Financial & Economic Review

The U.S. equity markets reported their best quarterly performance since 2013. Broader market indices jumped on a continued increase in consumer sentiment driven by higher wages, low unemployment, a favorable housing market and overall positive reported earnings. Crude oil prices dropped slightly to end the quarter, but are still up 21% for the year. Unlike last quarter where OPEC engineered a temporary oil supply shortage to keep prices elevated, this quarter they decided to increase production 600K barrels per day instead of ceding further global supply to the booming US energy market. We feel the market underestimates the capacity of U.S. production to keep the market in oversupply in the near term as $65-70 per barrel is attractive to shale producers.

The Federal Reserve once again raised interest rates 25 basis points during their September meeting, with the Fed Funds rate now holding at 2.00-2.25%. There has been some grumbling regarding the pace that the Fed has been raising interest rates and therefore putting the brakes on borrowing in the economy by tightening their policy. The interbank overnight lending rate (Fed Funds rate) has historically been held roughly 1.25% above reported inflation. With inflation ending the quarter at 2.9%, the historical Fed Funds rate would be over 4%, meaning that even after the recent and frequent increases, the overall policy posture remains accommodative from a historical perspective. One results observed as borrowing costs have increased is the slowing of M&A activity during the quarter.

The most impressive equity sector results in Q3 of 2018 were realized by Healthcare, Industrials and Communications, returning 10.6%, 7.7% and 6.2%. The worst performing sector results were in Precious Metals, Natural Resources and Real Estate, returning -15.3%, -0.3% and 0.5% respectively for the quarter. Regarding the broader indices, the S&P 500, Dow Jones Industrial Average and NASDAQ Composite Index returned an impressive 7.7%, 9.6% and 7.4% respectively for the second quarter. Internationally, the EAFE Index (Europe, Australia and Far East) retuned 1.3%. Basic Materials continues to represent the most overvalued sector trading at over 30% premium to fair market value. Technology and Healthcare were next, representing 8% and 7% premiums. Communications represented the best overall value at a 13% discount to fair value. All other equity sectors ended the quarter within a few percentages of their fair market value estimates. With equities remaining at elevated levels, we continue with our cautious posture and remain ultra-selective while putting new investment dollars into the market. We continue to favor individual stocks over broader market exposure for new money investment.

We appreciate your business and trust in allowing us to navigate a fully valued market and look forward to continually earning your respect and referrals in the final quarter of 2018.

Jack A. Kennedy
Chief Investment Officer

[1] Results referenced from Morningstar.com

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