CORRIGAN FINANCIAL, INC.

Market Update: 3rd Quarter 2016

Stocks ended the month of September with modest gains, capping off a solid third quarter performance. Foreign stocks (+6.9%) outperformed U.S stocks (+4.4%) during a relatively *quiet* quarter for investors. In fact, the S&P500 index went two months without a daily move of 1% or more until early September. Interest rates rose slightly, as the 10-year Treasury note ended the quarter yielding 1.605%, up from 1.492% at the end of June. The 10-year rate, which reached an historic low of 1.366% in July, remains below the 2.273% yield at the start of the year. (Note that bond prices fall as yields rise.)

Banks, insurance companies and pension plans have all been hurt by the zero-based and negative interest rate policies (ZIRP/NIRP) of global central banks. **The Federal Reserve has signaled that it expects to raise rates at least once before year-end.** That should help financial firms somewhat, but no one expects any *aggressive* near-term moves by the Fed. While financial stocks have started to recover, they still struggle with low interest rates … not to mention the recent problems regarding Deutsche Bank's diminishing capital and the scandal over sales tactics at Wells Fargo.

Recent economic and investment developments:

- The Commerce Department now estimates the U.S. economy grew at an inflation-adjusted 1.4% rate for the second quarter, up from last month's estimate of 1.1% growth. That is better than the 0.8% rate in the first quarter, but below the 2% average growth rate since the recession ended in mid-2009. Economists believe the economy has been accelerating, and they anticipate third quarter GDP growth to reach 3% or more.

> **Growth was weak in the first half of this year. We're seeing definite evidence that the economy is now expanding more strongly.**
>
> **Janet Yellen, Fed Chairwoman – WSJ 9/30/16**

- Economic data suggest that consumers are actually saving more in countries with negative interest rates. Evidently, households are compensating for negative interest rates by saving more, not less.

> **A typical consumer's lifecycle has three phases – a borrowing phase, a saving phase, and a phase for**

consuming savings in retirement. The aging of developing countries has increased the economic importance of the latter two life cycle phases. While negative real interest rates benefit borrowing households, they are a tax on savers and those in retirement.

Paul Kupiec & Alex Pollock, Real Clear Markets – 9/26/16

- Easy money central bank policies continue to prop up stock prices even in the face of declining earnings. Companies in the S&P 500 are expected to report an earnings decline of 2.3% for the third quarter. That would be the sixth consecutive quarterly earnings decline. The S&P 500 is now trading at 19.7 times its past 12 months of earnings … well above the average valuation of 16 times earnings over the past decade.

We've all relied too much on monetary policy. They used to call it the punch bowl. I say we've got to take the crack cocaine pipe away and start focusing on real fiscal policy and structural reform.

Daniel Loeb, Third Point Fund – CNBC 9/20/16

- Median household income rose 5.2% in 2015, the largest annual gain registered since the survey began in 1967. Still, household incomes remain 1.6% below the 2007 level (inflation-adjusted) and 2.4% below the all-time high reached in 1999.

It has been a long slog from the depths of the Great Recession, but things are finally starting to improve for many American households.

Chris Christopher, Jr., IHS Global Insight – WSJ 9/13/16

- Income gains and healthier household balance sheets helped consumer spending in the first half of the year. With both government and business spending on the decline, consumers were the only reason the economy grew at all.
- Crude oil futures were up nearly 8% in September after OPEC reached a preliminary agreement to reduce output.

Where do we go from here?

Investor concerns currently revolve around corporate profits, the Fed, and the election. Corporate profits are expected to rebound due to greater stability in the dollar and oil prices. If the Fed increases interest rates, most are betting it will happen in December. **In any event, it will probably take some time … a potentially long and somewhat painful journey … before monetary policy is normalized.**

As far as the election is concerned, both candidates are embracing increased fiscal stimulus. With monetary policy pushed to the limits, fiscal spending (especially on infrastructure) could give the economy a positive jolt. Still, increases to fiscal spending will be constrained by budget deficits and overall debt levels.

> **The economy is of course the sun around which all those other satellites revolve. The health of the banking sector, the election, the Fed, and corporate profits will all be determined by the strength or weakness of the economy.**
>
> **Paul Vigna – WSJ 9/30/16**

Let's hope that newly elected officials focus on investing in public infrastructure, reducing inefficient regulations, maintaining fiscal discipline, and simplifying our tax code.

The economy, while weak, continues to muddle through, thanks to steady job growth and an overall healthier consumer. Many investors expect stock prices to continue to advance, as our low-yield environment offers few alternatives to equities. However, let's not get complacent. **Expect increased volatility as we approach the U.S. presidential election and a year-end Fed rate hike.**

It's hard to believe that summer is over, and year-end planning is in full swing. The fourth quarter is always a busy time, and most of us already have plenty on our plates. Let us know if we can be of any help.

Daniel G. Corrigan, CPA/PFS, CFP®