Where Trust is Earned

THIRD QUARTER COMMENTARY **NOVEMBER 2017**

The S&P 500 had a positive total return of 4.5% for the third quarter. That extends its consecutive quarter win streak to eight quarters. For the first time this year, small cap stocks outperformed their large cap brethren, with the Russell 2000 returning a strong 5.7 percent in the quarter. At the sector level in the US, technology was the top performer at 8.6%, followed by rebounds in the Energy and Telecom sectors, with each returning 6.8%. Laggards for the quarter were centered in the consumer groups, with Discretionary up just 0.8% and Staples returning a negative -1.3%. Internationally, the Bovespa in Brazil returned a spectacular 18.1%, for the quarter, not the year. The German DAX, French CAC 40 and the Nikkei in Japan returned more modest numbers of 4.1%, 4.1% and 1.6%, respectively. Historically, the fourth quarter is the seasonally best quarter on the calendar. With valuations somewhat extended, we think it wise to maintain average cash positions, shorter than normal duration in fixed income holdings and slight over weights to Europe and Japan.

Volatility was again absent in the quarter with the average daily change of the S&P 500 a mere 0.3%. That is the lowest level of quarterly volatility since 1968. When viewed in the context of what is historically the weakest and least volatile quarter of the calendar year a 4.5% return, versus a historic quarterly return of 1.3%, the third quarter was pretty good. Short-term interest rates have finally been awakened from their Rip Van Winkle like sleep. Fed Funds have more than doubled over the past year, moving from 0.5% this time last year, to 1.25%, or an increase of 75 basis points. There has also been some minor flattening in the yield curve, with the 30 year Treasury yield rising just 52 basis points, year-over-year. A target to keep an eye on for year-end is 2.44 percent on the 10 year Treasury note. That was the yield on the 10 year on December 31. 2016. If the 10 year yield closes 2017 above the 2.44% level, it will be the first time since the early 1980s that, for three consecutive years, the benchmark 10 year has ended at a higher yield level than on the previous December. It is important because it may mark the end of the 35 year bull market in fixed-income instruments.