U.S. Wealth Management
U.S. Bancorp

Market and economic update

October 9, 2017

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Current economic events

Markets continue to look through Hurricane-related economic data distortions to achieve new highs on hopes for solid business growth. The September jobs report was a victim of Hurricanes Harvey and Irma, posting the first monthly payroll decline since September 2010. However, other elements of the jobs report and purchasing manager surveys point to a still healthy and growing U.S. economy.

- While nonfarm payrolls fell 33,000 in September, the unemployment rate dropped to 4.2 percent and labor force participation, an indicator of labor confidence, rose. As we recover from the hurricanes, we will likely see stronger-than-expected jobs reports in the coming months, which are also not likely indicative of the true trend in economic activity.
- U.S. manufacturing surveys generally pointed to solid economic growth trends and improving activity. Some of this uptick may be attributed to recovery efforts and a restarting of certain industries, such as refiners, post hurricanes. However, when combined with the positive trend before the hurricanes, we believe this indicates still solid growth and possible improvements in capital spending.

Global purchasing manager surveys generally remain in expansion territory, indicating the trend of synchronized global growth remains intact. Activity appears to be strongest in Europe and much of Asia is also improving. Brazil and Russia appear to be emerging from their recessions, with index data pointing to growth but not acceleration. The picture in China is somewhat mixed, with softer activity from smaller businesses and strong activity in larger businesses heading into next week's Communist Party Congress. This positive trend provides solid footing for global equity markets, despite emerging political risks in Spain, Iraq and North Korea.

Equity markets

Equities seem poised to trend still higher as the third quarter reporting season is about to begin amid favorable fundamental and technical backdrops. Increasing earnings, restrained inflation, an accommodative Federal Reserve (Fed), and constructive technical trendlines provide valuation support and the basis for stocks to trend higher.

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- Earnings are increasing. The release of third quarter results ramp up this week and next, with the release from several banks scheduled for later this week. At present, consensus third quarter year-over-year earnings growth is nearly 4 percent, according to S&P Global. Consensus earnings growth for 2017 and 2018 over year-ago levels is both approximately 10 percent, with further upside in 2018 likely pending fiscal stimulus. The S&P 500 currently trades at roughly 21.5 times and 19 times trailing 12-month and current year estimates, respectively.

While our outlook remains constructive, risks remain. Valuations are full, the status of President Trump's pro-growth agenda remains a work in progress, geopolitical tensions are elevated and unexpected events could stoke volatility at a time when complacency seems high.

Our published year-end 2017 price target for the S&P 500 is 2,550, which is the midpoint of a 2,500 to 2,600 price range. With fundamental and technical trends remaining favorable, it seems plausible that the S&P 500 will end the year toward the high end of this range.

Fixed income markets

Bond yields rose as high as 2.36 percent last week, reaching the highest levels in three months. The weekly move was driven by market expectations increasingly pricing in a rate hike by the Fed in December, wage growth appearing to solidify and potential tax reform out of Washington. This week, investors will be watching consumer price data on Friday, events that handicap the odds of tax reform and for any announcement from Trump regarding his pick to lead the Fed.

The minutes from the September Fed meeting will be released this week. Information released from this meeting indicate most Committee members view a rate hike in December as appropriate. In our view, there is unlikely to be material data that sways near-term expectations. Of much greater importance is an announcement from Trump regarding his nomination for the next Fed chair who would assume responsibility in February 2018. While most candidates would likely pursue consistent policy goals using a consistent approach, a couple of candidates, including former Fed Governor Kevin Warsh, have a generally hawkish reputation and appear to desire less central bank intervention in the economy. As such, a Warsh nomination could push bond yields modestly higher in the near term.

We continue to favor incurring credit exposure in lieu of extending duration given our expectations for modestly rising interest rates. The global economic backdrop continues to exhibit strength, which along with additional Fed rate hikes should push bond yields higher while pressuring bond prices, allowing credit spreads to remain relatively tight. For those with higher risk tolerances seeking out incremental yields, taking on additional exposure in emerging market and high yield bonds is prudent, so long as exposure to higher quality bonds, such as investment grade corporates, municipals, mortgage-backed securities (MBS) and Treasuries is adequate to diversify portfolios.

Real estate markets

Publicly traded Real Estate Investment Trusts (REITs) lagged the S&P 500 over the past week by approximately 1 percent and now trail the broader market by 11.5 percent for the year. The return of risk-on bias and investors leaving safe-haven assets has led to the drop in real estate-related equities. Since September 7, the 10-year Treasury yield moved up from 2.04 percent to 2.36 percent. Over the same time period, publicly traded REITs returned negative 0.86 percent and trailed the S&P 500 by 4.17 percent. The increase in interest rates also hurt infrastructure assets, in general. During the same time frame, Utilities returned negative 2.23 percent and trailed the broader market by 5.54 percent.

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Commodities markets

The recent hurricanes, accompanied by OPEC jawboning, led to oil markets breaking out above 50-day, 100-day and 200-day moving averages last month. However, that rally came to an end last week as gasoline supply data surprised to the upside. Oil finished the week off 5 percent, below $50 a barrel and back inside the moving averages. It will probably be hard for a well-supplied market, with net long speculators, to move significantly higher from here.