had the highest return of over 10% for the month. However, the agriculture sub-index had a small negative return dragged down by the decline in the grains sub-index due to bountiful harvests. The petroleum sub-index had the second highest return among sectors we track as crude oil prices advanced during the month to over $54 per barrel. The industrial metals sub-index was another strong performer due to higher demand particularly in China. The price of gold and silver retreated as geopolitical and inflation 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.