REMAINING CAUTIOUS IN THE QUARTER TO COME

The third quarter of 2016, in our opinion, was good for broad equity indexes. Most of the year-to-date (YTD) gains for these indexes came during the third quarter. July, August and September produced 85% of the 10.19% Russell 2000 Small Cap Index YTD price return and 54% of the 6.08% S&P 500 YTD price return.

Overall we saw positive improvement in the market environment:

- In general, riskier equity assets participated in market growth. Small cap stocks, international stocks and emerging markets had strong relative returns compared to the S&P 500.
- A positive change in leadership occurred in the technology sector. The 12.9% third quarter return helped the technology sector rebound and push the YTD return positive. We also saw money leave the “safer” telecoms and utility sectors.

At the end of the second quarter of 2016, our risk model showed that we were in a late-stage bull market in an unhealthy environment. Has the market risk picture improved enough to suggest that we are in a revitalized bull market? Has the U.S economy improved enough to grow without quantitative easing? Is it strong enough to withstand a rate hike? Thoughts on these questions help shape fourth quarter expectations. With that in mind, the chart below shows multiple index returns since the Russell 2000 set a high on June 23, 2015.

Since the peak in the Russell 2000 set 15 months ago, the overall market has demonstrated an incredible “will-to-live” by staving off a two corrections – bear market losses in many cases. The market survived the Brexit shock and the S&P 500 even set a new all-time high. As inspiring as that sounds, the major equity global indexes were outperformed from June 23, 2015 through September 30, 2016, by the anemic growth of the Barclays Aggregate Bond index at 3.54%. The S&P 500 return is 2.07%; Russell 2000 is -3.4%, MSCI Emerging Markets is -8.08% and the MSCI EAFE (developed international) is -11.35%.

If we were to describe our opinion of the global market as a hospital patient, its recovery would move it from the intensive care unit to progressive care. But that metaphor is not meant to understate the quality of the recovery—the Russell 2000 (riskier stocks) has led the S&P 500 (safer stocks) by a significant margin; defensive sectors are retreating (telecoms and utilities) and risk is advancing (technology).
OUR INSIGHTS

Some headwinds that could hamper the stock market recovery in the 4th quarter include:

- Election uncertainty. According to the Stock Trader’s Almanac October is the worst month during election years (data since 1950).

- If the earnings recession continues it could lower investors’ confidence in the market and trigger a risk off trade. According to FactSet “If the (S&P 500) index reports a decline in earnings for Q3, it will mark the first time the index has recorded six consecutive quarters of year-over-year declines in earnings since FactSet began tracking the data in the third quarter of 2008.

- The possibility of a December rate hike.

We are hopeful that the recent market strength will translate into resiliency during the 4th quarter and push the market into a healthier growth mode. Until the uncertainties of the market clear up, we believe that investors should expect daily volatility. This volatility will probably increase with the direction being biased towards election odds followed by rate hike odds.

TRADEMARK RISK MODEL

Our risk model continues to point to this being a late stage bull market. However, we saw positive developments in the market risk environment:

- In general, riskier equity assets participated in market growth. Small cap stocks, international stocks and emerging markets had strong relative returns compared to the S&P 500.

- A positive change in leadership occurred in the technology sector. The 12.9% third quarter return helped the sector rebound and push the YTD return positive. We also saw money leave the “safer” telecoms and utility sectors.

While the market has shown strong risk improvement in the 3rd quarter the market has not quite made into “healthy” territory. We believe that caution is still prudent.

DON’S CORNER

Artificial stability becomes instability!

In my opinion, the longer the Federal Reserve keeps interest rates low, the more distortion there will be in the financial markets. The Fed is behind the curve and should hike rates. And, rising rates are historically not good for the stock or bond markets. For the last several years, this stimulation from the Feds have been an intoxicant to the equity markets. There will be significant market turbulence as this process evolves.

Don Beasley
Principal and Managing Director

As with all investments, Trademark Capital Management’s investment strategies are subject to risk and may lose money. Investment return and principal value of an investment will fluctuate so that an investor’s portfolio may be worth more or less than their original investment. The investment strategy presented is not appropriate for every investor and individual clients should review with their financial advisors the terms and conditions and risk involved with specific products or services. Due to our active risk management, our managed portfolios may underperform during bull markets. Past performance is no guarantee of future results.

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