Fourth Quarter 2017 Review and Outlook

What a quarter! What a year! Both the economy and the stock market showed strength and growth. The major stock and bond market indices performed very well. The Dow Jones Industrial Average was up +11.0% and for +28.1% for the year. The broader S&P 500 was up+ 6.6% and +21.8% for the quarter and the year respectively. The NASDAQ Composite had returns of +6.6% and +29.6% for the quarter and year. The bull market has now endured for 103 months, the second longest in history. What will interrupt the upward trend is the question at hand. The bond market had lower level positive gains despite three interest rate increases during 2017; the Barclay’s Aggregate Index was up +0.4% for the quarter and 3.5% for the year.

The economy broke out in 2017. Confidence is high and employment, in terms of jobs created, is growing (the unemployment rate is down to about 4%); wages are beginning to move up. A large factor in the economic growth has been the reduction in the number of anti-business regulations on the books as well as the tax reform law. The major tax overhaul passed in December lowered corporate tax rates making the U.S. more competitive worldwide and individual tax rates were also lowered. It is anticipated that this will spur investment and job creation in the U.S. However, a very significant number of tax deductions – state/local taxes, mortgage interest and property taxes – were either eliminated or capped. The implication of this on the high tax states-NY, NJ, California and Illinois – remains to be seen.

Inflation is still low, however, as part of the effort to return rates to more normal historical levels, the Federal Reserve increased rates again in December by 25bp (1/4%). They will also probably increase rates 2 or 3 times in 2018. How this increase in rates will affect stock market valuation and investors’ appetite for equities is uncertain.

On the economic front, as measured by stock market indices, international markets also had a very good year. China led the way up +42.4%. The other major Pacific areas also had strong growth as did Europe (Germany, France and Italy in particular) and in Latin America stronger economic growth paved the way.

The International non-economic scene (if you can separate the two) was and is troubling. The Middle East continued to be a problem as North Korea’s nuclear threats and provocations are very real issues. As the U.S. has embarked on tougher pro-US foreign policy, the impact on trade is also at issue.

Aside from International political uncertainties, the US domestic scene has a number of issues; immigration, infrastructure, welfare reform, opioid/drug use. While the unemployment rate remains low, the labor participation rate which surveys adults age 16 or older who are employed or seeking work, remains at 62.7%, virtually unchanged since September 2015. Market results are detailed below.

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| --- | --- | --- | --- | --- |
|  | **QUARTER Ending 12/31/2017** | **12 MONTHS Ending**  **12/31/2017** | **THREE YEARS Ending**  **12/31/2017** | **FIVE YEARS Ending**  **12/31/2017** |
| **DJIA** | 11.0% | 28.1% | 16.0% | 16.3% |
| **S & P 500** | 6.6% | 21.8% | 13.1% | 15.7% |
| **NASDAQ Composite** | 6.6% | 29.6% | 16.7% | 19.6% |
| **Barclay Agg. Bond** | 0.4% | 3.5% | 1.9% | 2.1% |
| **Mutual Funds** |  |  |  |  |
| **Domestic** |  |  |  |  |
| **Large Cap** |  |  |  |  |
| **Growth** | 6.4% | 27.7% | 22.1% | 15.3% |
| **Value** | 6.0% | 15.9% | 8.7% | 13.3% |
| **Small Cap** |  |  |  |  |
| **Growth** | 4.7% | 21.5% | 10.0% | 14.0% |
| **Value** | 3.5% | 8.5% | 8.3% | 12.2% |

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| Europe | 1.6% | 23.7% | 7.9% | 8.1% |
| Latin America | -1.8% | 29.9% | 5.5% | -3.7% |
| Japan | 8.5% | 25.5% | 13.3% | 14.2% |
| Pacific ex Japan | 8.1% | 37.4% | 10.0% | 7.5% |
| China Region | 6.2% | 42.4% | 11.1% | 9.6% |
| Corporate Bond |  |  |  |  |
| Long | 2.0% | 9.7% | 4.6% | 4.6% |
| Intermediate | 0.3% | 3.7% | 2.2% | 2.1% |
| Short | 0.0% | 1.7% | 1.5% | 1.2% |
| Government Bond |  |  |  |  |
| Long | 2.2% | 8.4% | 2.6% | 3.3% |
| Intermediate | -0.2% | 1.6% | 1.1% | 1.1% |
| Short | 0.2% | 0.6% | 0.5% | 0.3% |
| Municipal Bond |  |  |  |  |
| Long | 1.0% | 5.7% | 3.0% | 3.0% |
| Intermediate | 0.4% | 4.6% | 2.3% | 2.4% |
| Short | 0.3% | 1.7% | 0.8% | 0.8% |

**Market Outlook**

Finally, a note on the 2018 stock market; we’re off to a good start. The economy is strong but the market is high and will be hard to maintain without fundamental support. Price earnings ratios, particularly for the largest technology stocks are historically high. Keep with your target asset (stock/bond) allocation strategy with periodic rebalancing. However, if you are anxious about the recent upward moves and want to capture gains now, a higher allocation to short term bonds is advised. We continue to track portfolio holdings and economic data on an on-going basis.

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