ROOF ADVISORY GROUP, INC.®
INVESTMENT ADVISORY & FINANCIAL PLANNING SERVICES

INVESTMENT INSIGHT
3rd Quarter Review

Mostly Quiet…

Market Update

Building on the momentum from the impressive late-June Brexit snapback, stocks continued to advance in the third quarter. Although it hasn't been a smooth or even path, the major U.S. stock market indices registered new all-time highs in the third quarter. In sharp contrast to the previous several quarters, the summer months were fairly uneventful. Other than a few brief periods of jitters caused by concerns over the health of several European banks and the uncertainty associated with the outcome of the Federal Reserve's September interest rate decision, the third quarter was defined by low trading volumes and unusually low volatility. In fact, we registered a period of 40 consecutive trading sessions with less than a 1% move in the S&P 500 Index.

For the third quarter, the S&P 500 Index advanced by 3.3%. International and global stocks outperformed U.S. equities by a wide margin this quarter with the MSCI EAFE Index (international stocks) higher by 5.8% and the MSCI All-Country World Index (global stocks) rising by 5.3%.

Bonds also posted positive returns for the quarter with the U.S. Barclays Aggregate Bond Index advancing by 0.5%. Fixed income returns were more muted this quarter compared to the first half of the year due to a slight uptick in interest rates. While the increase in interest rates was not very meaningful, it was a different outcome than the first half of the year where interest rates declined considerably which provided meaningful support to fixed income returns.

Economic Update

Overall economic growth remains stuck in low gear. Second quarter GDP growth registered a disappointing 1.4% advance. While estimates for third quarter GDP are tracking at a higher 2.2% growth rate, these estimates have trended downward throughout the quarter and given recent disappointments, estimates should probably be viewed with a skeptical lens. However, there are a number of economic positives to highlight. The employment picture strengthened further in the third quarter with monthly job gains averaging almost 200,000 and initial unemployment claims declining to the lowest level in over 40 years. Moreover, the number of job openings jumped to a record 5.87 million in July. In addition to the positive employment trends, consumers are benefiting from rising incomes, drastically reduced debt levels, appreciating home values and limited inflationary pressures. These positive tailwinds were reflected in September's consumer confidence reading which reached the highest level in nine years. We continue to feel that the main driver of our economy, the consumer, is in good shape.

Portfolio Positioning

As outlined last quarter, we used the Brexit induced stock market decline to increase our equity allocation in late June. We completed the balance of our targeted equity addition in early July and maintained our equity allocation at the one step above mid-point level for the remainder of the third quarter.

We made a few minor adjustments within our fixed income allocation but overall not much has changed with our fixed income positioning or views. The main themes remain diversification across strategies and short duration/limited sensitivity to changes in interest rates.

Second Quarter Performance Attribution

With the backdrop of upward trending equity markets and a modest advance in fixed income markets, our portfolios posted positive returns in the third quarter. There were a number of notable contributors worthy of mention. Fixed income performance was strong on a relative basis with the vast majority of our strategies posting measurably higher returns than the broad bond market index. Our tilt towards short maturity bonds and some exposure to higher yielding strategies were beneficial to performance results this quarter. Exposure to international stocks was also a positive contributor as foreign equities performed well on both an absolute basis and relative to the returns of the U.S. stock market. In addition, financial stocks rebounded in the third quarter after disappointing performance results for the first half of the year.

On the detractor side of the equation, a number of high-yielding domestic stocks and mutual fund strategies lagged the broad equity market returns in the quarter as the potential for a near-term interest rate hike dampened investors' appetite for stocks with high dividend yields. With bond yields still at historically low levels and expectations for interest rates to remain low for the foreseeable future, we still view high-yielding domestic equities as attractive. The performance of growth oriented portfolios where we utilize individual stocks in our allocation process was negatively affected by late-quarter declines of two individual stocks driven by company specific issues. While these two stocks have either stabilized or recovered a significant portion of their September declines so far in the fourth quarter, we are monitoring the developments closely and will make changes we deem appropriate.

Closing Thoughts

The docile market backdrop in the summer months was certainly a welcome change from the highly erratic environment we have faced over the previous four quarters. However, we do not expect the low volatility market conditions to be the norm going forward. In the coming months markets will grapple with the uncertainty surrounding the Presidential election as well as the battle for control over the House and Senate. In addition to the political issues, investors will be keenly focused on third quarter corporate earnings results with high expectations for signs of improvement after five straight quarterly declines in earnings growth. Also, there is little doubt that markets will continue their obsession with the Federal Reserve's interest rate decisions in November and December.

Despite the anticipation of a more volatile environment going forward, we remain encouraged by the continued improvement on multiple fronts – including – stabilization of energy prices, less pressure on corporate profits from a surging U.S. Dollar, some improvement in economic growth, and signs of a moderate rebound in China's economy.

Last quarter we wrote about the "trading range" that has contained U.S. stocks over the past few years. Our view was that solid corporate earnings growth would be the catalyst needed to finally breakout of this range. The positive equity market performance registered in the third quarter has pushed stocks above the upper limit of the previous trading range. However, we think one of the main drivers of this move has been the anticipation of a better near-term earnings environment. Therefore, the importance of the upcoming earnings results meeting these high expectations has increased considerably. Corporate earnings results and developments on the economic front will weigh heavily on our asset allocation decisions going forward.

We welcome all Roof Advisory Group clients to attend our interactive online webinar discussion scheduled for 4:00 pm EDT on Thursday, October 13th. The purpose of this webinar is to provide a more in-depth overview of the most recent quarter, financial market conditions, portfolio positioning, as well as our firm's outlook going forward. Invitations to register for the webinar are currently being emailed to our valued clients.