Market Perspectives | A Glance at How the World Affects You

Global Growth Improving Amid Low Inflation

November 7, 2017

Market Review

Stocks continued their climb on Friday following strong earnings from the Technology sector. The Nasdaq (tech heavy index) climbed 0.7%, while the S&P 500 added 0.3% and the Dow Jones Industrial Average followed with a 0.1% gain. Another healthy earnings season is winding down and Q4 is underway. If we use history as our guide, November and December tend to be good months for investors. Nevertheless, 2017 has already provided noteworthy performance. Year-to-date gains are now 25.7% for the Nasdaq, 19.1% for the Dow and 15.6% for the S&P 500.

Friday's non-farm payroll report showed the U.S. economy added 261,000 jobs in October, a redoubtable rebound from September when businesses were damaged by back-to-back hurricanes. In contrast, the consensus forecast called for a 325,000 gain. Still, the unemployment rate dipped to 4.1%, the lowest rate in more than 15 years. In spite of the poor September showing, trailing three-month payrolls average is in the 150k-165k area; that is what we believe the U.S. is capable of at this stage of the economic cycle. Average hourly earnings dipped slightly in the October report, and now show a 2.4% year-over-year gain. All of this points to subdued inflation which subsequently caused bond yields to dip slightly at weeks end; the 10-year Treasury yield settled at 2.33% (down from 2.41% the prior week). These conditions will surely raise expectations for a rate increase at the Fed's next meeting in December as the U.S. economic expansion continues to show unambiguous strength.

The employment picture has continued to improve, reinforced by positive earnings. With the bulk of third-quarter corporate earnings season in the rear view mirror, we note several positive trends during the quarter: generally better revenue growth, which has been aided by healthy consumer spending (in turn helped by the strong labor market and high consumer confidence); recovering international economies (particularly Europe); and continued profit margin improvement as wage growth has been kept low through technology efficiencies. At nearly 2,600, the S&P 500 currently trades at 17.8-times our 2018 earnings per share forecast.

Many of our clients and readers have asked, is the market due for corrective selling or will it continue higher? Admittedly, the forecasted earnings for 2018 is above the long-term average. However, underlying fundamentals are strong enough to justify a slightly higher valuation. Throughout history, equity investors typically pay a premium for stocks when certain metrics are in place. Current conditions provide above-average earnings growth rate, less variability in earnings (i.e. earnings consistency), and the attraction of alternative investments. With 2017 expected to end the year at 12% earnings per share and a 9% projection for 2018, investors will likely be content. With the exception of the commodity-driven Energy sector, earnings have been consistent and sub-3% bond yields are simply not attractive enough to provide risk-adjusted competition for equities. Frankly, this landscape is unlikely to change for the next year, perhaps longer. So, to answer the question, we are optimistic that stocks will provide the best opportunities on a risk-adjusted basis.

Another question from our clients is, what is having the greater impact on earnings? It is likely the globalization of the S&P 500 is becoming a significant factor, which decreases the pace of domestic growth and increases global growth. In other words, more and more companies are becoming global as opposed to domestic. Looking ahead, trends appear intact for continued growth into 2018. As an example, manufacturing remains a strong barometer of U.S. profitability. Most recently, the ISM Manufacturing Index and New Orders Index present a very encouraging story. As the globalization story unfolds, we will continue to update readers on correlations between domestic and global profits/earnings including the U.S. dollar, which does not have a strong direct correlation with S&P earnings, but it has many important indirect impacts, including export orders, industrial materials and crude oil prices.

OmniStar financial group

Technical Perspective – Investing should always be viewed as a long-term strategy and one that is based on investor goals and required returns. Keeping this in mind, valuable information can be found in technical analysis. Last week we experienced more some of our technical indicators pulling back towards neutral territory. The Chicago Board of Options Exchange trading indexes, however, pushed further into positive territory. These metrics give us added confidence to our equity heavy strategies. Looking at the evidence, we have no plans to change our over-weight to equities stance as we move towards the final trading month in 2017. Our expectation for volatility has not changed but we don't anticipate unusual selling in the broad market. Rebuilding efforts are underway in areas affected by natural disasters and that will produce a positive effect in many regions of the country.