Market View

October 2017

US stocks again reached record highs during the third quarter of the year. The US economy continues its moderate growth path. The Federal Reserve is beginning the difficult process of unwinding the stimulative policies put in place after the financial crisis. A massive security breach renewed concerns of cyber-crime.

Financial Markets

Building on gains from earlier in the year, the US stock market reached record highs during the third quarter despite renewed concerns of a potential conflict with North Korea and disruption from several major hurricanes. The Standard & Poor's 500 Index returned +14.2% during the nine month period. International markets have outpaced domestic stocks in 2017. The MSCI EAFE index of developed international markets returned +20.6% and the MSCI Emerging Markets Index returned +28.6%. US small capitalization and mid-capitalization stocks underperformed large capitalization stocks in the first nine months of the year.

The US stock market return has been notably concentrated this year. Through the end of September, the information technology sector, which includes Apple, Microsoft, Alphabet and Facebook, contributed 5.6% or over one-third of the markets' nine-month return of 14.2%. The spread between shorter-term bonds and bonds of longer maturities has decreased in 2017 resulting in a flattening of the yield curve. The yield on the ten-year US Treasury Note ended the quarter at 2.33%, after starting the year at 2.45%. During the same nine-month period, the yield on two-year US Treasury Notes increased from 1.19% to 1.47%.

The Economy

The US economy expanded at its fastest pace in more than two years in the second quarter, with US GDP growing at an annual rate of +3.0%. This represented an increase from the first quarter's pace of +1.2% and represented the strongest quarter of growth since early 2015. Overall, growth during the current expansion has averaged slightly over 2% annually. Although economic growth is expected to remain healthy for the balance of 2017, the effects of the recent hurricanes are uncertain.

The unemployment rate remained low at 4.4 % in August. The rate has been in a tight range of 4.3 to 4.4% for the past five months. While the economy shows signs of a recovery, the 1.7% annual inflation rate remains below the Federal Reserve's desired target of 2%.

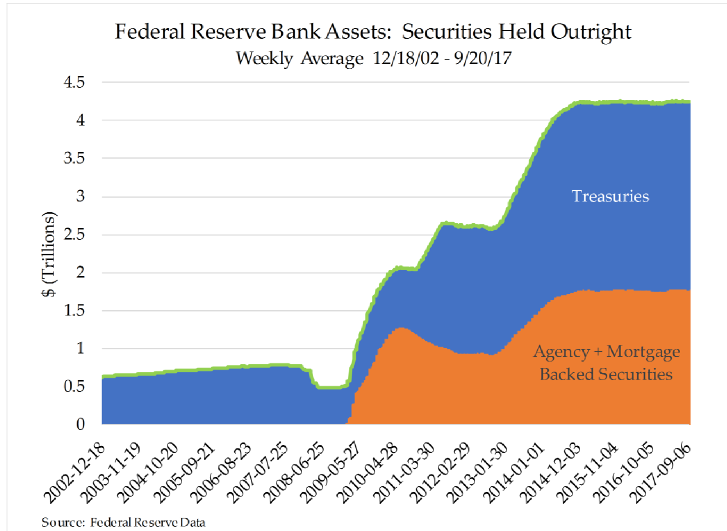
Market Indicators 9/30/2017

	Total Return	
US Stock Markets	**12 Mos**	**Year-to-Date**
S&P 500 Index	18.6%	14.2%
S&P 400 Mid Cap	17.5%	9.4%
Russell 2000 Small Cap	20.7%	10.9%
International Stock Markets	*ETF Returns in US$*	
EAFE Index *(Europe, Australasia, Far East)*	18.9%	20.6%
Japan *(MSCI Index)*	13.1%	14.8%
China *(Xinhua 25)*	18.7%	27.4%
Emerging Mkts Index	21.6%	28.6%
US Fixed Income Yields	**12/31/16**	**9/30/17**
6 Mo US T-Bill	0.61%	1.20%
2 Yr US T-Note	1.19%	1.47%
10 Yr US T-Note	2.45%	2.33%

Federal Reserve

The Federal Reserve has served as the backstop for the US economy since the financial crisis. Along with the more traditional tool of short-term interest rate changes, the Fed initiated quantitative easing, or QE, during the depths of the financial crisis.

This practice allowed the Federal Reserve to use the strength of their own balance sheet to purchase bonds and mortgage backed securities to directly lower long-term rates and aid economic growth. While the ultimate impact of QE will long be debated, the Federal Reserve announced at their September meeting that they will begin the process of unwinding the program this year. They expect this will continue over several years. They also announced the federal funds rate would remain unchanged at a range of 1.00% to 1.25%, but did not rule out an additional rate hike before year-end.



Why are people so concerned about the end of quantitative easing? It has never been done before and investors do not know what to expect. The Federal Reserve hopes that by widely signaling their plans and gradually reducing holdings of long-term bonds over several years the unwinding will have minimal impact. However, although inflation is below the Fed's 2% target, they think the economy is strong enough and the time is right to begin shrinking the balance sheet.

Cyber Crime

The recent breach of a major credit reporting company has renewed the focus on cyber crime. The latest incident is magnified by the fact that it may have affected 143 million people, or one-half the US population. Unfortunately these types of attacks have become more common. In addition to stealing personal information, cyber criminals have recently used ransomware attacks typically against large corporations. These attacks lock computer access until a payment is made to the attacker. Ransomeware attacks remind us of how vulnerable some businesses and markets are to cyber crime.

As the recent breach shows, major US financial institutions are not immune. They work closely with the Federal Government and invest heavily in defending against these ever changing threats. Consumers are wise to take an active role in protecting themselves. Consumers should have strong online security practices including a unique user identification and different passwords for every sensitive website. In addition, actively monitoring financial accounts is imperative to ensure there is no suspicious activity and to limit any exposure that may occur.

Conclusion

The stock market reached new highs during the quarter. Stock valuations are currently above average on many metrics, but are supported by reasonable earnings growth. The Federal Reserve's campaign of short-term interest rate increases is expected to continue and the end of quantitative easing may cause longer-term rates to rise. Investors should monitor portfolios to control risk.

Miner A. Crary, CFA *Gary R. Mikula, CFA* *Robert A. O'Neil, Jr., CFA* *Thomas E. Reilly, Jr., JD*
Timothy M. Malloy *Brett A. Mirliani, CFA,* CFP®