October 2017

Economic & Market

Forecast

A monthly report issued by the advisors at KPP Financial

Economy

Economic growth for the 3rd quarter looks likely to register in the mid 2% range which is stronger than the first half of the year. The ISM manufacturing and purchasing manager's index looks to be strengthening as well. Building permits and construction spending looks to be weakening overall which is the biggest worry right now. The hurricanes that devastated the Southeast and South have certainly distorted many economic indicators including employment. There will likely be some murkiness in the economic data over the next couple of months as those areas return to normal and economic activity adjusts. Auto sales will benefit the most as thousands of cars were destroyed and will likely need replacing. This should give a boost to that sector, which was ailing from oversupply, and the manufacturing sector overall. We still remain in a slow growth economy and much pent up demand is waiting on reforms promised by the Trump administration to be passed. We still remain very skeptical that the President is able to pass anything of material importance to the economy in the near term as his agenda will be watered down by political infighting within Congress.

U.S. Equities

Stocks had a very strong month overall with all the major indexes putting in gains. Earnings are going up, but not to the extent that the market has rallied this year which has stretched valuations to some levels that have not been seen since 1929 and 2000. Commodities and industrials were very strong while risk-off sectors like utilities and consumer staples lagging the overall market. Inflation looks to be increasing on the backs of money printing from Central Banks around the world, especially the ECB and BOJ. We continue to see extreme risk in much of the market, but pockets of value opportunities do exist. Clearly this market favors momentum investing over value, but when that changes it will happen quickly and suddenly. We remain cautious, especially as Central Banks look to be reining in liquidity in the near future.

Foreign Equities

Despite a strong dollar in the month of September, foreign stocks fared well. We continue to see geopolitical uncertainty out of North Korea and the Middle East, but that has not held back optimism about economic growth which in some cases is even stronger than what we are seeing here in the US. Greece was a weak spot in Europe which is something to watch, especially as Spain battles to keep Catalonia a part of their country. A complete exit of Catalonia as an economic driver of Spain could put some renewed worries in the Europe periphery bonds. Risks in Canada and Mexico remain as President Trump continues to threaten to rip up NAFTA which would throw a major wrench in economic growth in North America overall, but would likely benefit Asia.

Fixed Income

The Fed announced at the meeting in September that they would begin to reduce their reinvestments of maturing securities which will in effect slowly reduce their balance sheet by about $10 billion per month for the foreseeable future. They clearly see a market that has fully recovered and does not need extreme stimulus anymore. They remain concerned about lackluster inflation figures, but they are beginning to realize that stubbornly low inflation is more a function of technological advancement than anything else. They will continue to tighten policy as long as the financial markets remain risk on. If markets remain strong into year-end they will likely raise interest rates again in December and approach more balance sheet unwind early next year. We expect rates to rise slowly over time, but will likely remain range bound in the near future.

Commodities

After a strong August precious metals had a setback in September. They remain in an uptrend, but volatility is likely to persist as economic and central bank uncertainty remains high. Oil prices rose on slowing drilling activity and a weaker dollar over the past year. We still believe oil will be range bound as the market finds equilibrium between supply and demand after such a large price drop. Agriculture prices also look to be rising which supports our view that inflation is actually picking up and commodities look attractive overall as an asset class after years of underperformance.

Recommended Portfolio Weightings

As of September 30, 2017

Equity Sectors

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

Asset Classes

Overweight	Neutral	Underweight
Precious Metal Commodities	Emerging Market Stocks	U.S. Mid-Cap Stocks
Short-Term Investment Grade Bonds	International Developed Stocks	U.S. Large Cap Stocks
Resource Commodities	Long-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	2,519	2275-2325
NYSE	12,209	11,200 -11,700
10-Year	2.33%	2.3-2.5%

Crude Oil	$51.67	$50-55
Gold	1,285	1,475-1,525
Dollar Index	93.08	90-95
Effective Fed Funds Rate	1.16%	1.16 %

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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