MEEDER
INVESTMENT MANAGEMENT

Monthly Market Commentary

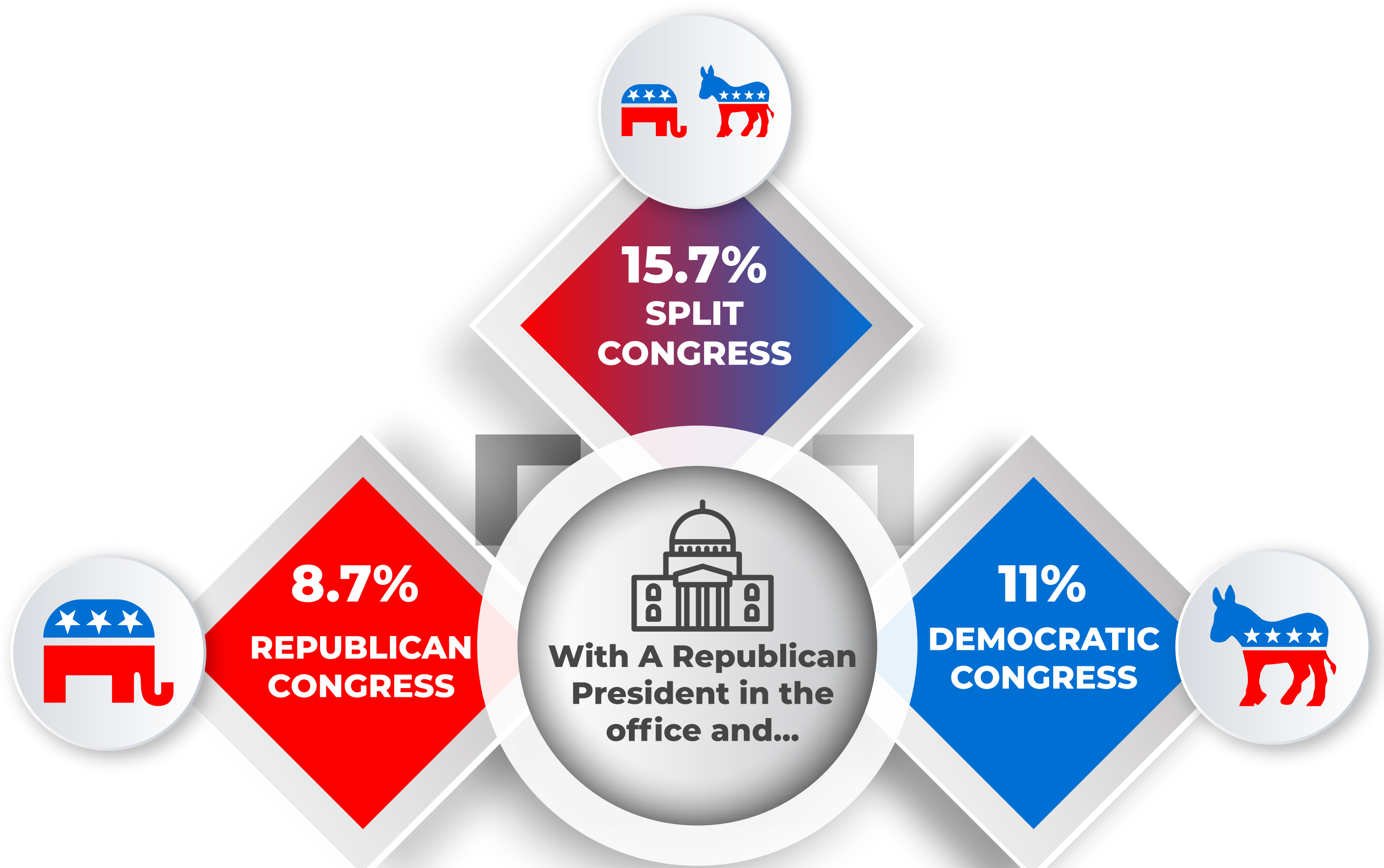
Discussion Points

- Volatility Increases in Equity Markets
- Inflation Fears
- December Rate Hike Likely

U.S Midterm Election Update

The 2018 U.S. Midterm Elections are in the books and the results played out as many pollsters had predicted. The Democrats took control of the House of Representatives while Republicans were able to maintain control of the Senate. So how will this impact markets? Historically, when looking at the last six midterm election cycles running from 1994-2014, the S&P 500 climbed higher an average of 5% after the election day through the end of the year, regardless of the winner. If we look back to 1950, according to LPL Research, when there is a Republican President, the S&P 500 has generated more positive returns with a split congress rather than single-party control. The rationale is that investors do not like uncertainty. Once investors understand what kind of political environment they can expect, they allocate their investments accordingly.

S&P Annual Returns 1950-2017



Source: LPL Research

Capital Markets Update as of October 31, 2018

Market volatility spiked again in October and the S&P fell 5.3% in just two trading days, ending the month down 6.84%. This drop erased much of this year's gains for the S&P 500 leaving the benchmark positive 3.01% year-to-date. So, what were the primary drivers of this most recent pullback? There are several considerations. First, the current unemployment level remained at a historical low of 3.7% and a more hawkish tone from the Federal Reserve has started to unnerve investors. In addition, wage growth jumped by 3.1% in the third quarter and was the first time since 2008 that it surpassed the 3% level, stoking fears of inflation. Finally, the October nonfarm payroll report easily exceeded estimates of 190,000 by adding 250,000 new jobs.

Each of these are reasons that continue to increase the likelihood of more interest rate hikes from the Federal Reserve. The Fed's meeting in early November is important because the Fed provided further guidance on rate hike expectations for the December Fed meeting. According to Bloomberg, markets are widely anticipating a 0.25% rate hike at that meeting. Fixed income markets have continued to struggle in this rising rate environment as evidenced by the Bloomberg Barclay's U.S. Aggregate Bond Index falling 2.38% year-to-date.

Despite the recent volatility in markets, consumers are still confident about the U.S. economy as the November index level exceeded estimates this month. This is an important indicator to investors because nearly 70% of GDP is comprised of consumer spending. Simply put, the more confident a consumer is in the current economic environment, the more likely they are to spend money and continue to fuel the bull market that investors have enjoyed since 2009.

The ISM manufacturing index reading for October missed expectations with a reading of 57.7 compared to a consensus estimate of 59.1. While this report is still positive, it did show a slowing in new orders of U.S. exports. This could be due to the tariff implications between the U.S. and China. The ISM non-manufacturing index tracks service related companies and exceeded expectations of 59.1 with a result of 60.3 for the month. These benchmarks are important to investors because a level above 50 represents expansion for that respective part of the economy, while a result below 50 represents a contraction.

International equities continue to experience negative performance this year. At the end of October, the MSCI EAFE Index dropped 9.2% year-to-date. Emerging markets as represented by the MSCI EM Index had fallen 15.7% and continue to remain in bear market territory from the previous highs reached in January. Some of the struggles in international markets are being attributed to trade disputes. U.S. trade relations with China continue to deteriorate as tariffs have escalated with little progress being made between the two countries. The U.S. has imposed tariffs on $250 billion of goods from China, while the Chinese have exercised tariffs on $110 billion of U.S. goods that are exported into their country. The U.S. threatened to place tariffs on the remaining $257 billion of goods that are imported into the U.S. if negotiations did not produce productive results. It currently appears to be subtle, but recent economic reports could be showing early signs that the sanctions are beginning to have a more notable negative economic impact.

Early in October oil prices reached a four-year high of over $76 a barrel. Throughout the remainder of the month oil prices plunged as global supply continued to increase. According to the EIA, the U.S. reached an all-time high oil production output of 11.6 million barrels per day for the week ending November 2. Productivity could remain strong as the Baker-Hughes rig count shows that more 14 additional operating rigs started production this week, bringing the U.S. total to 1081. In addition, Russia and Saudi Arabia have ramped up oil production since summer.

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