MarketUpdate

Another strong month for markets

Domestic and international stock markets had a good month. In the U.S., the Dow Jones Industrial Average popped 4.24 percent, the S&P 500 Index climbed 3.07 percent, and Nasdaq Composite gained 2.34 percent. All three indices hit all-time highs during the month.

Gains were driven by improving fundamentals. According to FactSet, as of November 24, the blended earnings growth rate for the S&P 500 for the third quarter was 6.3 percent, more than double the 3.1-percent estimate at the end of September. From a technical standpoint, all three U.S. indices remained above their 200-day moving averages for the month—a signal of probable continued strength.

International markets also moved up. The MSCI EAFE Index rose by a solid 1.05 percent in November. As in the U.S., performance was driven primarily by improving earnings growth and general economic expansion. Emerging markets, as measured by the MSCI Emerging Markets Index, improved by 0.21 percent in November. Both foreign indices remained above their 200-day trend lines.

Turning to fixed income, yields on the short end of the curve increased in anticipation of a rate hike and the potential for a government shutdown in December. The Bloomberg Barclays U.S. Aggregate Bond Index declined by 0.13 percent, and the Bloomberg Barclays U.S. Corporate High Yield Index fell by 0.26 percent.

Economic news to be grateful for

November's economic releases were generally positive. Job creation in October rebounded from negative headline figures with a print of 261,000 new jobs. In addition, unemployment and underemployment both declined, and wages held constant. Following dampened results in September from the hurricanes, this shows the continued strength of the job market.

Not surprisingly, consumer confidence climbed during the month. The Conference Board's survey is now at a 17-year high heading into the important holiday retail season.

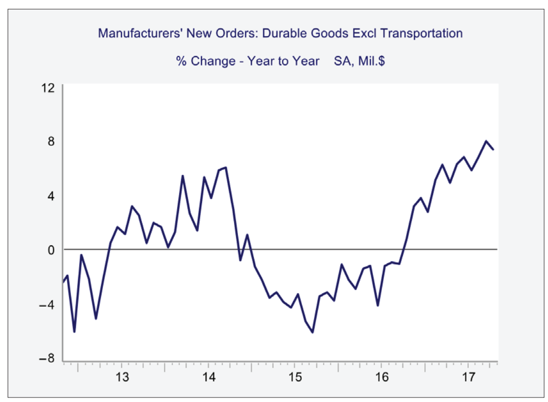
Despite high confidence levels, hard spending data has fallen short. Not so for the latest retail sales report. The headline figure grew, and September's figures also were revised upward, painting a solid if not spectacular growth picture for the fourth quarter.

Businesses also experiencing growth

The Institute for Supply Management's Manufacturing index, a measure of manufacturing confidence, declined slightly to 58.2—a healthy number that indicates ongoing expansion. The Nonmanufacturing index performed better, increasing to a 12-year high of 60.1. As the service sector accounts for the majority of economic activity, this is a very positive signal.

Here as well, better sentiment was accompanied by improvements in spending. Core durable goods orders increased by 0.4 percent in October, and the strong September figure was revised upward. Core business spending is close to a five-year high (see Figure 1).

Figure 1. Change in Core Durable Goods Orders, Year-Over-Year (2013–2017)



Source: Census Bureau/Haver Analytics

In the housing industry, improvements in sentiment also were matched by investment. Homebuilder confidence rose to an eight-month high, as strong consumer demand and rising prices continued to offset the high costs of labor and materials. The supply of new and existing housing stock remains near historic lows.

Consumer demand came in better than expected, with existing home sales growing at 6.2 percent. The level of new home sales is at the highest it has been since October 2007.

Political risks remain elevated

As we've been saying for months, the major source of risk is political. In Europe, the inconclusive German election and stalled coalition talks rattled European markets mid-month and have the potential to create more uncertainty. The ongoing Brexit process in the U.K. is also creating concern, while North Korean nuclear tests continue to destabilize the region.

The immediate political risks, however, are here in the U.S. tax reform and the debt ceiling. If tax reform passes, it could be positive for the markets. But passage is uncertain—and that uncertainty could create volatility.

Meanwhile, the current debt ceiling agreement expires on December 8. Without a new agreement between Republican and Democratic lawmakers, the government will shut down, potentially bringing more uncertainty and turmoil.

Markets remain strong

Given the strength in the economy and markets, any political disruption will be cushioned. That doesn't mean we won't see market volatility, but any short-term shocks should be offset by the strong economic and corporate fundamentals. As always, a well-diversified portfolio matched to your risk tolerance remains the best way to meet your financial goals over the long term.

All information according to Bloomberg, unless stated otherwise.

Certain sections of this commentary contain forward-looking statements based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Nasdaq Composite Index measures the performance of all issues listed in the Nasdaq Stock Market, except for rights, warrants, units, and convertible debentures. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Bloomberg Barclays Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Bloomberg Barclays government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Bloomberg Barclays U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

Co-authored by Brad McMillan, senior vice president, chief investment officer, and Sam Millette, fixed income analyst, at Commonwealth Financial Network.