



## THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – SEPTEMBER

### **US Markets and Economy:**

US stocks rallied to new records in September, historically the weakest month of the year, and finished with strong gains for the quarter. The monthly gains were broadly based, with increases between 2.5% and 3% in the Dow Jones Average, the S+P 500 Index, and the tech-heavy NASDAQ. For the year so far, the stock rally has been paced by the NASDAQ (up over 20%), while the Dow and S+P have managed excellent gains of about 13%, which is far above the historical average return for stocks over an entire year.

The bull market in stocks is still being driven by the twin engines of corporate profit growth and low interest rates. Corporate profits are still rising and would be further increased by Trump administration proposals to reduce corporate tax rates. They offer a special tax break for repatriated profits, which have been held abroad to avoid the US taxman. Economic growth in the US, which also drives corporate profits, is also accelerating, with the final estimate for second quarter GDP growth at 3.1%, the highest rate in years. This growth has been accompanied by benign inflation of less than 2%, which has encouraged the Federal Reserve's FOMC to continue its program of very modest increases in short-term interest rates. The benchmark Fed Funds rate is now projected to rise to only 1.25 – 1.5% by the end of the year, which means that, with inflation at 1.5%, real short-term interest rates will remain at or below zero through December. The Fed has also commenced its program of gradual reduction in its enormous portfolio of long-term bonds, which were acquired after the Great Recession to help stimulate a weak economy. This reduction has been well-advertised in advance by the Fed, and has not resulted in any stock or bond volatility.

### **World Markets and Economy:**

European blue-chip stocks rallied sharply in September, with the EUROSTOXX 50 Index rising over 5% for the month, led by an even sharper increase in Germany's DAX (up over 6%). Over the last 12 months, the red-hot DAX has managed to tie or beat the growth of US stock indexes. France also did well, with the CAC40 Index up almost 5%. The Italian market also rallied strongly, approaching a 2-year high, and is now up over 39% over the last 12 months. The good news driving the markets is that the European economy may have turned the corner into self-

sustaining growth, while interest rates remain at rock-bottom levels. The extra fuel for Italy comes from signs that the Italian banking crisis may be ending. The laggard in Europe continues to be Britain's FTSE 100, which gained only 0.05% for the month. The political and economic uncertainty created by the Brexit vote continues to plague the British market. To make matters worse, inflation in Britain (driven in part by a weak pound) has been running well over 2%, and the Bank of England may increase interest rates to combat rising prices.

Stocks in Tokyo also had a strong month, with the Nikkei up over 3%. Japan's economy has now managed six straight quarters of economic growth, suggesting that the decades of economic stagnation could finally be ending. Prime Minister Abe seems to have recovered from political scandals plaguing his administration, and he has called an early election while his opposition is in disarray. With Japanese interest rates still near zero or below, the stage is set for a further rally.

### **OUTLOOK:**

Although October has historically been a volatile month for stocks, the approaching November-January period has often provided the strongest returns. With the US economy growing, corporate profits rising, and inflation and interest rates still low, stocks are poised to continue the long bull market which began back in March 2009. With Europe and Japan showing more evidence of sustained economic growth, international stocks may rally in tandem with the US. Political uncertainties aside, the long bull market in stocks should continue.