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Monthly Market Commentary

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US Economy

The US economy continues on its trajectory through the latter stages of the current cycle, yet we do not believe that the cycle is coming to an end. Overall, the US consumer remains in a much stronger financial condition today than prior to the 2008 – 2009 recession. The robust labor market is supportive of higher household income, while low borrowing costs are keeping loan payments affordable. With household new worth also at record highs, it is this affordability factor, coupled with consumer sentiment at a cycle high, that is allowing consumers the capacity to spend and helping to sustain economic growth. We believe that the economy is likely past the midpoint of its current expansion, but that the expansion has further room to run, at least through 2018 (and potentially longer).

US Markets

During the month of October, US equity markets continued to hit new highs. In our opinion, there are three notable reasons why the markets are hitting record highs this year. One primary reason is that the macroeconomic picture is conducive to higher asset prices. With global growth firming and inflation tame across most countries, global equities have gained in price, while global bond prices have been supported by very low interest rates. Second, US stocks have experienced an earnings recovery this year – bolstered by a positive rebound in energy companies' earnings and higher growth rates in sectors such as Technology, Industrials, and Financials. A third reason for higher asset prices is that ample liquidity is available for investors to make purchases and for companies to borrow at very low cost. This may lead to companies and individuals borrowing to make financial-asset purchases – a behavior that eventually could contribute to a broad asset-price correction. However, our analysis of current debt levels for the US government and private sector leads us to conclude that this is unlikely to be a near-term problem.

Fixed Income

The Federal Open Market Committee (FOMC) met in October 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 federal funds rate. The Fed will continue reducing the size of its balance sheet by $10 billion per month, by reducing Treasury-security purchases by $6 billion per month and mortgage-backed-security purchases by $4 billion per month. We expect the Fed to increase this amount by $10 billion in January if conditions warrant.

Looking forward, the Fed believes that hurricane-related disruptions will continue to affect US economic activity in the near-term, but these disruptions are unlikely to materially alter the course of the economy over the medium-term. The FOMC continues to expect the US economy will expand at a moderate pace and that labor-market conditions will strengthen somewhat further. The committee also expects inflation to remain somewhat below 2% in the near-term, but believes that it will approach the target over the medium-term.

International Markets

During the 19th National Congress of the Communist Party of China, China's leader Xi Jinping was elected to a second five-year term. During the Congress, President Xi significantly consolidated power and was elevated in both stature and influence within the ruling party. Few communist leaders in China have held such power since founding party member Chairman Mao Zedong's days. What is important to note is that President Xi has achieved his personal level of success through an adherence to – and extension of – party influence, not outside of it. As a result, the body of the Communist Party, headed by the "core" leader Xi, is likely to play a more active and visible role in driving reforms in the country's economy and markets in the coming years.

In general, we expect the trajectory of President Xi's economic policies to remain largely unchanged from what was introduced during the last five-year plan that began in 2015. These policies specifically called for a slower pace of growth as the country's economy matures and transitions from a production-oriented focus to a services-based and consumption-oriented economy. We anticipate that reform implementation will gain pace over the next 12 – 18 months following Xi's consolidation of power and influence within the Communist Party. We believe that this political outcome could bring stability to an environment in which policies are in flux, particularly in the US and Europe. We believe that markets favor policy certainty over uncertainty, and that could continue to bode well for the Pacific and Emerging Market Asia region as a result.

Commodities

Drilled but uncompleted wells, or DUCs, are exactly what their name suggests – oil wells that have been drilled but have not been made ready for production (completed). There are several reasons why producers drill but hold off on completing a well. These include: waiting for higher oil prices; labor, equipment, and infrastructure constraints or shortages; and land lease considerations (among others).

It takes time, effort, and money to drill an oil well. DUCs represent money sunk into the ground that exploration and production companies cannot recover until the well is completed and oil starts flowing. These companies are anxiously waiting for the opportunity to get that cash back. An oil-price surge could spark a mass tapping of the DUC inventory. Like pulling a cork off of a bottle of shaken champagne, DUCs have the potential to rapidly flood the market with oil. Record DUCs represent another reason why we believe that oil prices will remain capped in the near-term, as the risk of a surge in oil supply should help to keep a lid on oil prices.

What Does This Mean To Me?

Despite some investor concerns about the US markets being at all-time highs, we believe that the US economy will continue to expand as we move into 2018, and potentially beyond. While we do not believe that 2018 will provide returns as robust as we have experienced in 2017, we do believe there is room for the markets to continue to progress as we look ahead. We continue to keep an eye on the evolving tax-reform situation in Washington. Should Congress pass a robust tax-reform package, we believe the markets could react well to this. However, if Congress passes a more "muted" tax-reform package (or is unable to pass one at all), we could see this weigh on sentiment in the markets. Nonetheless, we believe, with an improving global economy, the markets could continue to perform well for the foreseeable future.

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

Sincerely,

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