Quarterly Commentary: Q3 2018

VALLEY NATIONAL
FINANCIAL ADVISORS

Equities:

US equities continued to push higher during the third quarter, fueled by strong earnings growth and an improving economic backdrop. Barring a significant pullback in Q4, the US equity market is on pace to outperform its international counterparts for the seventh time in the past ten years. The fundamental strength in the US economy has helped US stocks shrug off the questions raised by the ongoing global trade saga, but international stocks, without the luxury of corporate tax reform boosting earnings and growth, have been unable to elude the risks of shifting global trade patterns and weakening currencies. Emerging markets have had a difficult year, and though there was a marked improvement over the volatility observed during Q2, risks in Turkey and Argentina have threatened to spill over into other markets and have made investors weary.

Bonds:

Bond returns have been flat to slightly negative in 2018, and we expect the headwinds posed by rising interest rates to continue until monetary tightening is paused, which doesn't appear to be anytime in the immediate future. Federal Reserve Chairman Jerome Powell suggested at the end of September that the Fed anticipates rate hikes could continue into 2020, which would put the Fed Funds rate at about 3% by that time; just 0.25% below the current yield on a 30 Year Treasury. President Trump has made it clear that he is displeased with the Fed's decision to continue hiking rates, but it is important to remember that the Fed is an independent body designed to operate free of political interference, and we do not expect the president's comments to be an influencing factor in future monetary policy decisions.

Outlook:

The fourth quarter will bring with it some intriguing potential catalysts for markets, and there are a few key things that we are watching moving forward:

1. **The Shape of the US Yield Curve**

   One of the most consistent themes of the past several years has been the flattening of the US yield curve (short term interest rates have risen faster than long term interest rates). Historically, a flattening yield curve has been a bearish signal for markets and the economy, prompting many to wonder if the bull market was finally winding down. However, we saw a small but meaningful break from this pattern at the end of the third quarter, and one reason for this may have been an increase in inflation expectations.

2. **US Inflation**

   Throughout this prolonged economic recovery, inflationary pressure has been conspicuously absent. But with tightening labor conditions and rising oil prices, it would not be surprising to see inflation finally become a factor for the Fed to ponder when it considers its next policy move. Higher inflation would likely force the Fed to keep its policy of increasing interest rates intact for longer.

3. **Mid Term Elections**

   It is no secret that the Trump Administration has made it a key policy initiative to focus on US trade policy, and the negotiating tactics that have been utilized have caused some disruption in global markets. Depending on the impact that the mid term elections have the President's political capital, he may be forced to take a more passive stance. If that happens, international equities (and emerging markets in particular) may find their footing as some of the uncertainty created by trade rhetoric fades to the backdrop.

1655 Valley Center Parkway, Suite 100 | Bethlehem, PA 18017 | 610-868-9000 | www.valleynationalgroup.com