Birch Hill
INVESTMENT ADVISORS

Market View

October 2018

The US stock market jumped to record highs during the third quarter. The advance was driven by strong earnings growth and continued economic expansion. The Federal Reserve continued their plan of gradual rate increases. Major changes were made to the Standard and Poor's economic sectors at the end of the quarter.

FINANCIAL MARKETS

Both the Dow Jones Industrial Average and the Standard and Poor's 500 Index reached record closing highs during the third quarter. Despite periodic setbacks due to trade concerns, volatility remained low during the quarter. Recently enacted corporate tax cuts and strong domestic earnings growth fueled the advance. The Standard & Poor's 500 Index returned +10.6% during the nine-month period.

Both developed international and emerging markets have underperformed the US markets thus far in 2018. The MSCI EAFE Index of developed international markets returned –1.4% and the MSCI Emerging Markets Index returned –8.3%. Economic troubles in Turkey and Argentina, combined with concerns about global trade, led to a sell-off in emerging market stocks. Broad emerging market stock indices entered a bear market, declining more than 20% from their recent peaks, during the quarter.

US small capitalization stocks outperformed large capitalization stocks year-to-date. Mid-capitalization stocks lagged the broader market. Small capitalization stocks have performed well as they have taken the role of a safe haven during trade tensions. Small companies tend to be more US focused in their revenue mix and are somewhat insulated from recent dollar strength that is typically a headwind for overseas profits of global large-capitalization companies.

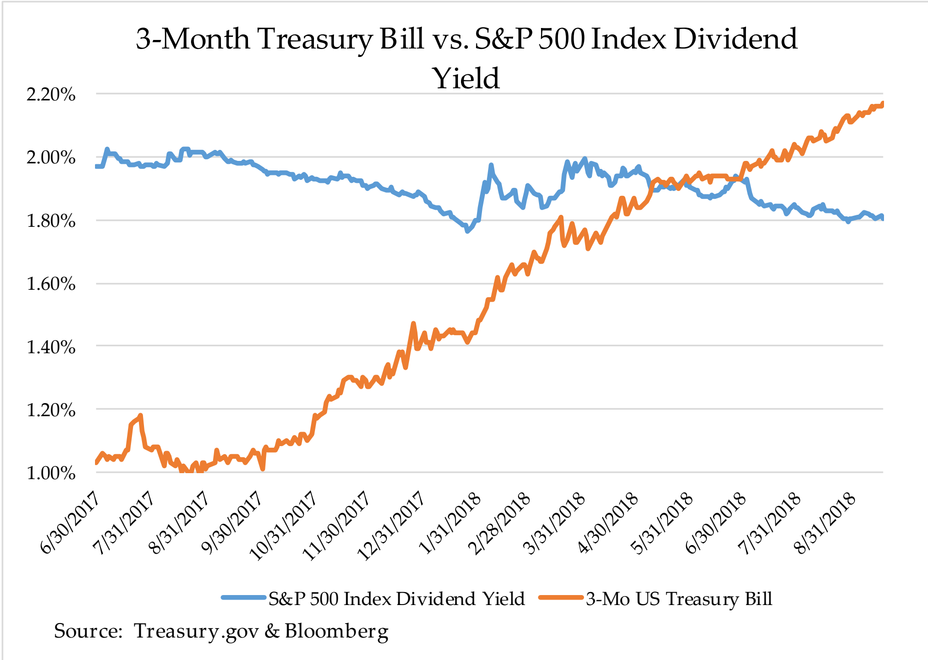
THE ECONOMY

US Gross Domestic Product (GDP) grew by 4.2% in the second quarter of 2018. This was the fastest rate since the third quarter of 2014. Growth in the first six months of 2018 was 3.2%. Business investment and trade both factored into the faster growth. While trade tensions and tariffs may restrict growth in the second half of the year, it is still predicted that growth will be close to 3% for the balance of 2018.

Market Indicators		9/30/2018
TOTAL RETURN		
US Stock Markets	12 Mos	Year-to-Date
S&P 500 Index	17.9%	10.6%
S&P 400 Mid Cap	14.2%	7.5%
Russell 2000 Small Cap	15.2%	11.5%
Int'l Stock Markets		
ETF Returns in US$		
EAFE Index (Europe, Australasia, Far East)	2.4%	-1.4%
Japan (MSCI Index)	9.7%	1.3%
China (Xinhua 25)	0.5%	-6.0%
Emerging Mkts Index	-2.1%	-8.3%
US Fixed Income Yields	12/31/2017	9/30/2018
6 Mo US T-Bill	1.53%	2.36%
2 Yr US T-Note	1.89%	2.81%
10 Yr US T-Note	2.40%	3.05%

Birch Hill Investment Advisors LLC
One International Place, Suite 770
Boston, MA 02110
Phone: 617-502-8300
BHBoston.com

The labor market remains strong with the August unemployment rate at 3.9%. Initial unemployment claims are at levels not seen since the 1960's. Wage growth finally saw a meaningful increase up +0.4% from the prior month and +2.9% from last year. This was a welcome change as wages have been slow to rise against the backdrop of very low unemployment.



A strong employment backdrop, along with low inflation, has given the Federal Reserve flexibility to continue to raise short term interest rates. In September, the Federal Reserve raised rates by a quarter point, their eighth increase since December of 2015. The Fed's benchmark funds rate of 2 percent to 2.25 percent is now at the highest level in 10 years.

Treasury Bill yields have been lifted by the Fed's increases and are now above the dividend yield offered by the S&P 500 for the first time since 2008. Much of the current bull market has occurred with short-term rates lower than the dividend yield, an anomaly versus longer term trends. Many believe the minimal yield offered by cash had forced some investors to higher risk asset classes such as equities and longer dated bonds.

GLOBAL SECTOR CHANGES

In late September, the S&P Dow Jones Indices instituted a major restructuring of their Global Industry Classification Standard (GICS). GICS is a common classification of economic sectors used worldwide. The changes are being made to respond to the evolution of the way people communicate and access entertainment content. The change involved the renaming of the telecommunications services sector to the communication services sector. The new sector expanded to include many large companies from the consumer discretionary and information technology sectors. In all, twenty companies found new homes.

Notable changes include Alphabet (Google), Facebook and Twitter leaving the technology sector to join the communications sector. Comcast, Disney and Netflix were also added to the communications sector from the consumer discretionary sector. EBay left the technology sector to join Amazon in the consumer discretionary sector. While major impacts are not expected, there may be some short term volatility as index funds shuffle their line-ups to match the new sectors.

CONCLUSION

Stocks moved higher during the third quarter supported by economic growth and strong earnings. The Federal Reserve continued to raise the discount rate. As shorter-term interest rates rise to more attractive levels, investors should continue to monitor asset allocation in order to control risk.

Miner A. Crary, CFA   Gary R. Mikula, CFA   Robert A. O'Neil, Jr., CFA   Thomas E. Reilly, Jr., JD

Catherine M. Kennedy, CFP®   Timothy M. Malloy, CFP®   Brett A. Mirliani, CFA, CFP®