The News You Need to Know

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As our clients know, we tend to avoid making predictions about investments, particularly in the short term. Doing so is a very uncertain business, and our view is that investment performance does not equate to success of a financial plan. We look forward to reminding everyone of the difference.

Quarterly Economic Update

A review of 4Q 2017

THE QUARTER IN BRIEF

The final quarter of 2017 was a great one for stocks: the Dow Jones Industrial Average, S&P 500, and Nasdaq Composite all posted 3-month gains of better than 6%. Landmark federal tax reforms were approved and signed into law. Home buying accelerated, even though mortgages grew more expensive and listings remained thin. Domestic indicators showed continued strength in consumer spending and hiring as well as a pickup in economic growth. The Federal Reserve made another interest rate hike and started to reduce its balance sheet, while the European Central Bank prepared to wind down its long-running stimulus. All in all, it was an eventful and positive quarter for investors.[1]

DOMESTIC ECONOMIC HEALTH

Without question, the fourth quarter's major story was the passage of the Tax Cuts & Jobs Act. Its most dramatic changes were arguably the ones benefiting businesses: it slashed the corporate tax rate to 21% and let the majority of pass-through companies deduct the first 20% of income. The legislation also took the individual estate tax exemption north to $11.2 million, put the standard deduction at $12,000, and did away with dozens of longstanding deductions, plus the personal exemption. In 2019, it removes the individual mandate for health insurance. Most of the above changes are set to expire after 2025, barring renewal in Congress.[2]

Consumer spending improved in the quarter. The Department of Commerce recorded a (revised) gain of 0.2% for October and a 0.6% rise in November. Retail sales were up 0.4% in October and 0.8% a month later.[3,4] Those numbers reflect consumer optimism, affirmed by fall readings for the key U.S. consumer confidence indices.

October and November were the best months for job creation since the middle of 2016, with the Labor Department recording

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net payroll growth of 244,000 hires in the former month and 228,000 in the latter. The main jobless rate reached 4.1% during November, while the rate for both unemployment and underemployment (the U-6) ticked up to 8.0%.[6,8]

Speaking of the central bank, it started unwinding its vast securities portfolio and hiked the federal funds rate another quarter point in December, resulting in a new target range of 1.25%-1.5%. Among the economic indicators that likely fostered that decision was the final federal government assessment of Q3 growth: a strong 3.2%. The Fed also raised its projection of 2018 GDP to 2.5% from its previous forecast of2.1% and its latest dot-plot indicated three rate hikes for the new year.[3,8]

GLOBAL ECONOMIC HEALTH
While Spain grappled with the Catalonia region's desire for independence and the United Kingdom contended with European Union demands involving its Brexit, there was much good news concerning the overall E.U. economy. The jobless rate across its 28 member countries continued to descend, falling to 7.4% in October. Inflation, barely above 1.0% at the end of 2016, increased to 1.8% in November. The European Central Bank kept interest rates steady in the quarter and announced it would buy fewer bonds per month; its monetary stimulus is expected to last through Q3 2018. In December, the ECB projected 2.3% growth for the E.U. economy in 2018.[9,10]

REAL ESTATE
Mortgage rates climbed higher in the quarter. Freddie Mac's December 28 Primary Mortgage Market Survey revealed the following interest rates: 30-year fixed, 3.99%; 15-year fixed, 3.44%; 5/1-year adjustable, 3.47%. Compare the numbers from the September 28 PMMS: 30-year fixed, 3.83%; 15-year fixed, 3.13%; 5/1-year adjustable, 3.20%.[17]

Home buying emerged from a Q3 slump in Q4. Resales rose 2.4% in the tenth month of the year and then 5.6% in the eleventh, according to the National Association of Realtors. (NAR's pending home sales gauge, incidentally, was up 3.5% in October, but just 0.2% in November.) New home sales, seemingly always volatile, were 1.7% lower in October, but jumped 17.5% in November.[3]

Looking at other real estate indicators, October brought improvements of 8.4% for housing starts and 7.4% for building permits; groundbreaking increased by another 3.3% a month later, with permits contracting 1.4%. October's S&P/Case-Shiller home price index (released in December) was up 6.4% from 12 months earlier.[3]

LOOKING BACK…LOOKING FORWARD
As the table beneath this paragraph shows, the blue chips had a phenomenal quarter, outpacing Wall Street's two other major stock benchmarks. The Dow settled at record highs 70 times last year; the S&P 500, 62 times. The gains in the fourth quarter made 2017 the best year for stocks since 2013. The Russell 2000 rose 13.14% for the year,

while the CBOE VIX slumped 21.37%. The year-end settlements: Dow, 24,719.22; Nasdaq, 6,903.39; S&P, 2,673.61; Russell, 1,535.51; VIX, 11.04.[18,19]

% CHANGE	2017	Q4 CHG	1-YR CHG	10-YR AVG
DJIA	+25.08	+10.33	+24.72	+8.49
NASDAQ	+28.24	+6.27	+27.09	+15.81
S&P 500	+19.42	+6.12	+18.87	+8.08
REAL YIELD	12/29 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.44%	0.55%	-0.73%	1.78%

Sources: wsj.com, bigcharts.com, treasury.gov – 12/29/17[1,20,21,22]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

Wall Street seems primed for a bullish first quarter. Institutional investors are hopeful that 2018 may surprise to the upside, just as 2017 did. The economy's 2-3% growth will probably continue in the near term, and corporate earnings should get a boost from the tax reforms in the months ahead. All that said, warnings continue to sound that the market is overpriced; the S&P 500 is now trading at about 18x forward earnings. The exuberance around equities does not always feel rational. Nearly two years have passed without a correction in the S&P, and the index had no more than a 2% downturn during all of 2017. Look at this first quarter optimistically, but be aware that the market is still susceptible to left hooks and gut punches from geopolitical events and the gradual erosion of confidence that can sometimes emerge to accompany an aging business cycle. Hopefully, bulls will not slow to a trot as 2018 proceeds.[18]

(equity) prices of the largest companies on the Toronto Stock Exchange (TSX) as measured by market capitalization. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The Russell 2000 Index is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index. The CBOE Volatility Index® is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. MarketingPro, Inc. is not affiliated with any person or firm that may be providing this information to you. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional.

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