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INVESTMENT MANAGERS

ECONOMIC UPDATE NOVEMBER 2018

LORI L. LIFFRING, CFA ♦ MICHAEL L. BRIDGMAN, ChFC ♦ JUSTIN S. ANDERSON, MBA AAMS ♦ KAREN K. BENEFIEL, CMT CPA
GAYLAN C. ABOOD, CHAIRMAN EMERITUS

Stocks suffered in October. Large stocks in the S&P 500 index fell -6.84% bringing its year-to-date return down to 3.01%. Small cap stocks in the Russell 2000 index fell -10.86% for the month erasing their gains for the year so far and giving them a -0.60% return year-to-date. International stocks in the MSCI EAFE index were down -7.96% for the month which meant the index was now down -9.28% in 2018. Emerging market stocks have fallen even more with a monthly negative return of -8.71% and year-to-date negative return of -15.72%.

Even though stocks were down, bonds did not provide protection. Yields on the 10-year US Treasury bond climbed from 3.06% at the beginning of the month to 3.16% at the end of October. Bond returns for the Barclays Aggregate Bond Index were negative for the month at -0.79% resulting in year-to-date negative returns of -2.38%.

Corporate earnings remain solid. Of the S&P 500 companies that have reported so far, third quarter earnings have grown 22.7% and revenues have grown 8.4%. The reports show that 78% of companies beat their estimates for earnings and 63% beat their estimates for revenue. Although earnings growth is expected to be around 21% for the full year, earnings growth is expected to come down to around 10% in 2019 as some of the the tax reform benefits were expected to be front-loaded. Companies have also been more conservative in their future projections as uncertainty has been increasing due to a stronger dollar, trade issues, and economic weakness outside the US.

GDP growth has also been solid. Initial readings for third quarter GDP growth came in at 3.5%. This reading follows 4.2% GDP growth in the second quarter. The Fed expects GDP growth of 3.1% for the full year and then 2.5% next year. Analysts and economists have been expecting this slower GDP growth since the boost from tax reform will be largely reflected by the middle of 2019.

In addition, unemployment is very low now at 3.7% and may not be able to go much lower. There are not enough qualified unemployed workers to bring back into the workforce so companies will not be able to hire additional workers to help fuel their growth. Plus, baby boomers are retiring and immigration is limited. GDP growth is based on the growth in the number of people in the workforce and how productive they are. Unless productivity can greatly improve, GDP growth will naturally be forced to slow.

The mid-term elections resulted in a democrat majority in the House and a republican majority in the Senate. The uncertainty is now erased. If the S&P 500 follows its historical path after other mid-term elections, investors would see gains in stocks over the next twelve months (although past performance is not an indication of future performance).

The Federal Reserve has signaled that they plan to continue to raise interest rates. We will likely see another increase in December of 2018 and then possibly three or four more in 2019.

Markets will likely continue to see increased volatility. Diversification should help to smooth out some of the bumps along the way. If you have any questions about your account, please do not hesitate to contact us. Also, if your situation has changed, please let us know that too as investment changes may be necessary.

17330 WRIGHT ST, STE 205 | OMAHA, NE 68130 | P: (402) 697-1166 | F: (402) 697-9271
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