Quarterly Outlook

OCTOBER 2018

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TANDEM
WEALTH ADVISORS®

Third Quarter 2018

US equities continued their upward trajectory in the third quarter of 2018, with the S&P 500 gaining 7.71% (total return) and consolidating above the 2,900 mark. The health care, industrials and telecommunications sectors provided the quarter's largest gains, returning 14.53%, 10.00% and 9.94%, respectively. Even the worst-performing sectors (materials, energy and real estate) managed to finish the quarter positive, with returns of 0.36%, 0.61% and 0.86%, respectively. Second-quarter S&P 500 earnings were up 26.7% from Q2 2017 thanks to tax reform, high consumer confidence and active share repurchase programs.

The key factor currently supporting the US economy is consumer confidence, which reached its highest level since October 2000 in September. Personal consumption expenditures were the single largest contributor to US GDP growth over the last several quarters. Also on the positive side are favorable wage growth dynamics, triggered by a multi-year low unemployment rate and declining initial jobless and continuing claims, which are at their lowest levels since the mid-70s. The Fed announced another 0.25% interest rate increase in September, with Fed Chair Powell signaling that further rate hikes are likely in the short term.

The ongoing trade war with China was the largest market disruptor in the quarter, as the two governments engaged in a tit-for-tat series of escalating tariff announcements. At the end of September, President Trump imposed tariffs on $200B of goods, adding to tariffs imposed earlier on $50B of Chinese imports. China responded by announcing its own new tariffs against $60B of American imports in addition to $50B of US goods tariffed earlier this year.

The synchronized global growth that characterized 2017 has since slowed considerably. Developed and emerging markets underperformed US-based indices for the quarter as a result of the further widening of the interest rate differential between the US and developed markets, general economic uncertainty in different parts of the world, and rising geopolitical risks. As a result of Brexit, the United Kingdom posted its weakest growth since 2012. Concerns over a similar exit from the European Union resurfaced in Italy, with the instability of the coalition government weighing on business confidence.

Going Forward: Tandem's Outlook

Tandem believes that near-term upside will continue to be found in the US equity market. However, the "sugar high" investors are experiencing fed by short-term GDP growth will not be sustainable if and when economic growth wanes as fiscal stimulus (tax reform) runs off down the road. Further, some choppy water can be expected as the Fed continues down its path to interest rate normalization.

We believe trade issues are likely to remain the largest source of market turbulence in the short term. Despite the obvious fact that the US maintains a large trade deficit with China, neither nation will come out of this conflict unscathed. The new tariffs could lead to an increase in input costs, which would either be passed on to consumers or erode manufacturers' profitability margins.

European markets present a lesser concern at the moment. In our view, the European Central Bank (ECB) had enough momentum last year to begin tightening monetary policy and keep pace with the Fed, but unfortunately, they have not done so. The ECB is now stuck with a loaded balance sheet and ultra-low rates. If the US were to enter a recession, the ECB would lack options with which to respond. Luckily, Tandem does not believe the US is currently at risk of recession.

As always, Tandem continues to focus on risk management, downside protection and risk-adjusted returns.