Quarterly Economic Update

Third Quarter 2017

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While political stories continued to dominate the headlines, investors again enjoyed another positive quarter. The third quarter extended the upward movement of U.S. equity markets from the first half of 2017, allowing equity investors to continue to enjoy reasonable returns for 2017.

As reported by Bloomberg Markets, equities just capped an eighth straight quarter of gains, the longest winning streak since the start of 2015. The S&P 500 climbed 4% as corporate earnings posted the first back-to-back double-digit advance in six years. Despite mounting tension with North Korea, a deadly U.S. hurricane season and escalating political turmoil, the third quarter of 2017 marked the eighth straight quarter in which both the DJIA and S&P 500 have risen.
www.BloombergMarkets.com (9/27/17)

Morningstar reported that during the third quarter, stocks continued to climb with the help of the Fed's announcement that it would begin to normalize its balance sheet. They felt that investors focused on the prospects of lower corporate tax rates while absorbing the news of escalating tensions with North Korea and a series of devastating storms.

MONEY RATES (as posted in Barron's 10/2/2017)		
	LATEST WEEK	YR AGO
Fed Funds Rate (Avg. weekly auction -c)	1.16	0.40
Bank Money Market -z	0.12	0.11
12-month Cert -z	0.40	0.31

c- Annualized yields, adjusted for constant maturity, reported by the Fed Reserve on a weekly average basis. z – Bankrate.com (Source: Barron's; bankrate.com)

In the third quarter of 2017 the DJIA passed 22,000 for the first time. The DJIA closed the third quarter at 22,405 up 4.9%.

Market Records Continue

New highs for equity indexes seem like old news. This "old" bull market is now the second longest one in history. Having said that, investors always need to proceed with caution. History doesn't always repeat itself, but it's often helpful for investors. In the final quarter of a year, in which the market made highs in September (statistically the market's worst-performing month) stocks have typically finished stronger.

Since 1928, there have been 29 Septembers in which the S&P 500 made a 12-month high. Following those 29 instances, the market rose over 80% of the time in the fourth quarter, averaging a 3.7% increase, says Doug Ramsey, Chief Investment Officer of the Leuthold Group. Additionally, 15 of those 29 September price highs were also accompanied by 12-month advance/decline line highs—as is the case now. Stocks increased an average 5.9% in the fourth quarter in those 15 instances. Ramsey says, "We expect higher highs in the fourth quarter."***www.Barrons.com (9/30/17)***

History shows that the S&P 500 has risen seven times since 2009 in the final three months. Many analysts feel that a bear market or significant correction in the fourth quarter is not likely.

Not everyone is as bullish. Ten of 18 Wall Street strategists surveyed by Bloomberg see the S&P 500 ending the year at 2,500 or below.

There is also concern regarding high stock market valuations. Currently, the S&P 500 trades at about 19 times consensus estimates, according to Thomson Reuters. That's above the market's long-term average of about 15. On a historic basis, this multiple is not cheap. According to Barron's, high valuations alone don't cause bear markets. They suggest investors also need to see a factor change. They write that a fourth-quarter rally isn't assured. Absent a big change in economic and monetary conditions, they feel the bear case isn't strong. They share that the bull market will at some time die, but probably not in the fourth quarter. The holiday season could be a good one for equity investors.

Interest Rates

For the rest of 2017 and beyond, interest rates should remain high on an investor's lookout list. Fed Chair Janet Yellen asserts that reducing the central bank's balance sheet from its crisis levels should be as uneventful as watching paint dry. She also says that the Fed's main policy tool will continue to be the federal-funds rate. The Federal Open Market Committee currently is targeted for another quarter-point hike in December, from the current 1% to 1.25% target range. This may or may not happen because its counterparts abroad continue to expand their assets.

The Federal Open Market Committee has also penciled in three more hikes for 2018. Less certain for investors now is who will be making those calls next year. Fed Chair Yellen's term ends February of 2018.

For the final quarter of 2017 and continuing in 2018, interest rates need to be monitored carefully.

Global Watch and Concerns

Geopolitical unrest still remains. Political gridlock and further interest rate movement can also be impactful on the U.S. and world investment markets. As always, if you are planning on making any investment changes, it is helpful to discuss these changes and your personal situation with us.

Investors need to continue to monitor the potential roadblocks that President Trump's administration will face when attempting to pass a stimulus plan, geopolitical unrest, especially with North Korea; and the potential of future terrorist attacks.

Key Points

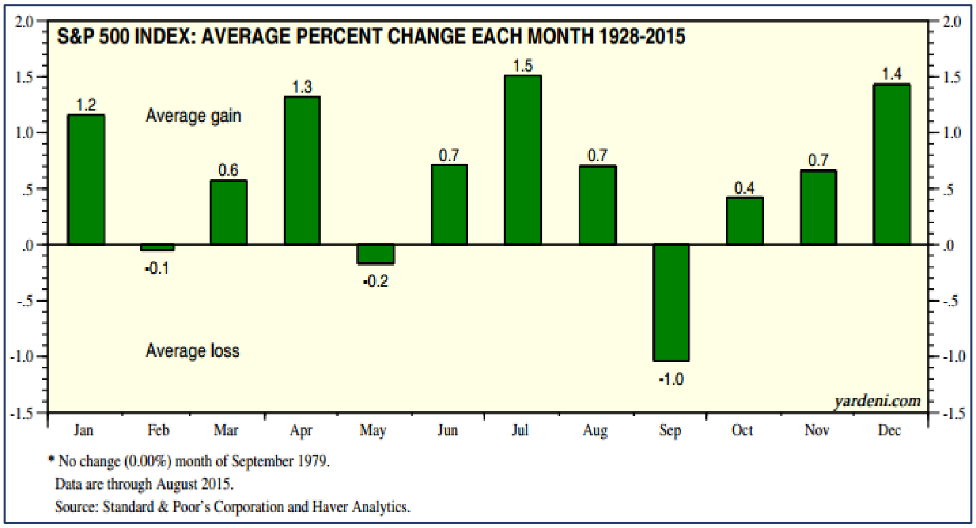
1. **Quarter 3 added to a strong 2017 for equities.**
2. **Equity markets continue to break records.**
3. **The Fed might raise rates in December and penciled in 3 rate hikes for 2018.**
4. **Global issue concerns could affect markets.**
5. **Budget battles and potential Tax Reform could influence markets.**
6. **Investors need to still be cautious and watchful.**
7. **Focus on your personal goals and call us with any concerns.**

Market Outlook

According to Fidelity Investments, current conditions have been a good backdrop overall for most assets. They feel that moving forward, investors are watching for progress toward tax reform and tax cuts. In fact, they are advising that the potential exists for an upside surprise in sentiment if tax progress occurs. Dirk Hofschire, Senior Vice President of Asset Allocation Research with Fidelity Investments, thinks that there's not a ton of optimism now and low expectations about whether or not Washington D.C. is really going to be able to pass major tax reform.

Now that the third quarter is over, it's time to look ahead. Typically, the fourth quarter sees quite a bit of investor activity. The United States is preparing for budget battles from both political and corporate arenas. The seasonal movements of equities are also a factor to consider. Since 1928, September—historically the worst month of the year—

brought little in the way of weakness. October has been the worst performing month of the fourth quarter, while November and December have both been kind to investors. That said, 2017 brings the upcoming 30th anniversary of the Crash of '87 which could spook some investors, however most analysts are entering the month of October with fairly optimistic outlooks.



For the first three quarters, 2017 has been marked by historically low volatility and there doesn't appear to be an imminent catalyst for a challenge to that status. This year we have only seen 5% of trading days with a move in the S&P 500 of greater than +/- 1%; by far the lowest level since 1982, when intra-day data began to be recorded. So far so good, but please remember the year's not over.

Dow 1,000,000

Warren Buffett offered a rosy long-term forecast in September. He predicted that the Dow Jones Industrial Average will reach 1,000,000 in a century. That's correct, 1,000,000 with six zeros, a seemingly unconceivable feat, relative to the current quarter's close of 22,405.

The Sage of Omaha actually was proving Einstein's observation that "compound interest is the eighth wonder of the world."

To reach 1,000,000, the Dow would have to increase at a compound annual rate of just 3.87% for the next century. That moved another longtime legendary investor, Mario Gabelli, to tweet, "Has Buffett turned bearish?" In actuality, over the past 100 years, the Dow's compound annual growth was 5.5%, boosting the index from 95 at the end of 1916 to 20,069 this past January.

Buffett suggests that it is foolish to ever bet against America. Attainment of a 4% nominal growth rate for the U.S. economy, implied by his Dow 1,000,000 prediction, may seem like a modest goal, but to many people it sounds outrageous.

Conclusion:
What Should an Investor Do?

Theories abound as to why the fourth quarter could be often the best one for equity bulls. They include the fact that fund managers need to catch up with returns, holiday spending could spread cheer and sometimes investors celebrate the January effect in December.

Some feel that with the stock market hitting yet another series of record highs, some investors may be inclined to take the money and run. Not the legendary investor Laszlo Birinyi, who for five decades has been sharing his thoughts on the stock market. Birinyi is bullish and currently disagrees with some of the most popular bear arguments floating around, like the stock market being too expensive.

So where does that leave us?

Analysts at Schwab feel the term cautiously optimistic seems appropriate, although admittedly overused. With no shortage of pundits looking for a correction, they feel that the "wall of worry" stocks like to climb is still intact.

So far in 2017, stocks have climbed higher, bond yields have remained low and volatility has not been an issue. Investors have not experienced any dramatic up or down swings in 2017, however, that does not mean investors should become complacent.

J.P. Morgan Asset Management feels that, "overall, despite all the political noise, markets continued to focus on the improving economic fundamentals. While the world worried about North Korea, markets cheered rising company earnings and improving global growth." They add that, "no expansion lasts forever, we think this one has further to go and that investors should enjoy the good times while they last. However, they should watch particularly carefully for any signs that the currently rosy global growth picture is starting to deteriorate." ***www.JPMorgan.com (10/2/17)***

As we have been saying all year, today's current fixed rate returns might not help most investors reach their financial goals so they will probably need to include equities in portfolios. We are carefully monitoring equity markets and interest rates so we can communicate with clients.

Volatility might return for investors and therefore we need to proceed with caution.

Market volatility is a part of investing and instead of being worried by volatility, try to be ready.

Focus on your own personal objectives.

The fourth quarter is typically an active one and we don't think this one will be any different. Solid economic growth and good corporate earnings could allow the bull market to continue but investors may experience periods of volatility and/or market pullbacks. During times like these many investors try to stay focused on their long-term objectives. This is the ideal time to ensure that you fully understand your time horizons, goals and risk tolerances. Looking at your entire picture can be a helpful exercise in determining your strategy. We always welcome the opportunity to discuss any updates to your thoughts or situation.

Please discuss any concerns with us.

Our advice is not one-size-fits-all. We will always consider your feelings about risk and the markets and review your unique financial situation when making recommendations.

We pride ourselves in offering:

- ✓ consistent and strong communication,
- ✓ a schedule of regular client meetings, and
- ✓ continuing education for every member of our team on the issues that affect our clients.

A good financial advisor can help make your journey easier. Our goal is to understand our clients' needs and then try to create a plan to address those needs. We continue to monitor your portfolio. Our primary objective is to take the emotions out of investing for our clients. We can discuss your specific situation at your next review meeting or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial matters.

Please share this report with others!

This year, our goal is to offer services to several other clients just like you! If you would like to share this report with a friend or colleague, please call **James at Kerntke Otto McGlone Wealth Management Group at (920) 733-3872** and we would be happy to assist you!

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