

Market Observations November 2018

POLITICS, POLICY & PROGNOSIS

The voting is over and a shift in political power has resulted. Interest rates have been rising and higher rates appear ahead. The U.S. economy has been growing at a healthy pace. Yet the U.S. stock market in October posted its largest monthly decline since 2011 and foreign stock markets have struggled all year. An assessment of these developments can provide perspective.



Perspective

One source of uncertainty was removed for investors following mid-term elections in the U.S. A shift in political power resulted in Democrats taking control of the U.S. House of Representatives, but overall results were in line with earlier expectations. As a result, “status quo” is expected for fiscal policies over the next two years. This is a favorable scenario for business as recent tax and regulatory changes continue. With respect to investment outcomes, **Table I** provides a more cautionary post-election assessment. The 12-month trailing return for all mid-term elections since 1898 is -0.1%. For any 12-month period, the average return has been +8.9%. The post-election frequency of gains was lower as well, but odds do favor a positive outcome.

Interest rates have been on the rise as shown in **Chart I**. The Federal Reserve’s monetary policy is reflected in the step-wise plot of the federal funds rate. U.S. Treasury bill rates are set each day by market forces. For much of the past year, the market has been leading the Fed to higher rates. Interest rates are the price of money to the borrower and the return on money to the lender. Higher rates can be discouraging to the former but most welcome to the latter, particularly to investors who have foregone any meaningful return on short-term investments for many years.

The most recent estimate is that real U.S. economic growth in the third quarter advanced at an annualized rate of +3.5%. This healthy rate reflected in part rising wages, strong consumer spending and the lowest monthly unemployment rate since 1969. **Chart II** provides evidence of these favorable developments. The year-over-year percentage increase in average hourly earnings has trended steadily higher since 2012. Consumer sentiment has moved higher as well.

Investment Implications

A market correction such as October’s -7.4% for U.S. stocks and -8.1% for foreign stocks tends to remove any excess enthusiasm and set a base for future gains. Fundamentals to be monitored ahead include interest rates, economic growth, profits and trade policy. Uncertainties are ever-present and best addressed with a disciplined investment process that keeps portfolios appropriately aligned with individual goals, time horizons and risk tolerances.

TABLE I

DOW JONES INDUSTRIAL AVERAGE Post Mid-Term Election Returns		
	Trailing 12-Months	All 12-Month Periods
Average	-0.1%	+8.9%
% Positive	63%	68%

CHART I

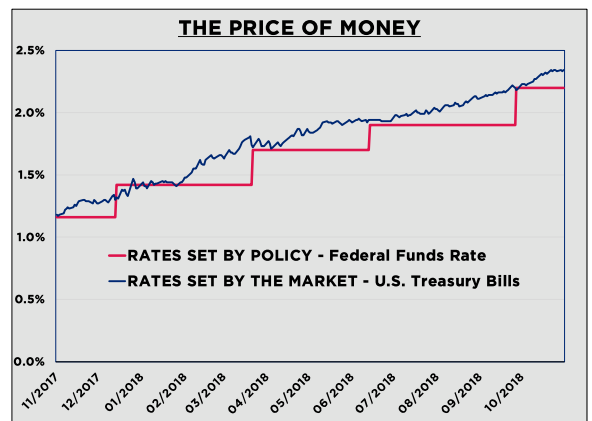


CHART II

