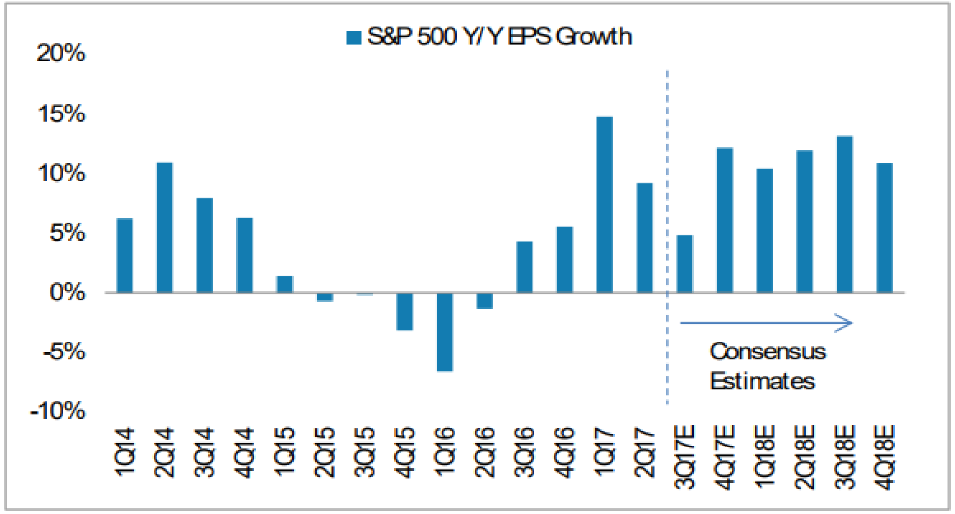
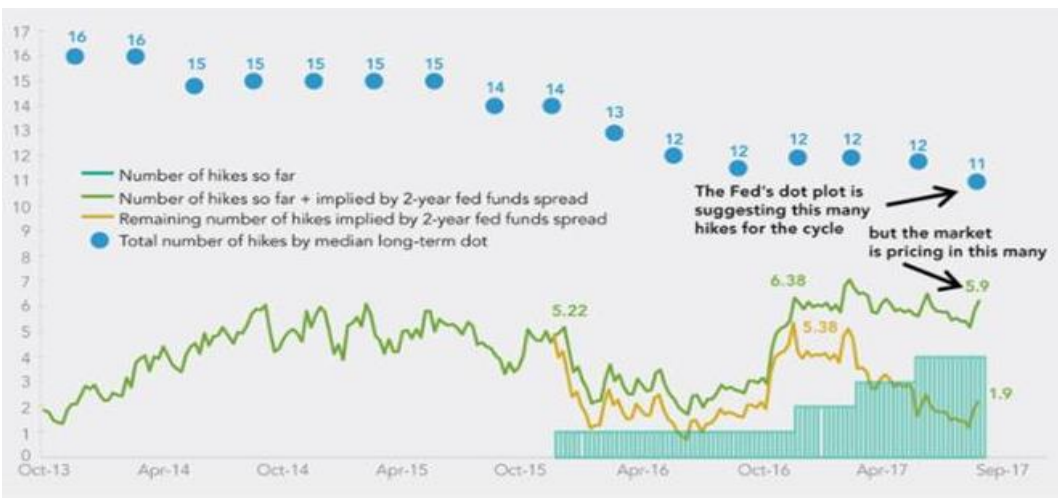
Market Recap

A Ripple in the Rising Tide of Earnings?



Source: Morgan Stanley

Fed Dot Plot Disconnected From Investor Expectations



Source: Goldman Sachs

In an environment characterized by low levels of inflation and accommodative monetary policy, investor sentiment remains largely positive as companies begin to report earnings for the third quarter of 2017. Although analysts have lowered near-term expectations due to a particularly destructive and disruptive hurricane season, improving economic conditions around the world are likely to buoy corporate profit growth in the months ahead. Given the relatively full valuation levels in the market, continued stock appreciation will be dependent on sustained earnings growth if the current bull run is to persist. Of course, in a constantly evolving world, economic forecasts are also subject to change. For example, successful passage of U.S. tax reform would provide an incremental tailwind to stocks, while unexpected strength in the U.S. dollar would likely pressure corporate profits. The upcoming holiday season will be an important gauge of how comfortable consumers truly feel about the future.

The Federal Reserve held short term interest rates steady in a 1% - 1.25% range at the September meeting, as expected, but reiterated its intent to hike rates once in December and three more times in 2018. While the decision not to hike in September was widely anticipated by investors, the status of the 'Dot Plot' graph – or future increases - was less certain. The Dot Plot reflects FOMC expectations for short term rates at the end of a given year (and the number of hikes required to reach that level), as compared to the views of investors. Today, with inflation running well below the Fed's 2% target, investors do not believe the Fed will hike rates as many times as has been projected. The Fed, on the other hand, believes this year's weakness in core inflation is only temporary, leading to rate increases through 2018. Inflation data will be a critical determinant and may serve as a strong tailwind to the market if it remains low.

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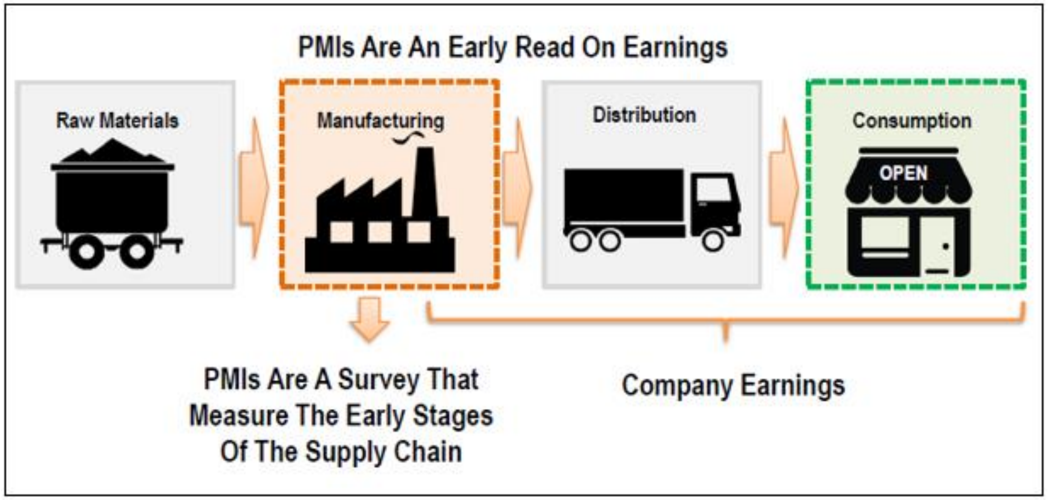
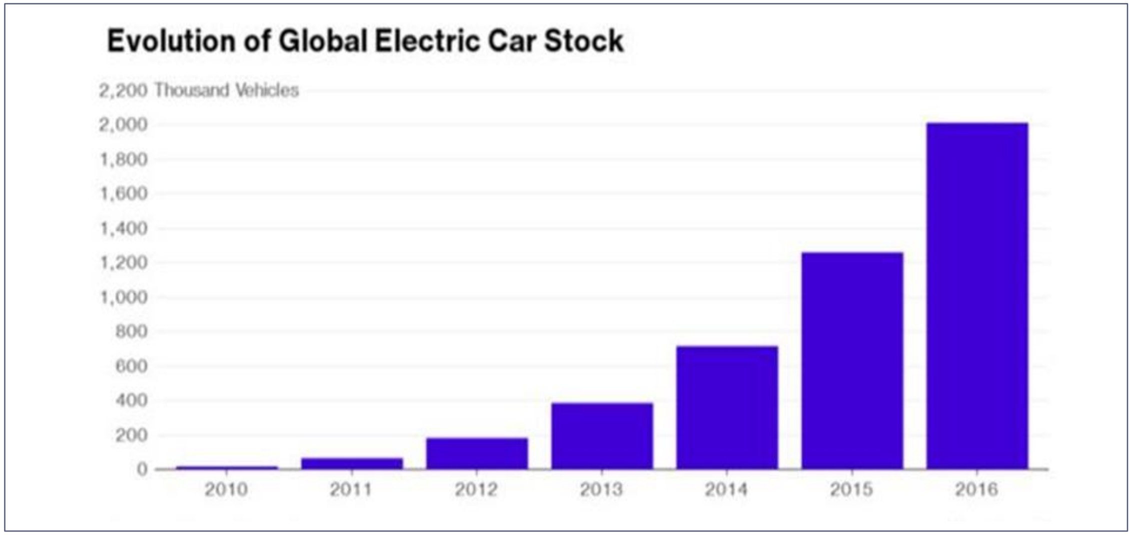
The Significance of PMI Surveys



Source: Cornerstone

The Dawning of the Age of Electric Vehicles



Source: Bloomberg, International Energy Agency

The Purchasing Managers' Index (PMI) is an often-referenced indicator summarizing the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries, and the employment environment. While manufacturing is a smaller percentage of the U.S. economy than it used to be, PMI data remains a reliable leading indicator of future economic activity given that manufacturing is at the front end of the of the supply chain. An uptick in manufacturing often occurs because firms project rising consumer demand, stimulating growth not only in manufacturing, but also in distribution. Put simply, monthly PMI readings offer insight into changing economic activity trends – changes that eventually flow through to earnings data and have significant effects upon the overall performance and underlying sector performance of equity markets.

Last Monday, GM made a landmark announcement by introducing two new fully-electric models in 2018, to be followed by 18 more by 2023. GM joins a larger group of automakers vowing to move away from gasoline- and diesel-powered vehicles, including Volvo, Aston Martin, and Jaguar Land Rover. Recently, sales of electric vehicles have surged, with the number of vehicles on the road rising more than 60% from 2015 to 2016 according to data from the International Energy Agency. While the growth has been staggering (78% annualized growth since 2012), electric vehicles still represent only 0.2% of light duty vehicles. Future growth will be driven by government initiatives (e.g. the Electric Vehicle Initiative, a multi government program calling for 30% market share by 2030) and a wave of consumer excitement spawned by the introduction of sleek and affordable electric cars such as the Tesla Model 3.

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