Corporate earnings growth and solid economic data supported equity prices in October, helping to push equity indexes to records. With roughly 60% of S&P 500 companies releasing quarterly results as of this writing, earnings were up 7.8%, while sales registered a gain of 6.0%, a marked increase in both measures over the same reporting period of last year (3.3% earnings; 2.4% sales in 3Q16). Meanwhile, economic data in the US still suggests that the expansion is continuing at a decent pace. Third quarter Gross Domestic Product (“GDP”) rose by 3.0%, after a second quarter GDP growth rate of 3.1%, the first back-to-back 3% or better quarterly gain in GDP since 2015. Non-US stocks also posted positive returns, despite political unrest in Spain as the Catalonia region’s parliament voted for independence. The index that tracks the Treasury market, on the other hand, declined during the month, as interest rates rose due to the improved economic backdrop, the expectation that a December rate hike was increasingly likely and that increased chatter that the new Federal Reserve (“Fed”) chair could be Jerome “Jay” Powell, who is viewed as more hawkish than Chairwoman Yellen, though still relatively dovish. Credit markets performed better than Treasuries, as spreads narrowed further. In commodities, the strong rally in oil continued, while industrial metals also saw large upswings in price.

US stock indexes finished the month near all-time highs, a common theme this year. Stocks were boosted by better than expected corporate earnings reports, while still benefiting from the solid economic growth environment. As previously noted, third quarter corporate earnings have grown by 7.8% thus far. Leading up to this reporting period, consensus expectations were for earnings growth closer to 5%, a strong beat. It is also noteworthy that approximately 74% of companies have exceeded earnings estimates and about 82% have beat sales expectations. A great deal of the earnings growth has come from two sectors, Information Technology and Energy. Information Technology firms are seeing earnings growth in excess of 25%, while the strong rebound in oil prices over the past year and a half continues to filter through to the sector’s earnings, which is showing
earnings growth of a whopping 99%. On the downside, Financials’ earnings declined by 0.5%, driven lower by Insurance companies (negatively impacted by the recent hurricanes and the earthquake in Mexico) and even though they posted earnings gains, many of the large banks delivered muted results.

Turning overseas, Developed International stock markets posted small positive returns, as European equities dealt with geopolitical risks in Spain. After continued demonstrations in the streets of Barcelona and elsewhere, the Catalan parliament voted to declare independence from Spain, threatening the economic stability and expansion that has materialized in Spain and the broader Eurozone. The euro weakened as these events unfolded. Nevertheless, economic data in the Eurozone continued to paint a steady expansion. Surveys of manufacturing and non-manufacturing activity for the euro area were solidly in expansion territory, while the European Central Bank (“ECB”) announced plans to reduce the size of its monthly bond purchasing program, a further sign of the increasing economic strength of the region. In Japan, Prime Minister Abe won reelection with further economic stimulus expected, helping to send the Nikkei 225 up over 8% in yen terms (7.5% in US dollars), reaching its highest level since the mid-1990s. In addition, Emerging Market indexes rose by nearly 3.0% for the month. Continued steady growth in many countries combined with still attractive valuations sent stocks there higher.

In fixed income markets, the index that tracks Treasuries posted a monthly decline, as yields finished the month higher than where they began, particularly on the short end of the curve. The longer end of the curve was relatively flat, consequently, the yield curve flattened further during the month. The short end of the curve continues to price in a strong likelihood of a Fed Funds Rate increase in December, with market-based probabilities exceeding an 85% chance. In addition, while the eventual nominee is still unknown, the market is also pricing in the likely appointment of Jay Powell to lead the Fed. Mr. Powell is viewed as someone that is more hawkish than the current Fed chair, Janet Yellen, even though he is still relatively dovish. He has served on the Fed board before; is not an economist by training; and has more of a regulatory focus than Ms. Yellen. John Taylor, creator of the eponymous Taylor Rule Model on setting of the Fed Funds Rate, appears to be out of the running as of this writing. He is certainly viewed by market participants as the most hawkish candidate, especially given the Taylor Rule suggests the Fed Funds Rate should be closer to 5.0% than the current 1.25%.

With Treasuries falling slightly, credit markets still managed to eke out a small gain. Investment Grade (“IG”) and High Yield (“HY”) corporate bonds posted returns less than 1.0% for the month, due mainly to further spread tightening. IG and HY spreads narrowed by 5 and 7 basis points (“bps”), respectively, during the month. Spread tightening is usually viewed as a bullish signal, as investors are willing to take on more credit risk. In addition to narrower spreads, corporate bonds benefited from the improving corporate earnings fundamentals. International sovereign bonds declined, in sympathy to the announcement by the ECB that further bond purchases would be reduced, eliminating a major source of demand from the market. Emerging market bonds, however, did manage to post positive returns, helped by a late month decline in the dollar, providing a boost to developing market bonds.

In commodities, the rally in oil and industrial metals helped to push the broad index to solid monthly gains. Beginning with oil, inventory data showed that stockpiles were running below year ago levels in the US, while demand on a global basis continued to climb. News reports also suggested that the crown prince of Saudi Arabia was agreeable to continuing the Organization of Petroleum Exporting Countries’ (“OPEC”) production cuts agreed to late last year and implemented with influential non-OPEC members like Russia. As a result, West Texas Intermediate rose by nearly 5% and Brent crude rose by more than 8% for the month. Industrial metals also continued to rally, supported by strong demand from China, while supplies are still low. Precious metals, on the other hand, declined on a stronger dollar and no significant geopolitical events. Gold even declined slightly. Agricultural commodities, generally, fell, as stockpiles remain elevated.

Should you have any questions about this update or your portfolio, please do not hesitate to contact your Portfolio Manager or Trust Officer.
**Unless otherwise noted, performance and return data sourced from Bloomberg, LP as of October 31, 2017.**

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