HNB BANK
Trust Services
573.629.3826
816.279.5900
www.hnbbanks.com

OUTLOOKS

September 2017

ECONOMIC OUTLOOK

Summary

As we entered August, optimism was high as July growth in non-farm payrolls continued to surprise on the upside at +209,000, and average hourly earnings finally began to respond to the tight labor market with a solid increase above the rate of inflation. The strong labor market and wage gains supported retail sales and there was also a nice bounce in the Index of Small Business Optimism. Consumer confidence surveys and regional Fed reports indicated we may finally be seeing a more rapidly growing economy.

Yet even with these signs of hope, enthusiasm faded as auto sales dropped sharply to the lowest level in more than three years and the housing market showed weakness in both home sales and new home construction. More recently, the August non-farm payroll report showed the rate of new job creation had slowed to +156,000 and job gains in the previous two months were overstated by 41,000. In the end, the trend of mixed economic data continues with some brief periods looking stronger and then some slower. The devastating effects of the hurricanes in Texas and Florida will only exacerbate variability as economic activity is depressed at first, then enhanced by a greater magnitude as rebuilding takes place.

We continue to search for the long-term catalyst that will change the trajectory of the economy out of 2%-type growth into something higher. In fact, if one looks back 2-5-10-15 years, the average GDP growth rate has been between 1.4% and 2.2%. Aging demographics, burdensome debt loads and excess global manufacturing capacity are powerful deflationary forces restraining long-term growth. While second quarter's GDP came in at 3.0% and current estimates by the Atlanta Fed for the third quarter is about the same, there is no reason to expect a significantly different outcome besides the rebuild effect from the storms.

Positives

Employment gains continue to be more than enough to absorb new entrants into the labor markets

Regional Fed reports and business confidence indicate future strength

The weaker U.S. dollar will spur exports and attract foreign travelers

Negatives

Personal income has not been growing much more than the rate of inflation

Construction spending declined 1.3% month-over-month

Car and truck sales continued to sag in July even with incentives running high

Expanding Possibilities

This material has been prepared for information purposes only. Factual materials obtained from sources believed to be reliable but cannot be guaranteed.

HNB BANK
Trust Services
573.629.3826
816.279.5900
www.hnbbanks.com

OUTLOOKS

September 2017

EQUITY OUTLOOK

Summary

In spite of a few bumps in the road, equity markets inched higher in the month of August. The S&P 500 rose 0.3% and the Dow Jones Industrials Average rose 0.6% bringing the year-to-date gains to 12.0% and 12.9%, respectively. International equities continue to perform well with developed international markets up 17.1% and emerging markets higher by 28.3% for the year.

Domestic market leadership trends that have been in place since the start of the year held steady last month. Large-cap growth stocks advanced 1.8%, while large-cap value fell 1.2%. Growth has now outperformed value by 14.4% (19.2% versus 4.8%) in 2017. That trend was particularly evident in sector performance for the month and year-to-date figures. Technology stocks are up 26.6% for the year and were once again the top performing sector in August. The only two sectors in negative territory for the year were energy (down 15.1%) and telecom (down 7.9%). They were also the worst performers for the month of August.

Throughout the year, equity markets have rallied steadily with few disruptions. Solid corporate earnings and a healthy economic environment have provided a compelling backdrop for stock performance. However, we have seen a return of volatility in recent weeks after a war of words erupted between President Trump and North Korean leader Kim Jong-un. Hurricane Harvey also unleashed a new wave of concerns and the Republican administration continues to struggle to implement their pro-business policy agenda. In spite of what was a relatively noisy August, volatility subsided by month's end.

Given the current equity market momentum and their ability to look past these recent events, it appears likely equities will continue on the current track until something much more significant jolts us off course. Legislators appear poised to intertwine Hurricane Harvey relief with a debt ceiling bill, which should help to insure its passage and relieve some uncertainty. As long as inflation remains muted the Fed will be measured with rate normalization and equities should continue to command a premium valuation. The consumer remains the heart of the U.S. economic driver and tight labor markets should ultimately result in sustained wage growth which should fuel consumer spending and propel equity markets higher.

Positives

Health of the consumer/labor markets

Strong economic backdrop and modest inflation

Solid corporate earnings momentum

Negatives

Geopolitical overhangs

Aging economic expansion/stretched valuations

Unknowns

Pro-growth policy initiatives stalled

This material has been prepared for information purposes only. Factual materials obtained from sources believed to be reliable but cannot be guaranteed.

HNB BANK
Trust Services
573.629.3826
816.279.5900
www.hnbbanks.com

OUTLOOKS

September 2017

FIXED INCOME OUTLOOK

Summary

After a quiet and range-bound July, rates stair stepped lower in August as North Korea related geopolitical fears led investors to seek relative safety in the U.S. bond market. Overall for August, the 10-year note declined almost 18 basis points (bps) ending at 2.12%. This was the lowest level since November 9, the day after President Trump's surprise victory. Impacted more by Fed policy, the 2-year note traded within a 6 bp range and ended the month only 2 bps lower at 1.33%. The yield curve flattened with the spread between the 2-year and 10-year yields declining to 78 bps after starting the month at 94 bps and the year at 125 bps. High-quality investment-grade credit spreads increased by about 8 bps during the month which caused their returns to slightly trail those of U.S. Treasury bonds. For the year, corporate bonds have delivered significantly higher returns than the safer U.S. Treasury notes.

When geopolitical tensions increase and military provocations escalate markets find it difficult to focus on the usual drivers of economic activity, inflation and subsequent interest rate policy. By most measures, the economy continues to advance with the employment market supporting generally solid broad economic activity. Even the devastation caused by Hurricane Harvey is unlikely to cause more than a blip in overall GDP growth as temporary disruptions in many industries are replaced by incremental rebuilding costs. Shortages in building materials and qualified labor are likely and inflation measures may tick up as a result.

On the shorter end of the maturity spectrum, we still believe the Fed is likely to announce, after the September 20 Federal Reserves Open Market Committee (FOMC) meeting, initiating the process to remove some monetary policy accommodations. Quantitative Tightening (QT) is the liquidating of government securities held on the Fed's balance sheet. The Fed will likely not increase the overnight Fed Funds rate at that meeting, but if conditions continue to be supportive, may do so at the December meeting. We believe three additional rate hikes in 2018 are unlikely and expect the terminal target for the overnight rate to be closer to 2% than the current Fed member consensus of 3%.

Longer-term rates like the 10-year Treasury note should trend higher but only with a de-escalation in the tensions with North Korea and its supporters, namely China and Russia. Even if this happens, we have reduced our year-end target for the 10-year Treasury note yield. We now view 2.60% as the highest we might see for the year. Looking out into 2018, a 3% yield seems possible but we are not convinced we will be that fortunate. The recent decline in rates certainly reinforces the role of bonds in a well-balanced portfolio.

Positives

The U.S. still has the highest yield of any large high-quality developed country

Inflation remains below the Fed's target level

QE (purchases) by ECB and Bank of Japan likely to continue for all of 2018

Negatives

Fed still appears on track to begin QT this year

Investors need to absorb additional supply, QT by Fed and heavy corporate issuance

Inflation pressures could emerge with Hurricane Harvey rebuilding

Unknowns

Escalation of North Korea tensions

Expanding Possibilities

Copyright 2017 by FCI Advisors. This material has been prepared for information purposes only. Factual materials obtained from sources believed to be reliable but cannot be guaranteed.