MarketUpdate

Treats, not tricks, for markets

Better-than-expected economic data in the U.S. and positive corporate earnings news lifted the major market indices in October. The S&P 500 Index returned 2.33 percent, the Nasdaq Composite popped 3.61 percent, and the Dow Jones Industrial Average climbed 4.44 percent.

Performance was driven by improving fundamentals. According to FactSet, as of October 27, the third-quarter blended earnings growth rate for the S&P 500 was 4.7 percent. This was up from the 4.2 percent projected at the end of September. On the technical side, all three U.S. indices remained well above their 200-day moving averages.

On the international front, developed markets, as represented by the MSCI EAFE Index, rose by 1.52 percent. Improving earnings and ongoing stimulus from the European Central Bank buoyed results. Emerging markets fared better, with the MSCI Emerging Markets Index gaining 3.51 percent on continued commodity and export strength. Both indices looked good technically, remaining above their trend lines in October.

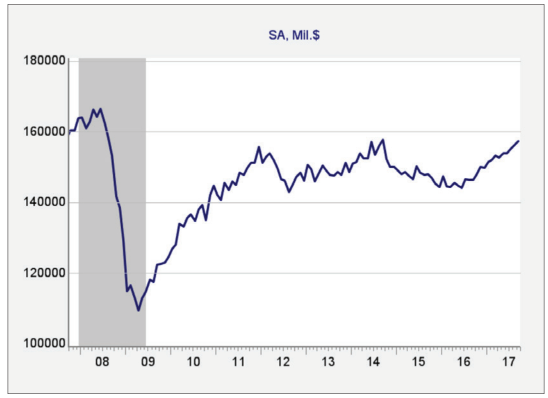
A slight uptick in rates weighed on fixed income performance in October. The Bloomberg Barclays U.S. Aggregate Bond Index gained just 0.06 percent. High-yield bonds did better, with Bloomberg Barclays U.S. Corporate High Yield Bond Index notching a 0.42-percent gain.

Positive economic surprises

Most major data releases beat expectations in October, pointing to accelerating growth. The first estimate of third-quarter gross domestic product (GDP) growth came in at 3 percent, beating expectations for a more modest 2.5-percent increase.

Durable goods orders, considered a proxy for long-term business investment, increased by more than twice the expected amount. Even better, core durable goods orders, which exclude volatile aircraft purchases, now sit at their second-highest level since the recession (see Figure 1).

Figure 1. Manufacturers' New Orders: Durable Goods Ex Transportation, 2008–2017



Source: Census Bureau/Haver Analytics

The Institute for Supply Management's Manufacturing Index, a measure of business confidence, remained at a high level in October. Combined with the weakening of the dollar year-to-date, this suggests that manufacturing growth is likely to drive faster overall economic growth in the fourth quarter.

Consumers and housing also outperform

Consumer sentiment continued to rise in October, with both major surveys at or close to their highest levels since the dot-com boom. This confidence was matched by actual spending growth.

Homebuilder confidence also rebounded during the month. This was likely driven by strong demand for new housing. New home sales came in at an impressive 667,000 versus expectations for 554,000.

Political risks diminish but can still spook markets

Both the domestic and global economies have exhibited solid fundamentals and the possibility of accelerating growth. Risks remain, though, and they are largely political. Tax reform and the pending debt-ceiling vote have the potential to destabilize markets. Changing leadership at the Federal Reserve is a point of uncertainty as well. These factors, combined with high market valuation levels, can certainly contribute to increased volatility here in the U.S.

In Spain, the confrontation between secessionist Catalans and the Spanish government could affect European markets. In addition, the ongoing negotiations around the British exit from the European Union are potentially heating up.

Risks in Asia have receded compared with last month, though. In Japan, key U.S. ally Prime Minister Shinzo Abe won a snap election and gained more seats in the legislature, suggesting more stability in the region. The situation in North Korea also appears to have moderated, despite ongoing rhetoric.

Fundamentals remain solid but volatility likely

Although the markets are calmer than they have been in decades, we need to be prepared for the return of market volatility. For now, though, the global economy continues to do well—and markets ultimately respond to growth. A well-diversified portfolio, designed to take advantage of that growth, and matched with an investor's time horizon, continues to offer the best path to reaching 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 U.S. 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.

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