Market Insights | 2016 September

RIVERPOINT
CAPITAL MANAGEMENT | INVESTMENT ADVISORS

MARKET INSIGHTS

From RiverPoint Capital Management

Market Insights is a publication of RiverPoint Capital Management.

Like everything we do, it is designed to bring you talented resources and proactive advice with a single purpose in mind – to help our clients achieve financial security and peace of mind.

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Latest Sound Bites on the Market and Economy

In an effort to continue to provide details on the current economic and market environment, we are providing our thoughts on multiple topics in a different format. This is a shift from our previous newsletter format which was longer and focused on a single topic. This will allow us to keep our clients more broadly informed and allow them to follow up with their Wealth Advisor Team should they want to discuss a given subject in more details. We will continue to produce the longer, thematic newsletter on a quarterly basis. We hope you enjoy.

Volatility takes the summer off, but now it is back!

As measured by the Volatility Index or often cited "VIX", daily swings in the market dropped to record low levels during the summer months similar to what we saw before the October 2014, August 2015 and January 2016 corrections. In all three of those periods, we saw a temporary sharp decline in volatility succeeded by a spike in that measure and we experienced mild corrections in each case. With seasonality headwinds, continued uncertainty about where the Fed's minds are, and a rather odd political campaign season coming to a head, we wouldn't be surprised to see a repeat. In fact, concerns surrounding these exact items have caused volatility to spike again over the past few weeks. The good news is that the underlying fundamental data suggests a buy- on-dips strategy would be the right course of action, yet again, and that the longer term bull market remains in-tact.

Trump Doesn't Have a Chance…wait a minute, correction, maybe he does?

This is by no means a political statement; it is merely our observation that Hillary Clinton's 7-8 point advantage in the polls has narrowed to 3-4 points in a head to head national competition between the two candidates. In the most recent CNN poll, Trump is now ahead of Clinton by 3-4 points when you include a third party candidate in the running. Further, Trump is even with Clinton now in polls in the important swing state of Florida and 4 points ahead of her in the equally important state of Ohio. Please note most polls released prior to the election have a margin of error of 3-5 percent. This is important to note, especially when the projected results are shifting and so close. With more Republicans that are undecided late in the election cycle this time around, and, seemingly, starting to report their warming to Trump, perhaps this is a tighter race than most thought only weeks ago. Grab your popcorn for the first debate on September 26. Why? It might actually be more entertaining than Monday Night Football, and it could set the course for the final result of the election…certainly for the tone of the finish to this race. We still think Clinton is viewed as the Centrist and most market-friendly candidate, but, as we've stated in our recent webinar on the "Impact of the Election" (9-6-16), investors will once again shift attention away from politics and back to fundamentals shortly after the results are in. The questions will quickly become: How are earnings progressing? What about oil price trends? How is the jobs data looking? etc. Regarding trends on these fronts, we still feel positive.

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So The Outlook is Positive, is there anything we are concerned about and watching closely?

1. Yield Curve; 2. Jobs Report/Consumer Strength; 3. Manufacturing and Service Sector Institute of Supply Management (ISM) Reports.

As we've shared with you many times in the past, these are three key indicators we use to identify whether or not we see a U.S. recession on the horizon. These all tend to go into decline several months in advance of a recession and signal an associated bear market in stocks. Positive readings in these measures earlier in 2016 is what kept us confident and invested versus some investors who were audibly in "the recession is coming" camp. We just didn't see it. With a positive and modest steepening in the interest rate yield curve and the continued healthy job report figures, we feel good about these two important indicators. The third measure, manufacturing and service sector ISM indices, bare watching. These indices tell us whether the manufacturing sector (12 percent of the U.S. economy) and the service sector (88 percent of the U.S. economy) are continuing to see strong demand and grow OR are rolling over. BOTH, not just one, must roll over to signal recession. They have been very accurate historically in that regard. The growth rate in both measures in August decelerated enough to catch our attention. This is only one month and the larger service sector index still signals growth, but the trend is of concern. If we would see continued meaningful deterioration in this metric over several months we would become more defensive.

Items NOT on everyone's radar yet.

There are several other events that we think could lead to a spike in volatility other than the Fed and the election in the U.S. First, Italy's Prime Minister, Matteo Renzi, has called for a referendum vote in the October/November timeframe for a significant makeover of the political system there; should his centrist administration lose this upcoming vote of confidence, it could resurrect EU disintegration fears and take original Brexit concerns to a higher level. Also the U.S. Congress must agree on legislation in that same timeframe to fund the government and if that starts to look clumsy—far from the first time—investors could get frustrated for a bit. Again, these events should not dictate true economic fundamentals, but knee jerk negative reactions like we saw around the Brexit vote in late June could ensue… and spell a buying opportunity.

Remember that ancient concept called Fiscal Policy?

Most everyone seems to be taking great delight at bashing the Fed. It's become great sport. We all can debate whether their actions to spur growth will end up, in totality, being good for our economy in the long run or not. Short term, it has helped, but, the long term consequences are yet to be determined. What is not debatable is the fact that the Fed is doing ALL the heavy lifting in the universe of "Policymaker land". There are other tools that could be employed to spur growth, but no one seems to know that right now. One is called Fiscal Policy.. aka spending initiatives. Again, both presidential candidates agree that the Fed could get a little assist here if the government would pass legislation to incent some productive spending on infrastructure projects. We do think additional legislation will pass in 2017 to spur capital spending, an important missing piece to the U.S. economic recovery story. Our investment team continues to look for appropriate companies that will benefit from these initiatives Stay tuned. Who knows, the Fed might even get surprised by a bonus prize from policy makers…tax reform? We'll see, but a smart balanced approach to help solve our growth challenges and help take the economy to the next level would include these complementary approaches alongside the accommodative Fed monetary policy.

We hope you enjoyed these snippets of timely, topical market and economic items we are monitoring over the coming weeks and months. We welcome any feedback and should you have any additional questions please don't hesitate to reach out to your Wealth Advisor Team.

Until next time…

Thanks,

RiverPoint Capital Management