ECONOMIC & CAPITAL
MARKETS REVIEW
NEWMAN DIGNAN & SHEERAR, INC.

Newman Dignan & Sheerar
INVESTMENT ADVISORS

Goldilocks Revisited

3rd Quarter 2016

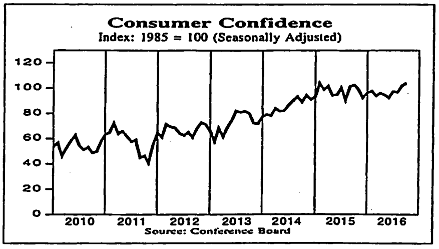
ECONOMY & MARKETS

Not too hot, not too cold, but not quite just right … that about describes the current economic and market environments. There is no doubt that many economic indicators are improving (not too cold), but growth remains fairly anemic (not too hot). Goldilocks is still looking for the porridge that is just right … let's hope the three bears don't return too soon to devour Goldilocks. Perhaps Goldilocks will be safe for awhile …

So much for a late summer correction … during the quarter, the S&P 500 traded 43 consecutive days without a move of greater than 1%. Equity markets moved higher and outpaced the slightly-less-than 1% average quarterly gain in the 3rd quarter of presidential election years since 1950. For the third quarter of 2016, the **DJIA** gained 2.1% while the **S&P** moved higher by 3.3%. The **NASDAQ** rocketed up 9.7%. International markets were strong as the **EAFE** Index advanced 5.8% for the quarter. Bond markets were fairly tame during the quarter despite ongoing and often conflicting rhetoric from the Fed about a change in monetary policy. For the quarter, the Barclay's Aggregate **Bond Index** inched higher by 0.46%.

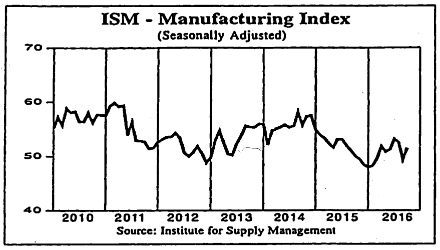
For the year-to-date period, the DJIA is up by 5.1% while the S&P 500 is ahead by 6.1%. The NASDAQ is positive by 6.1% while the EAFE index is eking out a 0.8% gain through September. Bonds continue to confound investors as the Barclay's Aggregate Bond Index is ahead by 5.8% through September (we have likely seen the best of bond returns for at least the next few years).

Economic conditions continue to improve, albeit at a slow pace. Some of the positive signs pointing to economic progress include: solid **labor markets**, improving **leading economic indicators**, reasonable **durable goods**, stable **housing starts and prices**, improving **retail and auto sales**, low **interest rates,** low **commodity prices,** mild **inflation** and rising **personal incomes**. Of course, all of these metrics point to higher **consumer confidence** (*see below*).

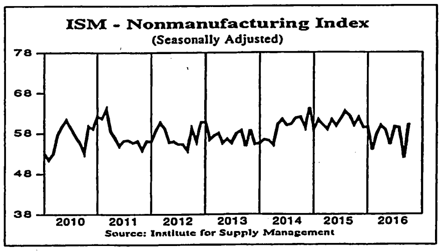

Consumer Confidence
Index: 1985 = 100 (Seasonally Adjusted)

Source: Conference Board

Two new additions to the above encouraging signs are improvements in the **ISM manufacturing index** and the **ISM non-manufacturing index** (*see below*). Domestic manufacturing dipped below 50 in August before rebounding to 51.5 in September (readings above 50 indicate expanding business conditions) … new orders, production and employment components all moved higher. The non-manufacturing index jumped to 57.1 in September signaling its highest reading since April 2015.


ISM - Manufacturing Index
(Seasonally Adjusted)

Source: Institute for Supply Management


ISM - Nonmanufacturing Index
(Seasonally Adjusted)

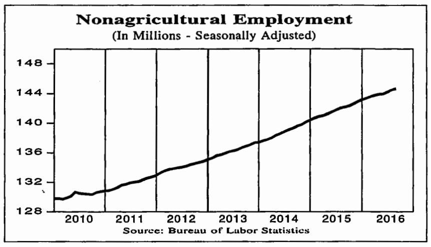
Source: Institute for Supply Management

Manufacturing data from overseas point to improving conditions as well. Data from

China, Philippines, and the U.K. all point to improving manufacturing PMI.

Labor market conditions remain healthy (*see below*), but tighter labor markets will put pressure on further improvement. Nonetheless, more people are working today than in past recent years. Wage growth remains tepid, but there is good news from the U.S. Census – median incomes rose in 2015 from $53,718 to $56,516. Real median incomes are still below the 2007 peak, but they are improving.

Good news ↪


Nonagricultural Employment
(In Millions - Seasonally Adjusted)

Source: Bureau of Labor Statistics

OUTLOOK

Bottom Line – Volatility is likely to stay high for the remainder of the year particularly given the nasty and ugly presidential election. Markets are overwhelmingly expecting Hillary Clinton to win the election (perceived as an extension of the current environment); however, a Trump victory would quite likely rattle the markets for some time. Hopefully, a new president will be the catalyst for a much needed dose of fiscal stimulus … this market cannot sustain itself on monetary policy alone.

Hopes for fiscal stimulus ↪

Despite the nauseating tone of the election, we see the markets finishing the year slightly higher than today's levels. Although a December Fed Funds rate hike (and the accompanying chatter) will cause some market turbulence, underlying economic conditions still point towards equities being a favored asset class. 3rd quarter GDP should climb to between 2.5% and 3% … a nice improvement from the 1.4% growth level in the 2nd quarter.

Uncertainty surrounding the Middle East (ISIS, Syria, Iraq, Iran, Afghanistan, etc...), China (slowing growth), the Fed (when will they hike?), rising labor costs, Brexit, European banks and political rhetoric from presidential candidates (can you believe it?) will likely provide enough drama to keep investors scratching their heads. Nonetheless, we urge investors to tune-out the noise. Remember, market corrections/setbacks are always temporary, and the long-term advance of the markets is permanent (the past is prologue).

Market valuations are higher-than-average with the S&P 500 trading at 17.5X 2016 estimated earnings of $124. Low inflation and low interest rates will allow valuations to creep higher before they become a concern again. Market multiples will probably move higher over the next month or so as 3rd quarter earnings (expected to be down y/o/y 0.5%) provide us with six straight quarters of declines. The good news is that 4th quarter earnings are slated to move higher, according to FactSet, by 5.8% (as oil company earnings rebound).

Bond prices should move a bit lower over the next quarter as bonds react to the ongoing rate-hike chatter (we expect the Fed to raise rates at their December meeting). Of course, geopolitical challenges could temporarily move bond prices higher and yields lower on a flight-to-safety. We anticipate keeping average durations in the short-to-intermediate range as interest rate normalization is under way.

We remain constructive on equities even as the risk-reward calculus for equities is diminishing a bit. *Small and mid-cap equities* still add value to an overall asset allocation strategy, and the stronger US dollar will play to their strength. We continue to be sanguine on *international equities* – both *developed* and *developing,* as their valuations remain relatively attractive (reversion to the mean is alive and well). Large-cap domestic equities - *particularly those with higher quality attributes and increasing dividends* - remain overweight in portfolios. *Commodities* have been bouncing back from oversold conditions, yet we would like to see stronger global growth before adding to this volatile sector. *Alternative assets* should continue to provide good risk-management for portfolios – particularly during times of volatility.

We suggest that investors maintain a fully diversified portfolio consistent with one's longer-term objectives and risk tolerance.

Happy Fall!

The US Stock Market is Shrinking

Many of our investment brethren in the banking field have been complaining about the significant decline in initial public offerings (IPO's) for new companies. Even though nine IPO's were issued last week, making it the busiest week of the year, there have only been sixty IPO deals priced this year. This has been the weakest nine months since 2009 and one-half the number of deals last year.

Companies like Uber have remained privately owned and others like ADT, the security company, went from a publicly traded firm to being privately held. Heinz and Dell went private as well back in 2013. There are now only about 3,300 companies listed on the exchanges whereas in the late 1990's there were over 6,500. The decline in the number of listed companies is the result of the higher compliance cost of being a publicly traded firm as well as private market values in some cases being higher than public market values.

Large US companies have been buying back their shares in record numbers. Share buybacks, in general, have the affect of increasing EPS, particularly in a low interest rate environment. The companies in the Standard & Poors 500 bought back $572 billion worth of shares last year. Apple, the bellwether growth stock, now has 17% less shares outstanding than five years ago.

Without a doubt, as investors, we would like to see more firms going public and reinvesting in themselves. Nevertheless, the dramatic decline in marketable shares of US companies greatly enhances their potential price appreciation as time goes by. It's simply a matter of supply and demand.

The Revised "Fiduciary Rule"
By The Department of Labor

As a fee-based, Security and Exchange Commission (SEC) registered investment advisory firm, Newman Dignan & Sheerar is governed by strict compliance policies and regulations. This includes being held to a fiduciary standard to act in the best interest of our clients at all times.

The Department of Labor has revised their "fiduciary rule" to brokers, financial planners and advisers receiving brokerage commissions, holding them to the same standards as fee-only advisers for client retirement accounts. Commissioned investment representatives will need to disclose all fees and commissions charged to retirement accounts and must sign a contract that says they are putting the customer's best interests first. The revised fiduciary rule goes into effect in April 2017.

Consumers still must understand the marketing rhetoric disclosing the new standards affecting commissioned investment representatives of retirement accounts. This fiduciary rule does not protect investors or their personal accounts from over zealous brokers, financial planners and advisors that are paid commissions. Investors must continue to demand full disclosure of fees and commissions as well as investments that directly benefit the brokerage firm.

Newman Dignan & Sheerar will continue to put our clients' interest first and foremost when assisting them with their financial goals.

3rd QUARTER 2016 SCOREBOARD

Index	Close	3rd Quarter % Change	Year-to-Date % Change
DJIA	18308.1	2.1	5.1
S&P 500	2168.3	3.3	6.1
NASDAQ	5312.0	9.7	6.1
Russell 2000	1251.6	8.6	10.2
MSCI EAFE	1701.7	5.8	0.8

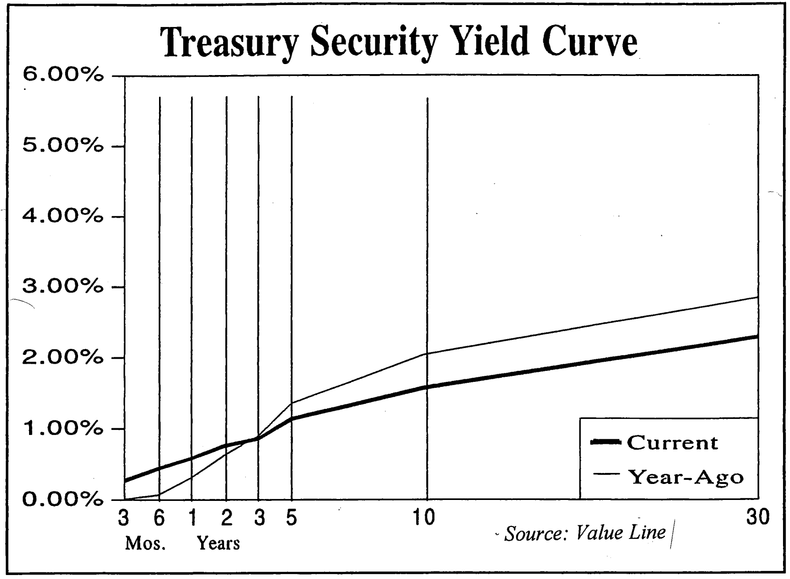
3 Month T-Bill	0.28%	Fed Funds Rate	0.25% - 0.50%
5 Year T-Note	1.15%	Prime Rate	3.50%
10 Year T-Note	1.60%	Gold	$1318.80
30 Year T-Note	2.32%	Oil	$48.05

Index returns are price only

Gold is higher by 24.4% in 2016 while oil is ahead by 29.7%.

44 bps below 9/30/15 yield of 2.04%.

Rates are beginning to slowly move higher



Source: Value Line

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