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Hinds Financial Group Quarterly Economic Outlook and Review Q3 2018

The Economy

The US economy, buoyed by the effects of pro-growth fiscal policies, accelerated sharply in the second quarter. The expansion is currently 111 months old, the second-longest in history, and will become the longest if the economy continues to grow through July 2019. The Bureau of Economic Analysis reported its third estimate of second quarter 2018 gross domestic product (GDP) of 4.2%, in line with the prior estimate, and much higher than the first quarter's 2.2% reading. The employment situation continued to post gains, with an average of approximately 185,000 jobs added each month. At the same time, the unemployment rate remained steady at 3.9%. The Fed (FOMC) modified its interest rate policy by raising the federal funds rate target 25 basis points to a range of 2.00% to 2.25%. Economists expect at least one additional increase in 2018, as economic growth remains robust, and inflation and wage pressures increase. The global economic environment has been strong in many areas of the developed world, but continues to be volatile in the emerging economies. In addition, many economists believe that the global economy may be nearing a peak. China's growth has continued to slow, generating 6.7% annualized GDP growth in the most recent report, the most sluggish pace since 2016. A deceleration in investment growth and industrial output, as well as uncertainty caused by trade friction with the US, were the primary reasons for the slowdown.

Domestic Stocks

Equity markets delivered strong gains during the quarter, bucking the negative seasonal trends of August and September. Stock prices thus far have shrugged off the ongoing trade disputes and higher interest rates. Volatility returned in early October. The focus has been primarily on the surging economy and the benefits of the tax cuts and increase in government spending. Consumer confidence remains elevated, and near the highest levels since prior to the bursting of the tech bubble in 2000. Against this backdrop, the S&P 500 Index finished the quarter with a solid gain of 7.7%. The ten primary economic sectors produced performance results that on balance were very strong during the quarter. Health Care, Industrials, and Telecommunications Services were the strongest performers on a relative basis, generating returns of 14.5%, 10.0%, and 9.9%, respectively. The Materials, Energy, and Utilities sectors were the poorest relative performers, posting returns of 0.4%, 0.6%, and 2.4%, respectively.

International Stocks

International stocks generally posted mixed results relative to US equities. Economic growth has been modest throughout the developed world, but emerging economies have struggled in the face of rising US interest rates. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, gained a modest 0.7%. The MSCI EAFE Index of developed markets stocks advanced by 1.4%. Regional performance was mixed for the quarter. Eastern Europe was the strongest performer on a relative basis, with a return of 7.0%. China was the poorest performer, falling 7.5%. Emerging markets performance was again negative, as the MSCI Emerging Markets Index dropped 1.1%.

Bonds

The Federal Reserve ended its recent September meeting by announcing an increase of 25 basis points in the federal funds rate target range from 1.75%-2.00% to 2.00%-2.25%. The rate increase was widely expected, and was the eighth time since 2015 that the committee has raised rates. The committee removed the "stance of monetary policy remains accommodative" language from the statement accompanying the increase. Economists believe that the Fed will continue to raise rates to mitigate inflationary pressures and to bring the federal funds rate in line with that warranted by economic growth. The factors affecting fixed income securities' prices and yields remained largely the same as in previous quarters. The surging economy, the Fed's decision to raise short-term interest rates once again at its recent September meeting, and the escalating rhetoric with trading partners such as China and Canada were among the most important drivers. The employment situation has been very strong, increasing wage pressures and leading the Fed to raise rates in an attempt to mitigate the resulting inflation. Interest rates have become more tied to the performance of the economy, which is accelerating due to the tax cuts and increases in government spending. Many analysts expect the Fed to raise short-term rates at least once more in 2018.

Outlook

The US economy has experienced a late-cycle acceleration, and if growth remains positive through July 2019, it will become the longest expansion in history. Aggressive fiscal stimulus in the form of deficit-financed tax cuts and increased government spending are the primary drivers fueling the growth, and their effects are likely to result in solid growth for the next few quarters. Although the current economic conditions have created favorable conditions for earnings gains and driven stock prices to record highs, it also is worthwhile to consider potential risks. One such risk is an overheating economy that produces increased wage pressure and inflation. Inflation currently remains fairly well contained at about the 2% level, but with the economy at or near full employment, it will be more difficult to restrain prices if growth continues to accelerate. The trade war also poses risks. The financial markets have so far done an excellent job of digesting the heated rhetoric on all sides of the trade debate; however, if the size of tariffs ratchets higher, investors could expect volatility to ensue.

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The Hinds Team

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