PERSPECTIVES AND POSITIONS

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This is a summary of our views on the economy and markets as shared with discretionary clients.

ECONOMIC OUTLOOK

- The pace of GDP growth has picked up during 2017. The GDP annual growth rate is 2.2% and the most recent estimate for the latest release is approximately 2.0%. Hurricane impacts could cause disruptions in the data, however, we see annual growth within a 2.0% – 2.5% range.
- The Federal Reserve decided to leave the Fed Funds rate stable in September at 1.25%. We expect at least one more rate hike before the end of the year to 1.50%.
- Headline inflation stubbornly has been lower than the 2.0% Federal Reserve target for removing monetary stimulus. Again, hurricanes can impact energy prices and unemployment data in the coming months. However, we believe the trend will improve to 2% for 2018 with improvement in commodity prices and wage growth. A growing economy will continue to put upward pressure on prices.
- The U.S. dollar has traded lower versus other currencies during 2017. However, the dollar has staged a slight rebound at the end of September due to the Fed announcement that it will begin to unwind its balance sheet. The dollar will consolidate into a new stable trading range into 2018.

STRATEGIC MARKET OUTLOOK AND TACTICAL ALLOCATIONS

Fixed Income

- The Federal Reserve will remain vigilant. The outlook is for rates to increase slightly at the end of 2017 and into 2018 due to improved economic activity and inflation pressures.
- High yield posted coupon-like returns in the third quarter of 2017. Historical returns have been influenced by tightening credit spreads but the impact going forward will be minimal. The risk to high yield is widening spreads which we do not expect given the modestly growing economy. We view high yield to be fully valued and will use it as source of funds to bolster other positions when conditions warrant.
- We continue to overweight credit versus Treasuries with duration tilted shorter than benchmarks. We also view investment grade credit as fully valued (like high yield) due to tight credit spreads.
- Emerging market debt denominated in U.S. dollars provides diversification and yield potential. The story of tighter credit spreads is evident in this bond sector also.
- Commercial real estate continues to provide positive returns. Queues can delay additions to positions and an increase in interest rates could dampen valuation improvements. Value added or opportunistic strategies can be a complement to a core real estate exposure.

Equities

- The domestic large cap stock market appears to be fully valued and has priced in an anticipated earnings rebound from the positive impacts on earnings of a weaker dollar.
- Small cap stocks are over weighted versus targets in portfolios. Small cap stocks, while more inherently volatile, will benefit more from fiscal stimulus and potential tax reforms. Small cap stocks have outperformed large cap during the past 12 months.
- International stocks are still slightly over weighted versus targets. The quantitative easing programs in Europe and Japan have provided tailwinds to stocks. The relative dollar weakening in the quarter added to returns on foreign stocks. We are moderating international exposure in anticipation that stocks are becoming fairly valued and the dollar will strengthen.
- Emerging markets stocks are over weighted versus targets. They are comparatively attractive due to their low relative P/E multiples, even with their strong 12-month performance. Asian stocks are preferred as consumer demographic trends favor that part of the globe.