ECONOMIC & FINANCIAL MARKET UPDATE – The Third Quarter 2018

The Past & The Present

The Financial Market(s) – A Reminder of The Past and A View of Tomorrow

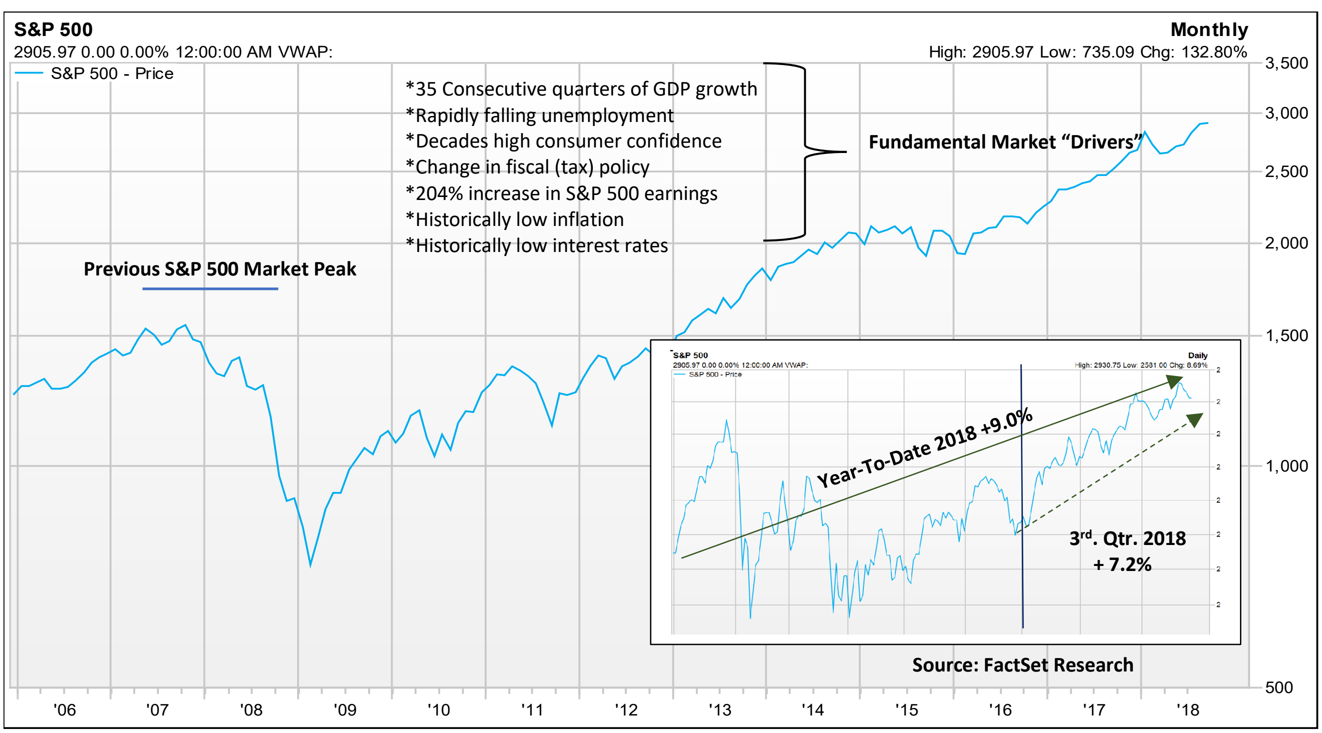
The latest calendar quarter was important in several ways. It marked the tenth anniversary (collapse of Lehman Brothers on 9/15/08)[i] of one of the most chaotic times in U.S. and global financial market history and the start of the Great Recession. ***On the other hand***, the fact that equity markets are flirting with new highs and at levels significantly higher than previous market peaks, is a testament to the success of the leaders of America's crisis response, the resilience of the U.S. economy and changes in policies of the current and previous administrations.

By most measures the domestic economy is strong, inflation modest, interest rates, while higher, remain low by historic standards, corporate profits are on a rapid ascent and, very importantly, unemployment is at a multi-decade low. An important corollary to very low unemployment and a growing economy, is consumer confidence at a multi-decade high.

Recent Market Results

After a challenging start to 2018, and a modest recovery during the year's second calendar quarter, market volatility moderated in the July to September period as the S&P 500 and other major U.S. indexes put together consecutive months of robust returns. Responding to the positive trends described above and in previous communications, the S&P 500 recorded its best quarterly return in nearly five years with a return of +7.2%; the Dow Industrials climbed +9.0% and the NASDAQ returned +7.1%. As a result, these important U.S. equity indexes have achieved year-to-date returns of +9.0%, +7.0% and +16.6% respectively.

The chart in the lower right-hand corner displays the 3rd quarter and 2018 year-to-date S&P 500 returns. We include the larger, and longer timeframe chart, to reflect what have been the "drivers" of this long bull market. We share this view because it is important to emphasize that fundamentals such as the direction of interest rates, inflation, corporate profits, employment, changes in fiscal/monetary policy, etc., are the most important determinants of long-term financial market returns. We monitor these inputs closely as we strive to make correct long-term investment decisions.



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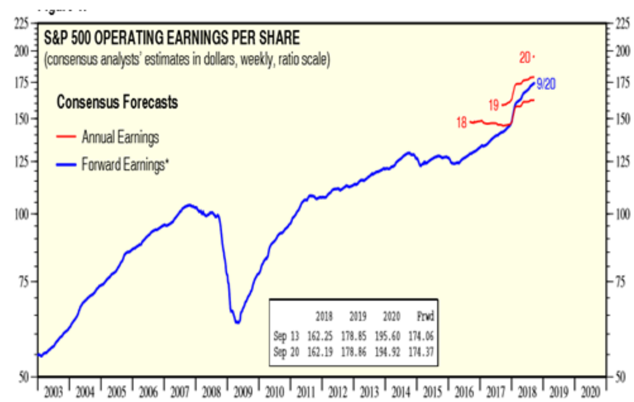
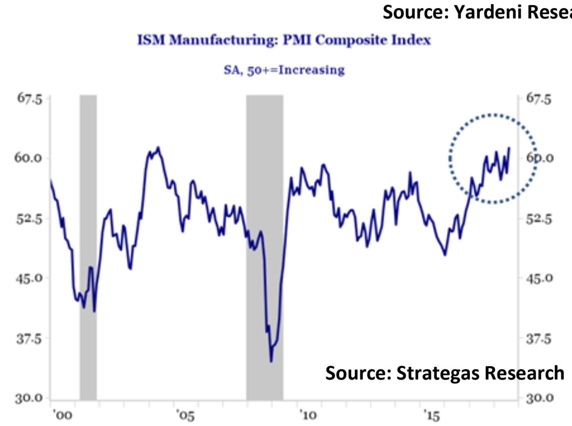
As we have previously postulated, bull markets don't die of old age; they do so because fundamentals deteriorate! Often, the fundamentals deteriorate as a result of a Federal Reserve that is too aggressive, and raises interest rates too high (we are not there yet).

The Current Environment

The current ten-year bull market, has had a very long run of positive returns (it is actually the longest bull market in U.S. history e.g., 3,453 days)[ii], but as the charts below show, positive economic fundamentals remain very much in place and don't appear to be weakening. A strengthening U.S. economy and the estimated increase in (S&P 500) corporate earnings of approximately +10% in both 2019 and 2020[iii] should help to maintain positive equity market trends.



Source: Yardeni Research, Inc.



One might normally expect investors to display renewed confidence in the equity markets during a ten-year period of an improving economy, low inflation, low interest rates, lower taxes, and a bull market. However, the opposite has been the case. During this 10-year positive period, investors have actually been net sellers of stock mutual funds and ETF's and purchasers of historically low yielding bond funds. That trend may be seen in the chart on the following page. In other words, despite powerful positive fundamentals, investors have maintained a skeptical outlook towards stock investments, hence our suggestion that this is clearly ***not a period of "irrational exuberance".***

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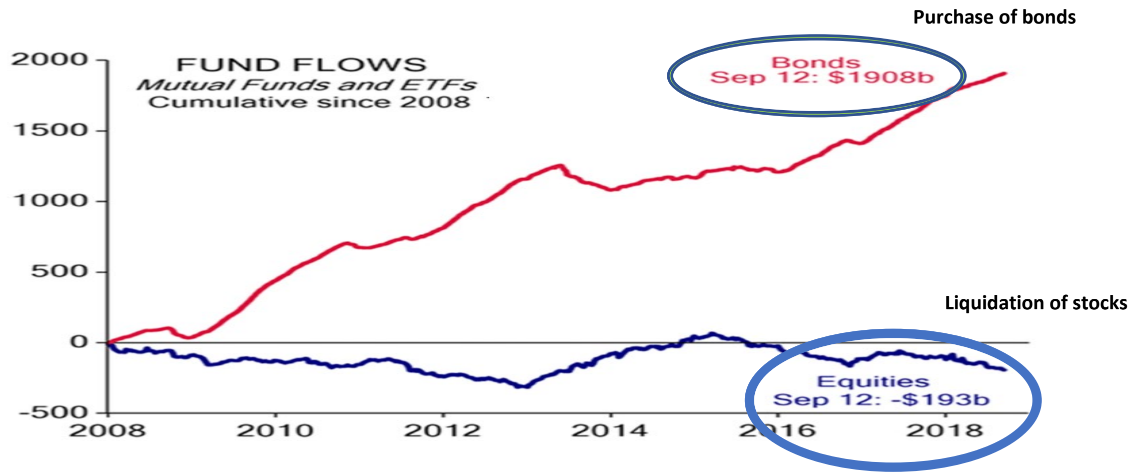
No Apparent "Irrational Exuberance



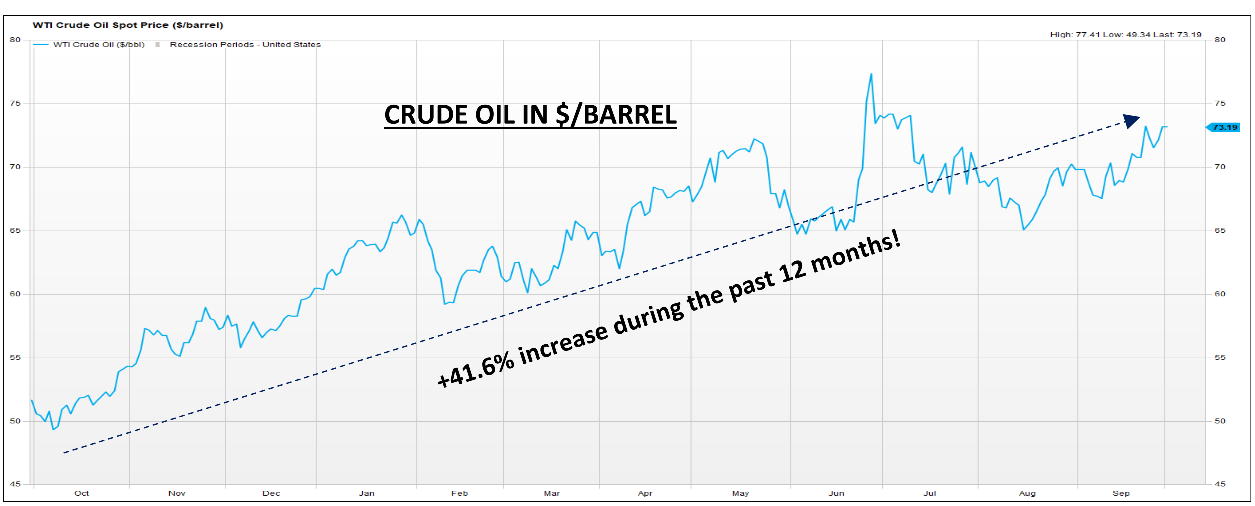
Source: Evercore ISI

Looking Ahead & Recent Actions

In retrospect, our 2018 Economic & Financial Market Outlook appears prescient thus far (we realize "things" can change quickly). Our expectations for an additional year of stock market gains was based upon the anticipation of benefits from tax reform, corporate profit growth, moderating government regulation, modestly increasing interest rates, and continued global growth. Thus far, only global growth has fallen somewhat short of our expectations.

Though our outlook remains positive, it is just as important to maintain diligence and disciplines in positive times as it is in challenging periods. As a result, we continue to be proactive in maintaining balance in client portfolios to be certain there is no "drift" in asset allocation, e.g. that accounts are within client agreed upon guidelines. In addition, "cash reserves" and investment in short maturity fixed-income have been increased while several high-quality equity additions have been made to enhance prospects for consistent long-term growth of capital and dividends.

We believe the fourth quarter will bring with it a number of challenges for investors. Those challenges include a combative mid-term election, a potential Federal Reserve rate hike, on-going tariff uncertainties, Brexit(?), the direction of oil prices (which we monitor very closely – see chart below), and the impact of the continued rise of anti-establishment parties around the world.



The Bottom Line & Strategy

Despite the uncertainties cited above, a stronger U.S. economy powered by the broad effects of the late 2017 tax legislation which reduced corporate and individual tax rates, and encouraged capital investment (immediate 100% depreciation) and repatriation of foreign reserves aid the current rally and help investors develop a longer-term investment perspective.

The potential for further stock gains, powered by strong earnings growth, reinforces our continued preference for equities over fixed-income. Also, the likelihood of further rate hikes suggests delaying any meaningful fixed-income commitments. Where additional fixed-income is required to enhance cash flow, we will concentrate investment in bonds with shorter rather than longer maturities. This strategy maintains flexibility and helps to reduce risk.

Within the equity portfolio, we continue to maintain our commitment to a high degree of portfolio diversification, including small and mid-capitalization stocks, and the “over-weighting” of positions in market sectors that are positively impacted by an improving economy. These types of companies are better able to increase their earnings and share dividends with investors. As we have mentioned before these companies are generally either Industrial, Technology, Financial or Consumer Discretionary companies.

We appreciate the opportunity to serve you. If you have any questions, or if we may be of assistance in any way, please do not hesitate to contact us. We look forward to meeting with you in the near future.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

Investment advice offered through Stratos Wealth Partners, Ltd., a registered investment advisor.

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[i] The New York Times, August 19, 2018
[ii] Std. & Poor's Global Research, August 22, 2018
[iii] Yardeni Research, Inc. August 28, 2018