Quarterly Outlook

OCTOBER 2016

Third Quarter 2016

Unlike the first two quarters of 2016, the third quarter was not characterized by a unifying theme or central story. Instead, equity and fixed income markets reacted to a number of events both at home and abroad. Overall, US equities continued to march forward, with eight of the S&P 500's eleven sectors posting gains for the quarter. Technology and Financial Services topped the list of best-performing sectors, returning 12.86% and 4.59%, respectively. Utilities, Telecommunications and Consumer Staples posted negative returns. On the whole, the S&P 500 index finished the quarter with a total return of 3.85%, bringing its year-to-date total return to 7.84%.

In its September meeting, the Federal Open Markets Committee (FOMC) announced its decision to leave its target interest rate unchanged. The decision was not unanimous, however, with three of the FOMC's ten voting members voting to increase the federal funds rate from its current 0.25%-0.5% range. Non-unanimous votes are rare for the FOMC, and the 7-3 split should be taken as a sign that another rate hike is very possible by the end of 2016. While the committee acknowledged encouraging signs from US economic indicators such as household spending and job growth, these data were likely overshadowed by concerns over Brexit and the slowdown in China as well as a potential hesitation to take action while the US presidential election enters its home stretch.

Quantitative easing measures taken by the European Central Bank have had arguably more impact on US fixed income markets than our own Fed policy in recent months. In June, the ECB began purchasing European corporate bonds in an effort to provide stimulus to the Eurozone economy, driving down yields. Investors have turned to the US credit market as a more attractive alternative, leading to huge net inflows into US corporate bonds. Additionally, negative yields in Japan and Europe have contributed to increased investment in US government issues, offsetting the effects of rate normalization on the US yield curve.

Oil prices failed to maintain the momentum of their record-breaking performance from the first half of the year, bouncing around between $40 and $50 per barrel in the third quarter. OPEC members, who share a strong desire to see oil prices return to their previous highs, agreed to a production ceiling in the last week of the September. It is unclear whether OPEC members will effectively cooperate to meet this end, as they have historically struggled with political pressures and infighting. US oil companies have displayed unexpected resilience by finding ways to reduce costs amid the slump in oil prices.

The US economy has been picking up steam, with second quarter GDP growth upwardly revised to an annualized rate of 1.4%. Consumer confidence rose to an 11-month high in August alongside low unemployment and rising real wages. However, a strong dollar, cheap oil, and weak global demand continue

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to undermine exports and fixed investments. Political uncertainty regarding the upcoming election also contributes to business investment pressures.

Going Forward: Tandem's Outlook

The final quarter of the year is poised to bring about some material changes to the investment landscape. The US will elect its next president in November, choosing between candidates with very different policies in terms of business, tax and trade. The Fed is unlikely to enact any policy changes before the election, but a December interest rate increase is looking like a very real possibility given the results of the September FOMC meeting and recent positive economic data. More details regarding the terms of the UK's departure from the European Union will be revealed, with formal negotiations set to begin by the end of March 2017.

With favorable fundamentals at home, accelerated market performance will largely depend on the success of economic recovery efforts abroad in Europe and Asia. Market performance in the first three quarters of the year exceeded investors' expectations, but the upcoming presidential election and potential for rate policy changes remain sources of uncertainty in the fourth quarter. The market doesn't like uncertainty, and a post-election "relief rally" is possible no matter who is elected president.

While an uptick in volatility is possible in the fourth quarter, portfolio performance is best measured in longer periods of time rather than days, weeks or months. 2016 has been another good year in equity markets to date. Through diversification and strategic asset allocation, Tandem's clients' portfolios are positioned for both up and down markets.

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