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Economic & Market Summary
October 2015

The U.S. economy posted Q2 GDP growth of 3.9%, while over the last 12 months growth was 2.7%. We believe U.S. GDP growth has the potential to accelerate beyond the average 2.5% rate experienced over the past 6 years; however, regulation, fiscal policies, and tax policies are headwinds to faster economic growth. While these policies are certainly well-intentioned, the unintended consequences are enhanced risk aversion by both consumers and businesses and lower long-term oriented investment. Consumer balance sheets have improved markedly since the recession, but growing cash balances infer conservatism. The good news is that in spite of these policies, unemployment is 5% which historically has been considered "full-employment" for a developed economy. Additionally, the housing market continues to be poised for growth as supply remains below demand. Commodity prices have fallen sharply over the past year and will continue to benefit consumer spending and savings as well as keep inflation pressures at bay. In short, the economy remains on track for growth in the 2.5% range.

Internationally, China has made headlines this year with a spectacular rise and fall of its stock market, slowing economic growth, and questions regarding expanding debt levels. The contraction in manufacturing and construction has had serious repercussions for commodity-driven economies. Meanwhile, private sector reports from Chinese-based and multinational companies show signs the economy remains on a growth trajectory, contrasting media reports of an impending collapse. It's also important to note that past episodes of emerging market cyclical downturns have not meaningfully impacted the U.S. economy.

The Federal Reserve kept interest rates unchanged at its recent September meeting. We reiterate our opinion that modestly rising interest rates will not be disruptive to the U.S. economy. The Fed appears to be taking a more international view of its policy decision effects, citing global economic and financial developments as reasons to maintain rates. We remain wary of long-term bonds and continue to see significant relative value in owning high-quality stocks. It is unlikely interest rates will rise as high as in previous cycles, but current rates are inconsistent with an economy growing at a 4% nominal rate.

Domestic equities have had a choppy year. After mid-single digit returns early in the year, the S&P 500 now sits near correction territory (down 10%) from its recent highs. This is a normal correction for a bull market that has been running for over 6 years. The potential for higher interest rates along with slowing profit growth makes it likely volatility will continue, at least in the near-term. Full year 2015 S&P 500 earnings are anticipated to decline 2% compared to last year due to losses in the oil/gas sector as well as the negative translation effects of a strengthening U.S. dollar on multinational companies. After these items anniversary in 2016, we anticipate earnings growth in the upper single digit range. The current P/E of 17x is near the long-term average. The recent correction has left a growing number of companies on our Working List trading at attractive valuations. As long-term investors, we've been using this opportunity to build or initiate positions.

Thomas H. Rippl, CFA

To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address above.