MARKET Insights

Webster Private Bank®

November 2017

Safe and Sound

The Goldilocks economy continued to reward investors in October. US stocks, as measured by the S&P 500 index, gained **+2.3%**. International markets and emerging markets, as defined by the MSCI EAFE and EM indexes, delivered returns of **+1.5%** and **+3.5%** in dollar terms, respectively. Yields on the benchmark ten-year Treasury note spiked from **2.31%** at the start of the month to **2.46%** by October 27th, then settled at **2.37%** at month end. This allowed the broader investment grade bond market, as measured by the Barclays US Aggregate Bond index, to complete the month slightly up **+0.06%**.

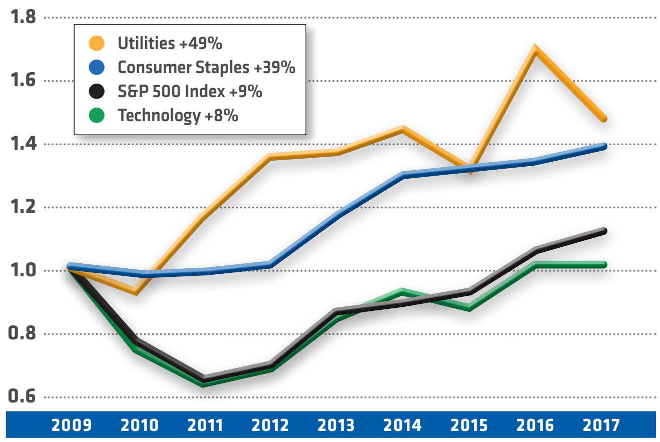
Broad measures of economic conditions remain strong. US economic growth continued to perform at **+3%** as of the third quarter. Reported earnings of blue chip S&P 500 companies were up **+4.7%** on a year-over-year basis in Q3. Inflation remains tame at **+2.2%** and low interest rates bode well for borrowers of mortgages, business loans and corporate bonds.

Recent Market and Economic Results

Markets	October	YTD 2017
Blue Chip Large Stocks S&P 500	+2.3%	16.9%
Small Company Stocks Russell 2000	+0.9%	11.9%
International Stocks MSCI EAFE (in US $)	+1.5%	22.3%
Emerging Markets Stocks MSCI EM (in US $)	+3.5%	32.6%
Investment Grade Bonds Barclays US Bond Aggregate	+0.1%	3.2%
High-Yield Bonds Barclays US High Yield	+0.4%	7.5%
Economic Indicators	**Latest**	**Previous**
Economic Growth US Real GDP	+3.0% 2017 Q3	+3.1% 2017 Q2
S&P 500 Earnings Growth Reported through Oct 27	+4.7% 2017 Q3	+9.1% 2017 Q2
Inflation CPI (year-over-year)	+2.2% Sep	+1.9% Aug
Interest Rates US 10-Year Treasury Yield	2.37% Oct 31th	2.31% Sep 30th

Source: FactSet indexes, as of 10/31/17.

Change in Stock P/E Ratios Since 2008



Source: FactSet data. Annual average price/earnings ratios, through 10/31/17.

What's on Our Minds

How Safe Are Those "Safe" Stocks?

As noted previously this year, we are underweight in historically "safe" sectors, such as utilities and consumer staples, in our clients' individual stock holdings. Speculative growth stocks (Netflix, Chinese internet companies) certainly have participated well in the current market rally. However, it is traditionally conservative, low growth companies that have reached near-record valuations. Investors seem to have placed a great amount of faith in steady, slow-growth investments over growth or cyclical companies. As the chart below shows, this has led the valuations of utilities and consumer staples companies (as measured by P/E) to appreciate more rapidly than the overall market since the Great Recession.

> *"Investors seem to have placed a great amount of faith in steady, slow-growth investments over growth or cyclical companies."*

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A Cautionary Tale

The risk in utilities or consumer staples now might be simply the opportunity cost of missing returns offered by higher growth companies (technology), or cyclical companies geared to economic growth (financials, industrials). We don't expect "safe" investments to deliver sharp losses as in other sectors such as small-caps or emerging markets. However, we got a preview of how such a scenario could unfold last year. Then, the yield on the ten-year Treasury note rebounded from an all-time low of **1.37%** on July 6, 2016 to a peak of **2.61%** on December 15, 2016. The S&P 500 index gained **+7.7%**, but the utilities sector actually fell by **-9.6%** over the five-month period. It seems that faster economic growth and higher interest rates do not bode well for such apparently "safe" investments.

"Safe" Stocks Can Lose Money Too

JULY 6 - DECEMBER 15, 2016, CHANGE IN…

Ten-Year Treasury Yield (from 1.37% to 2.31%)	+124 basis points
S&P 500 Index	+7.7%
S&P 500 Utilities Sector	-9.6%

Source: FactSet data.

Bottom Line

What It Means for Investors

Those who are concerned about the stock market should note that growth stocks have not been the primary drivers of the bull market. Conservative, "safe" companies have reached near-record high P/E ratios and are contributing to the market's apparently high valuation. This is contrary to the normal experience of bull markets – investments that are considered "safe" now carry a potentially greater risk of losses or subpar returns. We have positioned our clients' individual stock holdings accordingly, by avoiding utilities, telecom and most consumer staples. We maintain an overweight position in financial, industrial and technology companies that will benefit from continuing economic growth and a higher interest rate environment.

"We maintain an overweight position in financial, industrial and technology companies that will benefit from continuing economic growth."

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