Proactive Investment Management & Financial Planning

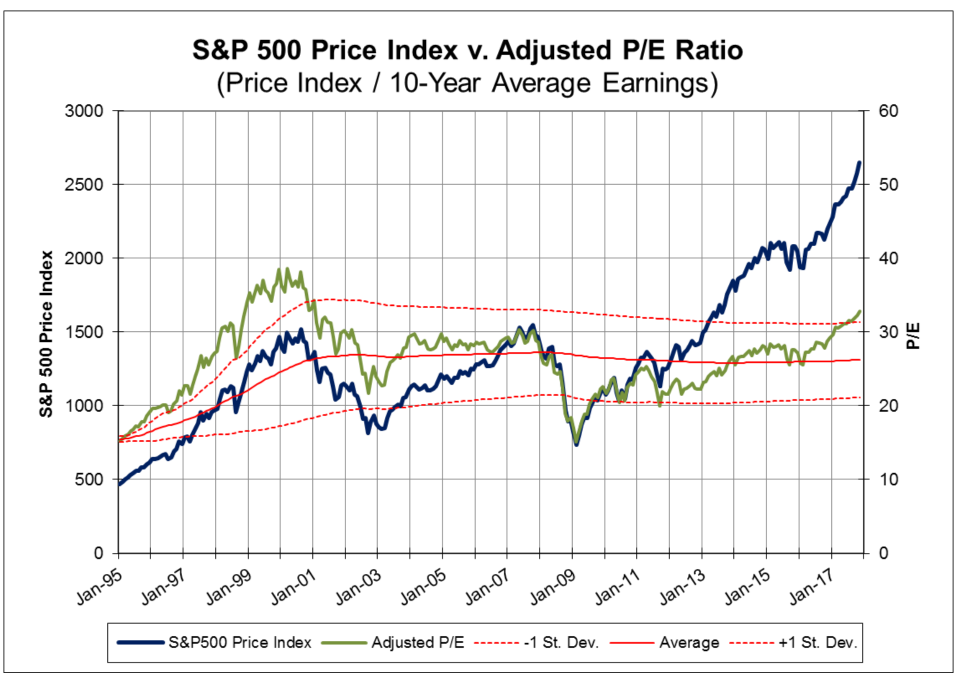
Monthly Market Comment
December 1, 2017

In November, prices for stocks and alternative assets generally rose, reflecting a continued "risk on" attitude among investors. Indeed, stocks got a strong jolt at the very end of the month on account of good progress on tax-cutting legislation in Congress. In contrast, bond prices fell modestly.

Stocks

The S&P 500 stock price index continued to rise in November, with a number of big increases in the second half of the month. The index ended the month up 2.8% from the end of October and 20.4% higher than at the end of November 2016. The S&P 500 has now notched a month-end record high in each of the last eight months, and in 12 of the last 13 months. Taking into account dividends, the total return on the S&P 500 was 3.1% in November and a strong 22.9% over the last year.

Ultimately, the long bull market has been fueled by the on-going expansion in the economy. The economic growth rate may be modest by historical standards, but that suggests inflation pressures are likely to build only slowly and global central banks should be able to continue tightening monetary policy only gradually. We therefore expect continued economic growth and increased corporate profits over time. On top of the economic momentum, the tax reform legislation now making its way through Congress holds out the possibility of even stronger corporate profits going forward. The expected rise in profits is especially important to our outlook, as the price/earnings ratio is already extended and may not be able to improve much further. Indeed, one developing risk is that investors may at some point get skittish about high stock valuations and start to sell *en masse*, though at this point we can discern no obvious trigger for such a sell-off. Other key risks include geopolitical tensions with North Korea, a possible trade war, and the potential for policy mistakes. Nevertheless, we remain optimistic that stocks could keep trending higher for a while yet.



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Technical indicators also suggest stocks could potentially keep moving higher. The S&P 500 price index remains above its 20-day simple moving average (SMA), while its 20-day SMA stands above its 50-day SMA, and its 50-day SMA stands well above its 200-day SMA, all of which we consider to be a pattern consistent with an entrenched upward trend. In addition, the recent string of consecutive month-end record highs suggests stocks will continue to climb, though perhaps with new records coming less frequently. Another positive indicator is that over 77% of the stocks in the S&P 500 index are now trading above their 200-day SMA, indicating the market uptrend is once again quite broad. Finally, the Dow Jones Transportation Index has recently been rising faster than the overall market, which has traditionally been a positive sign for stocks. The main short-term negative is that momentum indicators (such as the "moving average convergence/divergence," or MACD) suggest stocks have become relatively over-bought and are now more susceptible to a short-term pullback or correction. If such a pullback materializes, we suspect the S&P 500's next significant support level would be at approximately 2,600, with a secondary support level at about 2,555. If stocks keep rising instead, we suspect the next significant resistance levels would come around the psychologically important reading of 2,700.

S&P 500 Stock Price Index + "MACD" Momentum Indicator

Source: BigCharts.com

Bonds

Bonds traded in a relatively narrow range throughout November, but by the end of the month, prices were generally lower. With prices down, yields rose. The yield on the benchmark 10-Year Treasury Note increased to 2.417% from 2.376% at the end of October. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was a loss of 0.1% in November. The total return over the last year was a gain of 3.0%.

Looking forward, we continue to put a high value on the income, stability and safe-haven characteristics of fixed-income investments, especially if geopolitical tensions continue to rise. In addition, incoming data suggest to us that inflation pressures will remain limited in the coming months and quarters, so we think the policymakers at the Federal Reserve could well continue to hike interest rates and reduce their bond buying slowly and gradually enough to avoid disrupting the financial markets, though one developing risk is whether or not the tax cuts being considered in Congress might eventually blow out the federal budget deficit and prompt higher interest rates than we currently envision. In any case, we don't look for total returns on bonds to be particularly juicy for the foreseeable future, but we do think they can be modestly positive.

Real Estate and Commodities

For publicly-traded real estate investment trusts (REITs), the FTSE NAREIT Price Index rose 2.4% in November, leaving it up 9.5% over the last year. Reflecting their relatively high dividends, the total return on these REITs was 2.7% in November and 13.9% since November 2016. Publicly-traded REITs remain in the trading range they've been stuck in over the last year, reflecting a tug-of-war between those investors who see moderate economic growth as positive for real estate and those who see gradually rising interest rates as an opportunity to roll out of higher-yielding risk assets and back into bonds. Going forward, we suspect that tug-of-war will continue, so we think returns for these assets could well be challenged as long as interest rates are gradually rising.

For commodities, the S&P GSCI Total Return Index ended November up 1.4% from the end of October. The index was up 6.1% from the end of November 2016. The rise in November stemmed almost entirely from the continued rebound in prices for crude oil and products thereof. Those prices continued to be buoyed by market confidence about rising demand and more disciplined production going forward. In contrast, gold prices were flattish, while prices for silver and industrial metals declined. Agriculture prices were also weak, with especially large declines for grains and livestock. Going forward, we agree that fundamentals in the energy market are starting to look a bit better, but we still worry that rising crude output and higher crude inventories in the United States could swamp any increase in demand and offset much of the output cuts that the Organization of Petroleum Exporting Countries (OPEC) and its partners agreed to late last year and extended further in May and November of 2017. We therefore remain cautious regarding the near-term outlook for the broad commodity sector. We still believe that excess supplies in many commodity categories will gradually be brought under control in the coming months and quarters, ultimately allowing prices to rise again, but we think prices will remain volatile and could post meaningful retreats in the near term.

Patrick Fearon, CFA
Chief Investment Officer

Asset Class	Index	Ending Reading, Latest Month	1-Month Change	3-Month Change	12-Month Change
U.S. Stocks	S&P 500 Price Index	2,647.58	2.8%	7.1%	20.4%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	299.37	0.7%	4.2%	24.4%
REITs	FTSE NAREIT All-Equity Price Index	689.25	2.4%	1.0%	9.5%
Commodities	S&P GSCI Total Return Index	2,448.66	1.4%	8.7%	6.1%
Bonds	S&P U.S. Aggregate Bond Index	192.74	-0.1%	-0.4%	3.0%