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Financial Market Commentary: 3rd Quarter 2017

Market Resilience Continues

No bad news has been able to derail the current financial market cycle. In the face of North Korean missiles flying over Japan, a U.S. administration under investigation and unable to pass legislation, the third largest Eurozone economy grappling poorly with its exit plans, and the Federal Reserve determined to raise interest rates with or without evidence of inflation; global markets shrugged it off, enthusiastically reaching all-time highs. On balance, third quarter financial market performance was awesome.

Global Markets Set New Record Highs

A broad array of global markets set new record highs or rebounded sharply. In the U.S., third quarter performance was spurred by a spectacular turnaround in the energy sector. Although the beleaguered energy sector is still negative for the year, energy was up double digits in the last month and 6.0% for the quarter. Technology was the overall leader, up 8.3% in a broader market that returned 4.5%. U.S. equities are being driven by two consecutive quarters of double-digit earnings growth that is expected to continue. U.S. small caps surged 6.0% in Q3 and look even more attractive now that tax reform is back on the table.

Overseas markets continued their power march with emerging markets adding an 8% return in Q3 while international (EAFE) added 5.5% in the quarter, putting both above 20% year-to-date. Looking forward, emerging markets should continue to fair well. Structural reforms should boost profitability as the ease of doing business improves. Two of the largest markets, India and China are both pursuing aggressive reforms, and they have much company in other countries such as Indonesia and several Latin America countries. Synchronized global growth continues to fuel demand for products stimulating further growth given the dependence on trade by most emerging market economies. Stimulative fiscal and monetary policies should also fuel ongoing expansion.

Looking Forward

After all the positive news driven by very attractive fundamentals, a couple notes of caution seem appropriate. At least some of the recent rise in equity markets has been driven by tax reform expectations. If this initiative stumbles, markets will likely react adversely. President Trump also seems to be pursuing his war on trade and has formed an unlikely alliance with Ohio Democratic Senator, Sherrod Brown, an avowed trade opponent. If Trump's protectionist policies were to advance significantly, profits here and abroad will be impacted, likely pushing down stock prices.

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Another potential problem results from investor confidence or exuberance which becomes more dangerous as it grows. Three of the largest losses since the creation of the S&P in 1957 were primarily driven by a reversal of exuberant markets without a specific trigger. Markets lost about a third in October 1987, and drops of 21% and 28% occurred respectively in 1966 and 1962. While many justify today's valuations, they remain elevated by nearly every measure. Pullbacks are simply more likely at these valuation levels because it takes less to scare investors into selling.

Still, numerous improving fundamentals here and abroad suggest that markets could continue upward. Critically, a recession is not on the horizon. Since recessions serve as the usual trigger that ends a bull market, the combination of positive and improving global fundamentals combined with a lack of concern regarding a significant slowdown suggests that equity markets continue to offer attractive potential in spite of their elevated prices.

Conclusion

Many investors who were burned during the 2008 Great Recession are anchored to the fear that it could happen again. It certainly could for a host of reasons. However, current risks are decidedly to the upside, which suggests this market will continue to demonstrate. The probability is greater than zero that the U.S. gets a comprehensive tax cut sometime in the near future. For hesitant investors, the way to capitalize on market gains is to engage in broad global diversification, across continents, stocks and bonds. The pro-business economic backdrop further enforces the resilience of these markets.

Sources: NY Times, Voya

Disclosure: Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Free Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Barclays Capital Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Barclays Capital government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Barclays Capital U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moodys, Fitch, and S&P is Ba1/BB+/BB+ or below.

Equity Performance

Equity Index	Style	YTD Return As of 9/29/2017	1 Year Return As of 9/29/2017	3 Year Return As of 9/29/2017	5 Year Return As of 9/29/2017	10 Year Return As of 9/29/2017
Russell 1000 TR	U.S. Large Cap Stocks	14.17%	18.54%	10.63%	14.27%	7.72%
Russell MidCap TR	U.S. Mid Cap Stocks	11.74%	15.32%	9.54%	14.26%	8.13%
Russell 2000 TR	U.S. Small Cap Stocks	10.94%	20.74%	12.18%	13.79%	7.37%
MSCI EAFE NR	Foreign Develop Stocks	19.96%	19.10%	5.04%	8.38%	1.62%
MSCI EM NR	Foreign Emerging Stocks	27.78%	22.46%	4.90%	3.99%	2.42%
DJ US Real Estate TR	Real Estate	7.09%	3.76%	9.72%	9.21%	5.79%
Bloomberg Commodity TR	Commodities	-2.87%	-0.29%	-10.41%	-10.47%	-6.09%

Fixed Income Performance

Fixed Income Index	Style	YTD Return As of 9/29/2017	1 Year Return As of 9/29/2017	3 Year Return As of 9/29/2017	5 Year Return As of 9/29/2017	10 Year Return As of 9/29/2017
BarClays US Aggregate Bond TR	U.S. Core Bonds	3.14%	0.07%	2.71%	2.06%	4.40%
BarClays US Corporate High Yield Bond TR	U.S. High Yield Bonds	7.00%	8.88%	5.83%	6.36%	8.02%
BarClays Global Aggregate Bond TR	Foreign Developed Bonds	6.25%	-1.26%	1.30%	0.48%	3.63%
Morningstar Emerging Market Bond	Foreign Emerging Bonds	7.30%	5.52%	5.31%	4.30%	7.60%
CitiGroup 3-Month T-Bill	Cash	0.47%	0.58%	0.26%	0.18%	0.44%

Source: Morningstar®

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