November 2017

Economic & Market

Forecast

A monthly report issued by the advisors at KPP Financial

ECONOMY

The initial GDP report for the 3rd quarter came in at 3% overall which is about in line with growth in the second quarter. Certainly there was some data distortion from the hurricanes in the growth, which is why October specific data might be more telling even if there is some snap back from distortion in September. The ISM manufacturing report came in light in October and construction figures continued to deteriorate. Housing permits ticked down in September along with housing starts even as construction spending rose slightly after four months of declines. Once again there is likely some distortion in the September data. Job gains remain solid and unemployment remains very low which is likely to push the Fed to tighten policy again in December. Personal Consumption Expenditures remain very strong which is a good indicator consumer spending health, however this also pushed down the savings rate to the lowest level since the last recession as income gains remained low. The White House is promising tax reform to boost the economy even more, but we are skeptical that the details will be hashed out by year end. We do expect the bill to be passed sometime before the mid-term elections next year, but in a much more watered down form. In the meantime, the economic trajectory does not look much different than what we saw when President Trump was elected a year ago.

U.S. EQUITIES

The Major Indexes closed with strong gains in the month of October, but the Small Cap Russell was roughly flat and credit market weakness is beginning to show. Technology remains a strong area of the market despite broad overvaluation in most names. Transportation had a weak month which is also something to keep an eye on. Earnings are increasing but not fast enough to compensate for a frothy market up much more than earnings are growing. Industrials were weak, but consumer discretionary was strong once again. QE from Europe and Japan have kept liquidity pumping since the Fed stopped printing money back in 2014, but the ECB will halve their purchases in January. How stocks react to this change will be intriguing. We continue to find pockets of opportunity to put money to work, but we are quick to take profits. We remain wary of the broader index valuations especially as underlying market strength waned due to an increasing number of new lows compared to new highs.

FOREIGN EQUITIES

Stocks abroad were strong which was especially impressive given the stronger dollar, but weakening global GDP is something to keep an eye on. Geopolitical uncertainty remains above average, but seems to have subsided as of late with North Korea tempering its missile launches. Catalonia remains on everyones radar, but the end result continues to be up in the air as factions of the Remain and Separatist sides exchange verbal barbs and actions. Greece equities remained weak and flair up of tension in the European periphery looks inevitable as the ECB reduces its support for their debt markets. Valuations continue to look good relative to the US, but this does not mean foreign markets are cheap in a historical context.

FIXED INCOME

The bond markets seemed to have handled the reduced Fed reinvestment well as rates did not move dramatically higher. High yield bond prices were flat on the month which did not vibe with equity markets moving higher. This is likely a worry with yield spreads back to historically low levels which means bond investors are not getting much compensation for the risks they are taking. The Fed met again and indicated they are very likely to raise rates in December barring unforeseen events. We continue to believe that as long as equity markets go higher the Fed will tighten policy at every other meeting. We expect rates to rise modestly over the next year and credit spreads to widen as global QE falls and liquidity levels tighten some. Inflation is also on the rise which is likely to be another catalyst for higher rates. Can the economy handle higher costs on debt? We do not think it can handle much more..

COMMODITIES

Oil prices remain on the rise as supply growth looks to be subsiding and the weak dollar over the past year is finally catching up to the market. Gold prices remain range bound, but with rising inflation, heightened geopolitical uncertainty and lower liquidity we think it is only a matter of time before prices break out to the upside again. Agriculture prices also remain on a tear.

Recommended Portfolio Weightings

As of October 31, 2017

Equity Sectors

Overweight	Neutral	Underweight
Consumer Staples	Consumer Discretionary	Technology
Energy	Materials	Telecom
	Utilities	Health Care
		Industrials
		Financials

Asset Classes

Overweight	Neutral	Underweight
Precious Metal Commodities	Emerging Market Stocks	U.S. Mid-Cap Stocks
Long-Term Investment Grade Bonds	International Developed Stocks	U.S. Large Cap Stocks
Resource Commodities	Short-Term Investment Grade Bonds	High Yield Bonds
Cash Alternatives	International Developed Fixed Income	U.S, Small-Cap Stocks
Agriculture Commodities	Intermediate-Term Investment Grade Bonds	International Emerging Market Fixed Income
	REITs	

Fixed Income

Overweight	Neutral	Underweight
TIPS	U.S. Treasuries	Bank Loans
Agency Securities	Mortgage-backed Securities	Preferred Securities
		Corporate Bonds
		Municipal Bonds

Economic & Market Forecast

Data Point	Current	Year-end Projection
S&P 500	2,575	2375-2425
NYSE	12,341	11,700 -12,200
10-Year	2.38%	2.3-2.5%
Crude Oil	$54.38	$50-55
Gold	1,271	1,375-1,425
Dollar Index	94.55	90-95
Effective Fed Funds Rate	1.16%	1.41 %

Disclaimers

There is no assurance that any of the target prices or other forward-looking statements mentioned will be attained. Any market prices are only indications of market values and are subject to change. Past performance is no guarantee of future results.

The prices of small and mid-company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

There are special risks associated with investing in preferred securities. Preferred securities generally offer no voting rights with respect to the issuer. Preferred securities are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination.

Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment. Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility.

All fixed income investments may be worth less than original cost upon redemption or maturity.

Although Treasury Inflation-Protected Securities (TIPS) are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and the securities to underperform traditional Treasury securities. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

The yield, average life and the expected maturity of mortgage-backed securities are based on prepayment assumptions that may or may not be met. Changes in prepayments may significantly affect yield, average life and expected maturity.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

Investments in the energy sector are subject to the adverse economic events within that industry. A downturn in the energy sector of the economy, adverse political, legislative or regulatory developments or other events could have a large impact on a portfolio's investments in this sector.

Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Real Estate investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Additional information available upon request.

Past performance is not a guide to future performance.

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