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

Chaos, Calm & The Markets

3rd Quarter 2017

ECONOMY & MARKETS

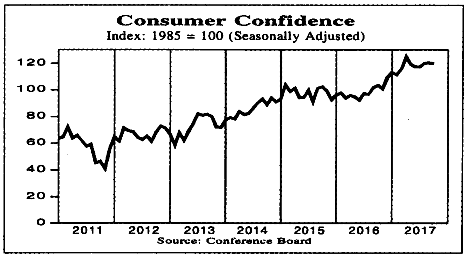
It is said that markets climb a wall of worry, and we have certainly had enough things to worry about lately. Hurricanes, floods, fires, mass shootings and the threat of nuclear war haven't deterred investors from pushing market averages higher. As Alfred E. Neuman would say, ***"What, me worry?"***

Despite the chaos swirling around, markets have been remarkably calm and resilient. The CBOE's Volatility Index (a measure of expected volatility) remains very low, perhaps indicating investor complacency. Strangely enough, the S&P 500 has not experienced a decline of 3% or more since Nov. 7, 2016. At least for now, the markets are focusing on a global synchronized recovery as global GDP grew at its fastest pace since 2010.

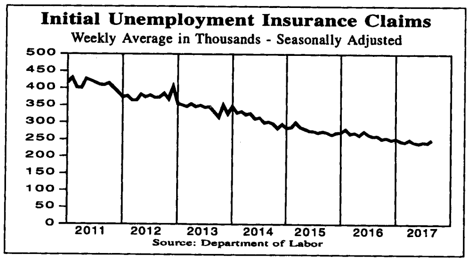
For the third quarter of 2017, the **DJIA** gained 4.9% while the **S&P** moved higher by 4.0%. The **NASDAQ** rocketed up 5.8%. International markets were strong as the **EAFE** Index advanced 4.8% for the quarter. Bond markets were fairly tame during the quarter despite ongoing and often conflicting rhetoric from the Fed about a change in monetary policy. For the quarter, the Barclay's Aggregate **Bond Index** inched higher by 0.85%.

For the year-to-date period, the **DJIA** is up by 13.4% while the **S&P 500** is ahead by 12.5%. The tech-heavy **NASDAQ** is positive by a whopping 20.7% while the **EAFE** index is positive for a nice 17.2% gain through September. Bonds continue to confound investors as the Barclay's Aggregate **Bond Index** is ahead by 3.1% through September (we have likely seen the best of bond returns for at least the next few years).

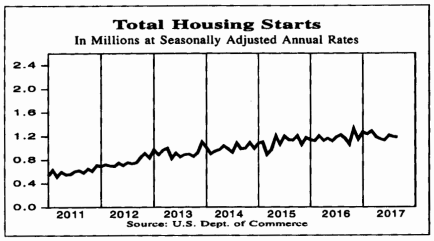
The proverbial wall of worry is alive and well (as we mentioned earlier), but it is more than offset by a number of positive economic and market metrics – continued market resiliency, steady housing statistics, improving employment data, benign inflation, low interest rates, low commodity prices, decent durable goods orders, strong manufacturing data, mostly healthy corporate balance sheets, rising consumer disposable income, reasonably strong leading economic indicators and a reduction in the regulatory drag. Of course, all of these data lead to a healthy dose of **consumer confidence** *(see below)*. The Conference Board Consumer Confidence Index posted a reading of 119.8 in September as consumers' optimism regarding their short-term outlook improved over August's reading. The overall reading declined slightly in September, but the reading was impacted by Hurricanes Harvey and Irma.



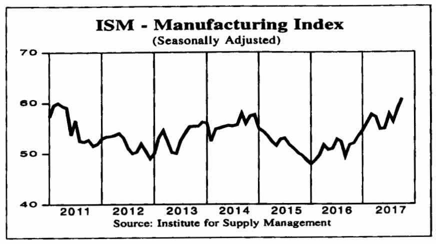
Favorable **labor conditions** *(see below)* are certainly adding to consumer confidence, particularly as consumer disposable income is rising.



With the labor market healing and interest rates low, **housing** remains fairly stable *(see top of next page)*. Housing is an important component of ongoing economic expansion in the U.S.. September's housing starts were less-than-expected, but we see the issue as weak supply rather than weak demand. Building permits (forward looking data) are at a seven-month high … good news.



Nice Rebound



September's **ISM Manufacturing Index** *(see above)* came in at 60.8, up from August's reading of 58.8. Activity in the U.S.'s factory sector expanded for the 13th consecutive month.

Wall of Worry

Let's not forget the **wall of worry**. Besides natural disasters and ongoing tensions with North Korea and Iran, a number of concerns remain. Washington has failed to deliver on its promises of tax reform (among other things). Profit margins seem to be peaking (as tight labor conditions and tame inflation keep margins in-check). Personal spending is tepid as the U.S. savings rate holds at 3.6% and below its 20-year average of 4.9%. Consumer debt is beginning to show signs of strain. Valuations, which we address later, are fairly stretched and leave little room for disappointment.

OUTLOOK

Constructive

Bottom Line – We remain constructive on the markets, and we see the markets finishing the year at higher levels – remember, the 4th quarter is typically the best quarter of the year (gaining on average 4.9% for the past 25 years). Of course, the market will take a pause on its march higher, but any pullback will likely be fairly shallow as buyers come in to support the markets. The cyclical backdrop for the markets simply remains too strong for the markets to stay down for very long. Besides, every market pullback that we have ever had has been temporary, and we don't think it is different this time (it never really is …). We are reminded of Byron Wein's (Blackstone Group) saying that disasters *"have a way of not happening."*

Market valuations are higher-than-average with the S&P 500 trading at 19.3X 2017 estimated earnings of $130.70. According to FactSet, the forward 12-month P/E ratio on September 30th was 17.8 … above the 10-year average of 14.1. Interestingly, the forward 12-month P/E for the markets is still decently below the peak P/E ratio of the past 20 years of 24.4 set in 1999 and 2000. Low inflation and low interest rates will allow valuations to stay elevated provided underlying economic growth remains reasonable. The good news is that 4th quarter earnings are slated to move higher, according to FactSet, by 11.1% with revenue growth of 5.7%. Nonetheless, the market's 'margin of safety' is fairly thin.

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. *Small and mid-cap equities* still add value to an overall asset allocation strategy, particularly if the weakness in the US dollar subsides (we are seeing signs of an inflection point). 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 a core position in client portfolios. *Commodities* remain under pressure due to low inflation. *Alternative assets* should 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!

Don't Delay...

YEAR-END TAX PLANNING

With the end of the year fast approaching, now is a good time to consider funding or adding to your retirement plans. You can make contributions for 2017 to most retirement plans up to the tax filing deadline which is 4/18/18 (401k contributions must be made by year-end). Due to phase-out limits based on your income and other factors we recommend consulting with your tax advisor to be sure that you are maximizing your options.

Here are the retirement plan contribution limits for 2017:
<u>IRA and Roth IRA Contribution Limits:</u>
Maximum Contribution: $5,500 If age 50 or older: $6,500
If neither you nor your spouse is covered by a retirement plan at work, your deduction is allowed in full.
Phase-Out ranges for IRA deductibility if you are covered by a retirement plan at work:
Married/Joint: $99,000 - $119,000 Single: $62,000 - $ 72,000
If you are not covered by a retirement plan but your spouse is, the phase-out is $186,000 - $196,000.
<u>Roth IRA Phase-Out Limits for Contributions:</u>
Married/ Joint: $186,000 - $196,000 Single: $118,000 - $133,000
<u>Contribution Limits for 401(k) plans:</u>
Maximum Contribution: $18,000 If age 50 or older: $ 24,000
<u>SEP-IRA Contribution Limits:</u>
Up to one quarter of salary, limited to a maximum of $54,000. This limit also applies to Keoghs and profit-sharing plans.
<u>Simple IRA Contribution Limits:</u>
Maximum contribution: $12,500 If age 50 or older: $15,500
<u>IRA contributions after age 70 ½</u>
You can't make regular contributions to a traditional IRA in the year you reach 70 ½ and older. You can, however, still contribute to a Roth IRA, provided you have earned income above your contribution amount, and make rollover contributions to a Roth or traditional IRA regardless of your age.

<u>Things to consider:</u>
If you're maxing out your 401(k) and have more to save, opening a Traditional or Roth IRA can help you sock away another $5,500 or $6,500 a year depending on income restrictions.

If you are not eligible to take an IRA deduction for your contribution to your IRA and you make too much money to make a Roth IRA contribution, then you might consider making a non-deductible IRA contribution. You can then immediately convert it to a Roth IRA. This is referred to as a "back-door Roth IRA" strategy. You will need to file form 8606, which reports your basis, when you file your taxes. When you convert your IRA to a Roth IRA you pay taxes on any amount that is converted that is above your basis. If you have other IRA accounts, your basis must be calculated using a pro-rata formula.

DOW 1 MILLION?

Think Long-term!

Warren Buffet is at it again. The Oracle of Omaha, ever the optimist about the future, recently predicted that the Dow Jones Industrial Average will be "over 1 million" in 100 years. So is such a prediction possible? For the Dow to hit 1 million in 2117, it would simply need to post annualized gains of 3.87%. So, yes, it is certainly and most likely possible … particularly since the blue chip index has risen 5.73% per year, on average, for the past century, according to Don Luskin at TrendMacro. What's the message? Think long-term!

3rd QUARTER 2017 SCOREBOARD

Index	Close	3rd Quarter % Change	Year-to-Date % Change
DJIA	22405.1	4.9	13.4
S&P 500	2519.4	4.0	12.5
NASDAQ	6495.9	5.8	20.7
Russell 2000	1490.9	5.3	9.9
MSCI EAFE	1973.8	4.8	17.2

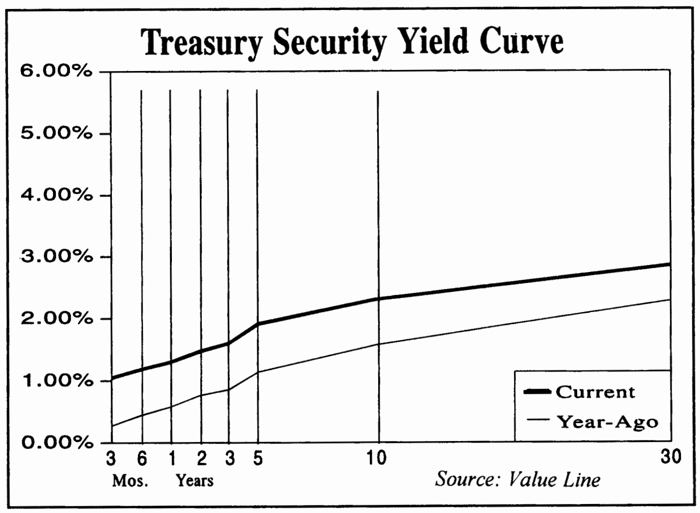
3 Month T-Bill	1.06%	Fed Funds Rate	1.00% - 1.25%
5 Year T-Note	1.94%	Prime Rate	4.25%
10 Year T-Note	2.34%	Gold	$1281.50
30 Year T-Note	2.86%	Oil	$51.67

Index returns are price only

Gold is up over 11% year-to-date while Oil is down nearly 4%

Still time to Re-fi!

Very little movement in rates



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Newman Dignan & Sheerar INVESTMENT ADVISORS

NEWMAN DIGNAN & SHEERAR, INC.

Registered Investment Advisors

56 Exchange Terrace, Suite 200 • Providence, RI 02903 • 401.351.4010 • Fax 401.351.4011