WESTLAKE
PRIVATE WEALTH MANAGEMENT
WELLS FARGO ADVISORS FINANCIAL NETWORK

Quarterly Market Missive
October 2017

As we close the books on the third quarter of 2017 and turn the corner into year-end, there's one thing we can say for sure about the last three months – they've been eventful. Saber-rattling politicians on both sides of the Pacific have spiced up the front pages but they've had to share space with hurricanes, health care reform bills, unthinkable acts of hatred, and of course continual tweets - any of which could have been destabilizing to the markets. But the news from the economy and corporate boardrooms has been decidedly more cheerful. Earnings - the underpinning of share prices - have grown at a robust clip throughout the year and are on pace to show further gains as third quarter earnings season begins in earnest. The economy remains strong as well, with low unemployment, moderate yet consistent GDP growth and leading economic indicators that suggest the positive environment should remain in place for a while.

While corporate earnings growth is a key driver of stock performance, the level of short term interest rates is an important metric as well. During the third quarter the Fed took a decidedly hands-off approach to its short-term rate policy, although we do have two rate hikes under our belt in 2017 and possibly one more to come in December. It is widely believed that the hikes we've already experienced have been so well accepted by the financial markets because of the transparency involved and the slow-yet-deliberate pace. A key observation: the yield curve (the relationship between short-term and long-term interest rates) is positively sloped and perfectly normal, suggesting a healthy economy and confident investors. This is a very good thing.

Beyond corporate profits growth and interest rates, we typically look to valuations when assessing the markets. Domestic stocks look a touch pricey here, but not unreasonably so given the level of interest rates and the growth we're seeing in corporate profits and in the overall economy. International stocks appear a smidge less expensive because their growth rates throughout this bull market have been more modest than their domestic counterparts. Looking at fixed income, bonds have neither impressed nor disappointed us, but given the still-low rate environment, continued rate hikes will likely constrain returns for some time. Our outlook for this asset class however remains modestly positive.

So as we head into the end of the year and into 2018, we need to ask what the future holds. As always it is a challenge to anticipate the unexpected, but we can certainly draw inferences from the current environment. We're likely to experience continued modest earnings growth through 2018, and perhaps beyond. The economy continues to move along in a positive, if unspectacular, fashion. The leading economic indicators continue to suggest optimism…unemployment remains low, inflation is muted and there is a comforting absence of "excesses" (a la 2000 and 2008) as we view the landscape. This environment has often been referred to as "Goldilocks" – neither too hot nor too cold, and one can see why.

But as we've said repeatedly, markets don't advance in straight lines. Corrections can and do occur. That we haven't experienced a pullback of any magnitude in a year-and-a-half suggests we may be due. And as uncomfortable as it may be, we must remember that corrections are an absolutely normal and unavoidable part of the path we take as investors. As Warren Buffett said, "the stock market is a device to transfer money from the impatient to the patient". Let's collectively remember his advice when the time comes and decide rationally from which side of that line we'd prefer to operate.

Finally, this is the time of year we start thinking about year-end tax planning and we'll be reviewing taxable portfolios to see if there are any adjustments we can make as the year winds to a close. We'll be weighing unrealized capital losses against gains and anticipated mutual fund distributions and looking for opportunities to capture tax losses (a tall order after a profitable year). Depending on what happens on Capitol Hill we may have abundant opportunities, so we'll have to wait and see what direction tax reform takes. As usual, we'll offer to send reports to your CPA to assist with their – and our - year-end work.

We hope the rest of this year is fruitful for you and your family and that you take the opportunity to pause and enjoy the best of what autumn has to offer. And as always, we so very greatly appreciate the continued trust and confidence you place in us.

James H. Dryden, Director
October 13, 2017