

October 2018

Market Recap: International equities stole the spotlight for the month of September but were still down over the third quarter. U.S. large cap stocks fared better than their mid and small cap brethren over both time periods.

What's Working: The technology sector gave up some ground year to date to the healthcare sector this past month but both are still posting large gains versus the S&P 500 index.

What's Not Working: The U.S. aggregate bond index remains in negative territory year to date as the Federal Reserve continues to increase the Fed Funds Rate. Although this is a challenge for fixed income holdings, our fund selections continue to provide income in addition to solid performance relative to the index.

Portfolio Changes: A newly introduced money market option was put in place recently and is increasing returns through higher yields. With additional interest rate increases anticipated from the Federal Reserve we expect this change to add even more value.

Concerns: Expect a bumpy ride in the markets as we approach the midterm elections. History shows us that equity markets don't like the uncertainty prior to national elections but tend to rally after the dust settles.

Sincerely,



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In this month's recap: the Fed hikes again, wage growth ascends, mortgage rates rise notably, and stocks advance.

Monthly Economic Update

Presented by Integrated Financial Solutions, October 2018

THE MONTH IN BRIEF

Wall Street maintained its optimism in September. While trade worries were top of mind for economists and investors overseas, bulls largely shrugged at the prospect of tariffs and the probability of another interest rate hike. The S&P 500 rose 0.43% for the month. On the whole, U.S. economic indicators were quite good, and some offered pleasant surprises.¹

DOMESTIC ECONOMIC HEALTH

As many analysts expected, the Federal Reserve raised the main interest rate by 0.25% on September 26 to a target range of 2.00-2.25%. The word “accommodative” was absent from its latest policy statement, distinctly hinting at a shift in U.S. monetary policy. As September ended, the CME Group’s FedWatch Tool had the odds of a quarter-point December rate hike at 76.5%.^{2,3}

On the last day of September, Canada joined the U.S. and Mexico in a new proposed trade pact representing an evolution of the existing North American Free Trade Agreement (NAFTA). The new accord, if approved by the governments of Canada, Mexico, and the U.S., would toughen intellectual property and trade secret regulations, require 75% of autos made in North America to use parts from North American manufacturers, stipulate new labor requirements for Mexican industry, and seek to crack down further on unsanctioned fish, animal, and timber imports.⁴

New data showed hiring bouncing back in August. The Department of Labor stated that the economy added 201,000 net new jobs in that month. Annualized wage growth reached 2.9%, the best number seen since the end of the Great Recession in 2009. The main jobless rate remained low at 3.9%; the underemployment (U-6) rate ticked down to 7.4%, a 17-year low.⁵

While wages grew 2.8% in the year ending in August, the Consumer Price Index rose only 2.7% in those 12 months. July's CPI showed yearly inflation at 2.9%. Yearly core consumer inflation also declined 0.2% to 2.2% in the August CPI.^{5,6}

Consumers saved some of what they earned in August. Personal income and personal spending were both up 0.3% for the month; retail sales, though, only advanced 0.1%; 0.2%, with automotive and gas purchases factored out.⁶

Households viewed the present and near future of the economy with considerable optimism. The Conference Board's consumer confidence index came in at a remarkable 138.4 last month, up another 3.7 points. The University of Michigan's barometer rose 4.6 points to 100.8 in its initial September edition, then leveled off to a final September mark of 100.1.⁶

Off Main Street, durable goods orders advanced 4.5% in August, more than reversing a 1.2% July decline. Industrial production rose 0.4%; factory output, 0.2%. Producer prices retreated 0.1% in August, sharply reducing their annualized gain from 3.3% to 2.8%. The Institute for Supply Management's purchasing manager indices, gauges of business activity in the manufacturing and non-manufacturing sectors of the economy, looked good in August. The factory PMI climbed to a stellar 61.3 from its 58.1 July level, and the service sector PMI rose to 58.5 from the prior reading of 55.7.^{6,7}

GLOBAL ECONOMIC HEALTH

Economists, investors, and journalists in Asia-Pacific nations were anxious about what U.S. tariffs and continued Federal Reserve interest rate hikes might mean for the region's economies. The Institute of International Finance said last month that foreign investment dollars flowing into emerging markets had shrunk alarmingly in mid-summer, from \$13.7 billion in July to \$2.2 billion in August. India's rupee was down 12% against the dollar YTD in September; Indonesia's rupiah, 9.2%. On the bright side, India's annualized GDP was at 8.2% through the second quarter. In its latest forecast, the Asia Development Bank projects 5.8% growth for the Asia-Pacific region in 2019. If that holds true, that would be an 18-year low. The ADB projects China's GDP to decline from 6.6% this year to 6.3% next year.^{8,9}

Unlike the Fed, the European Central Bank left interest rates alone in September: its deposit rate remained -0.4%, and its main refinancing rate stayed at 0.0%. On September 13, the ECB announced it would keep interest rates at those levels through at least summer 2019 and end its asset-purchase program in December. The European Union had to deal with yet another economic drama last month as the populist government of Italy replaced a plan that would have reduced its budget deficit to 0.8% of GDP with one that would introduce a basic income,

boost pensions, and generate a deficit of 2.4% of GDP for the next three years. While the tactic could help a strained Italian banking system, it could also make it tougher for Italy to service its national debt, which is now expanding 30% faster than its economy is growing.^{10,11}

WORLD MARKETS

Benchmark performance varied widely in September. The biggest gain came in Argentina, where the Merval soared 33.67% (it ended the month up 30.73% year-over-year). Russia's Micex rose 6.87%; the Nikkei 225, 5.73%; Brazil's Bovespa, 2.41%. South Korea's Kospi added 1.73%; the Shanghai Composite, 1.56%; Taiwan's TSE 50, 1.08%. Less consequential gains came for the MSCI World (0.39%) and France's CAC 40 (0.15%).^{12,13}

There were significant retreats last month as well. In India, the Nifty 50 fell 6.88%; the Sensex, 6.86%. No other major index suffered a loss that large, but in Europe, Spain's IBEX 35 slipped 2.26%; Germany's DAX, 2.24%. Hong Kong's Hang Seng lost 1.99% on the month. To our north, the TSX Composite gave back 1.73%. The United Kingdom's FTSE 100 lost 1.40%; Australia's All Ordinaries, 1.37%; Mexico's Bolsa, 1.04%. MSCI's Emerging Markets index declined 0.76%.^{12,13}

COMMODITIES MARKETS

Three important commodities gained 5% or more in September. Copper futures advanced 5.47%, WTI crude gained 5.27%, and heating oil added 5.00%. Oil wrapped up the month at \$73.56 on the NYMEX. Other gainers included coffee, +4.43%; platinum, +4.01%; natural gas, +2.74%; silver, +1.80%; soybeans, +1.38%; corn, +1.28%. An ounce of silver was worth \$14.69 on the COMEX at the September 28 close.¹⁴

Other commodities made September descents: gold, -0.82%; wheat, -1.64%; unleaded gasoline, -1.73%; sugar, -5.19%; cotton, -5.58%; cocoa, -11.06%. COMEX gold was worth \$1,196.20 an ounce on September 28. The U.S. Dollar Index was basically flat for the month, declining 0.16% to 94.99.^{14,15}

REAL ESTATE

Existing home sales did not retreat in August; they did not advance, either. The National Association of Realtors pronounced them unchanged in the eighth month of the year, as its pending home sales index slipped 1.8%. New home buying improved 3.5% in August, according to the Census Bureau; that was a nice switch from the (revised) 1.6% decline in July.⁶

While residential construction activity picked up in August, another indicator hinted that the expectations of home sellers were being recalibrated. The Census Bureau said that groundbreaking increased 9.2% in August (though the number of building permits issued decreased 5.7%). All the same, September brought the release of the July edition of the 20-city S&P CoreLogic Case-Shiller home price index, which displayed an annual appreciation of just 5.9% – quite a drop from 6.4% just a month before. Mortgage rates jumped: between August 30 and September 27, Freddie Mac’s Primary Mortgage Market Survey measured the average interest rate for the 30-year FRM moving north from 4.52% to 4.72%. Mean interest rates for the 15-year FRM rose from 3.97% to 4.16% in that span, while the average interest on a 5/1-year ARM went from 3.85% to 3.97%.^{6,16}

TIP OF THE MONTH



Life insurance proceeds normally pass to beneficiaries without being taxed. There is one notable exception: if a policy is transferred between business owners to fund a buy-sell agreement, its tax-exempt status may be lost.

LOOKING BACK, LOOKING FORWARD

Two of the key Wall Street indices rose in September, while two others fell. The Dow Jones Industrial Average and S&P 500 respectively gained 1.90% and 0.43% last month; the Nasdaq Composite and Russell 2000 respectively lost 0.78% and 2.62%. These September ups and downs aside, the big three had an exceptional third quarter. Across Q3, the S&P improved 7.20%; the Dow, 9.01%; the Nasdaq, 7.14%. (The Russell rose 3.26%.) When the month ended, the four indices settled as follows: DJIA, 26,458.31; SPX, 2,913.98; COMP, 8,046.35; RUT, 1,695.10. Finally, the CBOE VIX declined 1.94% last month to a September 28 close of 12.61.^{1,17}

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	7.04	18.22	14.68	15.53

NASDAQ	16.56	24.68	22.56	30.56
S&P 500	8.99	16.09	14.45	16.34

REAL YIELD (%)	9/28 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.91	0.44	0.46	2.03

Sources: wsj.com, bigcharts.com, treasury.gov - 9/28/18^{1,18,19,20}

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.
10-year TIPS real yield = projected return at maturity given expected inflation.

Through the years, October has tended to be one of the more turbulent months for equities. The historic standard deviation for the Dow Industrials in October is 1.44%, as opposed to 1.05% for the other eleven months. Yes, two of the most unsettling drops in Wall Street history happened in Octobers – but even with Black Monday and the 1,000-point slides of late 2008 factored out of calculations, volatility in the tenth month of the year remains historically above average. (Only one bear market out of the past 35 has begun in October, in case you are wondering.) This October may break the pattern and be remarkably placid; the past can be a faulty tool indeed for predicting the future. Whether stocks rollercoaster or not this month, investors may want to scale back bullish expectations. Wall Street looks forward to the fourth quarter, year after year, but the trajectory of any gains in Q4 might be flatter than some investors anticipate, since stocks advanced so much in Q3. Still, bullish sentiment is hardly flagging, and the oncoming earnings season could spark a fall rally.²¹

QUOTE OF THE MONTH



*“The **end result** of kindness is that it draws people to you.”*

ANITA RODDICK

UPCOMING RELEASES

What will investors pay attention to as the rest of October unfolds? The September Challenger job-cut report and August factory orders (10/4), the Department of Labor's latest employment report (10/5), September's Producer Price Index (10/11), September's Consumer Price Index (10/12), the University of Michigan's preliminary October consumer sentiment index (10/13), September retail sales (10/15), September industrial output (10/16), September residential construction activity (10/17), the Conference Board's latest leading indicators index (10/18), the NAR's newest existing home sales snapshot (10/19), September new home sales (10/24), the NAR's latest pending home sales index and September durable goods orders (10/25), the initial estimate of Q3 GDP from the Bureau of Economic Analysis and the final University of Michigan consumer sentiment index for October (10/26), September personal spending and the September PCE price index (10/29), a new consumer confidence index from the Conference Board (10/30), and the October ADP payrolls report (10/31).

THE MONTHLY RIDDLE



*A thief **steals \$100** from a cash register at a store. An hour later, he returns with the same \$100 and buys \$70 worth of goods, receiving **\$30 back** in change. **How much does the store ultimately lose to the thief?***

LAST MONTH'S RIDDLE: Two parents have four girls, and each girl has one brother. Given this, how many people are in this family?

ANSWER: Seven people: two parents, four sisters, and one brother.

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The Bovespa Index is a gross total return index weighted by traded volume & is comprised of the most liquid stocks traded on the Sao Paulo Stock Exchange. The Korea Composite Stock Price Index or KOSPI is the major stock market index of South Korea, representing all common stocks traded on the Korea Exchange. The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The FTSE TWSE Taiwan 50 Index consists of the largest 50 companies by full market value and is also the first narrow-based index published in Taiwan. The MSCI World Index is a free-float weighted equity index that includes developed world markets and does not include emerging markets. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The Nifty 50 (NTFE 50) is a well-diversified 50-stock index accounting for 13 sectors of the Indian economy. It is used for a variety of purposes such as benchmarking fund portfolios, index-based derivatives and index funds. The BSE SENSEX (Bombay Stock Exchange Sensitive Index), also-called the BSE 30 (BOMBAY STOCK EXCHANGE) or simply the SENSEX, is a free-float market capitalization-weighted stock market index of 30 well-established and financially sound companies listed on the Bombay Stock Exchange (BSE). The IBEX 35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange. The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The DAX 30 is a Blue-Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The Hang Seng Index is a free float-adjusted market capitalization-weighted stock market index that is the main indicator of the overall market performance in Hong Kong. The S&P/TSX Composite Index is an index of the stock (equity) prices of the largest companies on the Toronto Stock Exchange (TSX) as measured by market capitalization. The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The All Ordinaries (XAO) is considered a total market barometer for the Australian stock market and contains the 500 largest ASX-listed companies by way of market capitalization. The Mexican Stock Exchange, commonly known as Mexican Bolsa, Mexbol, or BMV, is the only stock exchange in Mexico. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. The US Dollar Index measures the performance of the U.S. dollar against a basket of six currencies. 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