Third Quarter 2018 Market Commentary

A Fantastic Third Quarter - At Least in the U.S.

A fantastic third quarter pushed 2018 into a solid year as the broad-based S&P 500 finished the third quarter with a 7.2% gain - its best quarter since 2013.

Very good corporate earnings, historically low unemployment, increased wage growth and still relatively low interest rates have all caused the U.S. markets to handily outpace global markets.

Lost in all the good news is that the bull market is still very much alive, as the S&P 500 is up over 14% since February, when the bears were starting to make noises. Equally lost in the noise was that volatility was down considerably. The CBOE Volatility Index plummeted by almost 20% over the period, its biggest quarterly decline since the first quarter of 2016. Further, the S&P 500 did not have a single day in the third quarter that brought an up or down move of over 1%. Both the S&P and the DJIA have risen in 11 of the past 12 quarters, while NASDAQ posted its ninth straight quarterly gain.

It was, however, a different experience for investors across the oceans as the prospects of trade wars and the ongoing Brexit saga pushed overseas markets lower.

The stock markets strong third quarter could bode well for the rest of the year. According to CFRA Research, when the S&P 500 rises in the third quarter, it has advanced an average of 3.8% in the fourth quarter of all years since 1945, And in midterm election years, the S&P 500 rallies an average of 7.1% in the fourth quarter following a third-quarter gain. But as always, past performance is no guarantee of future results.

Fixed-Income Markets

In fixed-income, interest rates continued to move upward, in line with the Fed’s third interest rate hike of 2018 coming in late September.

The 10-year U.S. Treasury – the benchmark used to decide mortgage rates and the most liquid and widely traded bond in the world – ended the second quarter at 2.85% and since mid-August has remained above 3.0%, closing the quarter at 3.05%

- The yield on the 3-year U.S. Treasury ended the quarter at 2.88%

- The yield on the 2-year U.S. Treasury ended the quarter at 2.81%
- The yield on the 3-month U.S. Treasury ended at 2.15%

The Fed Raises Rates for the 3rd time in 2018

Late in the third quarter, the Federal Reserve increased short term rates by 0.25% in what was probably the most predictable rate movement the markets have ever seen. Here are the exact words from the Fed's release:

"Information received since the Federal Open Market Committee met in August indicates that the labor market has continued to strengthen and that economic activity has been rising at a strong rate. Job gains have been strong, on average, in recent months, and the unemployment rate has stayed low. Household spending and business fixed investment have grown strongly. On a 12-month basis, both overall inflation and inflation for items other than food and energy remain near 2%. Indicators of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2% objective over the medium term. Risks to the economic outlook appear roughly balanced.

In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate to 2% to 2-1/4%."

U.S. and China Continue Their Trade Banter and the Markets Shrug

Economists braced all quarter for bad news on the trade conflicts between the U.S. and China and while the news was dramatic, the markets didn't really react as many expected.

Stocks moved down a little in anticipation of news from the White House, such as when President Trump announced that $200 billion worth of Chinese goods would be subject to a 10% tariff immediately and that would rise to 25% by the end of 2018. But the very next trading day saw stocks rise steadily, a trend that continued throughout the quarter to the surprise of many economists.

Glass-half-full economists are suggesting that the market's reaction to these trade barbs points to investor confidence that the White House is willing to negotiate. Time will tell.

On the weekend after the third-quarter closed, President Trump fulfilled his campaign promise and announced that NAFTA will be replaced by the United States-Mexico-Canada Agreement – USMCA for short.

Jobless Claims Lowest Since 1969

Investors received a lot of positive news from the Department of Labor seemingly every time weekly jobless claims were reported. The latest from the Department of Labor toward the end of the quarter:

- In the week ending September 15, the advance figure for seasonally adjusted initial claims was 201,000, a decrease of 3,000 from the previous week's unrevised level of 204,000.
- This is the lowest level for initial claims since November 15, 1969 when it was 197,000.
- The 4-week moving average was 205,750, a decrease of 2,250 from the previous week's unrevised average of 208,000.
- This is the lowest level for this average since December 6, 1969 when it was 204,500.