STATE BANK OF CROSS PLAINS
Wealth Management Division
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September 11, 2017
Statement Commentary

End of Summer

Summer is over, school is in session, and investors have turned their attention to fall and the potential risks the markets face. Fall can be a rough time in the markets though not as frequently or as bad as the perception is. As the bull market and economic expansion continue well beyond historic averages, there may be cause for concern. But what are those concerns and are they legitimate? That will be the focus of this article and next months. This month we will take a look at some short –term issues, both positive and negative, along with some thoughts on interest rates, inflation, and the Fed. Next month we will focus more on the markets and valuations.

As usual let's take a quick look at how the markets performed in August. Both stocks and bonds were somewhat mixed and total returns were relatively flat. Large cap stocks represented by the Dow Jones Industrial Average and the S&P 500 Index increased slightly while mid- and small-cap stocks had a rougher month. International stocks also gave back a bit of their year-to-date gains. On the fixed income side, the picture was somewhat rosier as the Barclay's U.S. Aggregate Index added value. Economic activity was more of the same although preliminary numbers for second quarter GDP were better than many expected. While August was nothing to write home about, good or bad, overall returns for the year are generally still very good. For more detail see below.

While our preference is to take a long-term approach to investing, it is wise to keep an eye on short-term events and how they might impact portfolios. As is usually the case, there are both positive and negative elements to any story and that is the case here. Looking at the negative side of the ledger and we have several things to be concerned about including various geopolitical, weather, and market concerns. The North Korea narrative continues and it doesn't seem like the problems there will go away anytime soon. We have gone through scenarios such as these in the past – remember Iran, ISIS, and the like? The world isn't a safe place and markets have been affected by overseas events before but this time it seems different because we now have someone who seems to be actively set on war with us. Whether all of this is bluster or reality is not up to me to determine but the good news is that, for now, the markets have been resilient. Obviously a missile launched directly at South Korea, Japan, Guam, or the U.S. would be a game changer. Issues in the Middle East never get too far below the surface and ISIS, Afghanistan, Syria, and Iran may not be the focus right now but they certainly add to world tension. Weather issues seem to be dominating the news today and rightfully so. The hurricane that hit Houston will likely be the most expensive in history and there are indications that a powerful hurricane may threaten Florida in the coming days. The fact that the U.S.

hasn't faced the kind of damage from a large hurricane in several years and was overdue for one does little to console those affected by the storms. And make no mistake about it, but even those living a great distance from Houston or Florida feel the effects as gas prices have surged in the face of refinery shut downs and insurance rates are likely to increase as well. Finally, market concerns reflect not only these issues but also many fear a fall sell-off (perhaps driven by one or more of the above) or an end to the long running bull market. While these fears are somewhat justified as the fall has seen its share of market pull-backs and the bull market is aging, there is no evidence that suggests a sell-off wouldn't be short-lived or that the bull market is actually ending anytime soon since we continue to have reasonable economic growth.

On the positive side, the economy continues to chug along, tech stocks are (still) growing in value, mergers are occurring, and in a twist, investors aren't going crazy over the markets. Economic growth has ticked up this year with two quarters potentially showing 3% plus growth. Whether we finish the year that strong or not remains to be seen but so far growth is slightly stronger than expected. Should this continue, earnings will likely follow suit and that would mean higher stock prices (or at least less overvalued stock prices). The economy may be growing slightly faster but the key word there is "slightly" as there is no evidence of an overheating economy that could threaten growth and usher in a recession. Tech stocks such as Apple, Facebook, Amazon, and Google (Alphabet) continue to post solid earnings gains and their stock prices reflect that growth. Apple has set the date for their annual product announcement (September 12th) and with the anticipation of a new iPhone, Apple's stock has reached new heights. While the old adage "buy the rumor, sell the news" may hold true here, it is also likely that a well-received new product line will ultimately drive Apple's stock higher. Amazon continues to shine although its P/E is very high. Their recent takeover of Whole Foods has sent shock waves through the grocery industry. Google continues its leadership position in research and Facebook's growth seems to have no end. While there may be concern with valuations, they are nowhere near the runaway numbers posted by tech stocks prior to the tech bubble bursting in 2000. Mergers and acquisitions continue even though the market is near all-time highs. Already mentioned was Amazon's takeover of Whole Foods but recent days have seen another huge takeover in United Technologies purchase of Rockwell Collins. The combination of companies providing airplane parts provides a potent supplier to Boeing and Airbus. Finally, investors haven't gone crazy over this market as usually happens late in bull markets. By and large, investors are enthusiastic towards equities but mainly because there is largely nowhere else to turn. In fact, some of the measures we have taken this year to stay invested but reduce risk are symbolic of that feeling. This type of skepticism is good for the markets vs. 1990's irrational exuberance. Does this mean the bull market will continue forever? Of course not, but old age alone won't do it in either.

A quick note about inflation and interest rates. Inflation seems to be stuck at or below the Fed's target of 2% and that is putting pressure on the Fed to not raise rates later this year as planned. Perhaps the unwinding of the Fed's balance sheet will be enough for the Fed this year as a forced rate hike without economic data to back it up could cause more harm than good. This bears watching as we move through the fall.

It sounds like a broken record, but we will keep an eye on the economy and the markets and will make adjustments to portfolios as necessary. Any adjustments we make will be done so without adding significant risk or volatility to portfolios.

If you haven't had the opportunity to do so yet, please stop by our office in Madison or call our Wealth Management department at (608)826-3570 to schedule a portfolio review.

As of August 31st, 2017…..

Dow Jones Industrial Average up 13.01% YTD
S&P 500 up 11.93% YTD
S&P 400 up 5.28% YTD
S&P 600 up 1.13% YTD
NASDAQ up 20.34%

Barclays U.S. Agg. Bond Index up 3.64% YTD
EAFE up 14.66% YTD
Inflation (CPI) 1.7% (as of July 31st)
Unemployment 4.4%

Thank you for your business – we look forward to speaking with you soon. *(Note – this commentary used various articles from Morningstar, the Wall Street Journal, Investor's Business Daily, Northern Trust, CNNMoney.com, msn.com, Kiplingers.com, nytimes.com, Fidelity Investments, American Funds, LPL Financial and other tools as sources of information)*