Monthly Market Commentary

September, 2017

US Economy

Headline jobless measures in the US suggest that employment conditions are tightening. Indeed, the unemployment rate has fallen to pre-crisis levels in recent months (currently 4.2%). At first glance, such a figure would confirm part of the US economic recovery story and strengthen an argument for tighter monetary policies (higher interest rates) from the Federal Reserve (Fed). Nevertheless, we believe that these figures likely are masking distortions in the US labor market. As the headline jobless rates suggest, more individuals are entering the workforce in the US, yet the type of employment they are finding does not naturally lend itself to higher wages. Various measures from the US Bureau of Labor Statistics reflect an elevated trend of individuals employed in part-time and temporary assignments. It is these kinds of jobs in which a worker is marginally attached to the labor force and has a more limited ability to negotiate higher wages.

In the US, there historically has been an inverse relationship between wage growth and the U6 rate, which (unlike the U-3 rate) includes the unemployed as well as part-time and marginally-employed workers (currently 8.3%, as of this writing). This suggests that wages rise as employer demand for labor increases amid a shallower pool of applicants, later prompting individuals employed in part-time and marginal positions to enter the formal job market. Over the past few months, the historical relationship between wage growth and inflation (along with its recent weakness) has become a point of focus in monetary-policy speeches delivered by Fed Chair Janet Yellen. Given this recent point of focus, looking forward, we believe that the Fed is likely to keep rates "lower for longer" so long as data suggests that widespread labor-market distortions persist.

US Markets

After coming off a choppy August, the US equity markets trended slightly higher in September. We attribute this modest increase to continued positive US and global economic growth and news that the US Congress is beginning to look at tax reform. Looking ahead, while we believe the markets will end the year on a positive note, we are in what is a historically choppy time of year. As such, we would anticipate near-term volatility to increase; however, we would expect it to be rather short-lived as US and global economic growth continues to improve.

Fixed Income

The Federal Open Market Committee (FOMC) met in September and, as anticipated, decided to maintain the current range for the federal funds target rate at 1.00 – 1.25%. The FOMC reiterated that it expects economic conditions to evolve in a manner that will warrant gradual increases in the fed funds rate. In addition, the Fed announced that it will begin reducing its balance sheet in October by $10 billion per month. The Fed will reduce Treasury purchases by $6 billion per month and mortgage-backed-security purchases by $4 billion per month. We would expect the Fed to increase this amount by $10 billion each quarter if conditions warrant.

The FOMC continues to expect that the US economy will expand at a moderate pace and that labor-market conditions will strengthen somewhat further (we would agree). The committee expects inflation to remain below 2% in the near-term, but believes that it will approach this target over the medium-term. The market's expectations of a future rate-hike probability for December moved to higher levels after the Fed's announcement (at a 70% probability, as of this writing).

International Markets

Germany held elections in September and, as anticipated, Chancellor Angela Merkel's conservative bloc won the elections. Merkel's center-right Christian Democratic Union (CDU) and its Bavarian sister-party the Christian Social Union (CSU) won 33% of the vote. Despite the victory, the parties fared much worse than recent polling suggested. Also, as anticipated, the far-right populist party Alternative for Germany (AfD) finished third, winning a greater-than-anticipated 12.6% of the vote. The AfD will be the first nationalist, right-wing party to enter the German parliament since World War II.

The AfD is an anti-European Union (EU), anti-immigrant party formed in 2013. The party attracted both left- and right-leaning voters who were dissatisfied with Merkel's decision to allow over 1 million refugees, mainly coming from the Middle East, to enter the country during Europe's refugee crisis. While we do not believe the outcome of the election will have an immediate impact on Germany's economy, we are keeping a close eye on the rise of anti-EU populist parties, as these parties could shape politics and economies in the future.

Commodities

Gold broke out of its recent trading range and peaked in the mid $1,300s (it has since retreated into the upper $1,200s). Ask investors what is to blame, and most will say concerns surrounding North Korea. And we agree, however, the US dollar needs to be given its fair share of the credit as well. The recent decline in the dollar certainly has helped to fuel gold's rise. Out of all commodities, gold has had the strongest, and most consistently negative, correlation to the dollar through time (negative correlation means when one goes up, the other goes down).

The US dollar recently reached lows not seen in more than two and half years. And if the dollar continues its decline, we expect gold would likely benefit. This (and concerns surrounding North Korea) are the two biggest risks to our gold target. If, as we forecast, the dollar strengthens (and if concerns ease), we feel gold should find its way back to our year-end 2017 target range of $1,150 – $1,250.

What Does This Mean To Me?

Despite concerns over low wage inflation, the US economy continues to improve, which we believe will persist through 2017 and into 2018. In addition, looking globally, we continue to be encouraged by positive global economic growth. Many European and Asian country's economies continue to expand, which has led their equity markets higher. While we may be in what is historically a choppy period for US equities, we believe that positive economic fundamentals could bode well for equities as we finish out 2017 and move into 2018. Despite this potential for near-term volatility, we continue to encourage investors to stick to their long-term investment plans.

If you have any questions or concerns, please do not hesitate to reach out to us at any time.

Sincerely,

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