

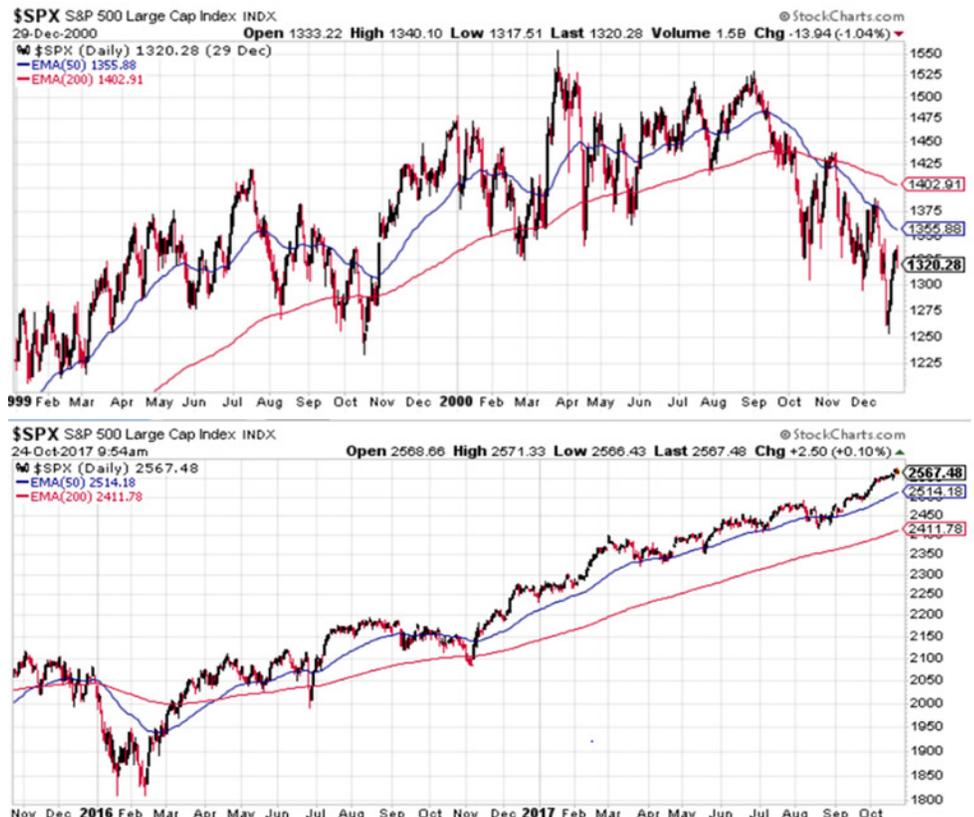
PeoplesBank Wealth Management Economic & Investment Strategy Outlook October 25, 2017

Economic Outlook

Most people could not tell you what an idiom is although they use them fairly frequently. I include myself in that statement as I had to use the internet to find the right word. Commonly used idioms include “there is a method to my madness”, “to make a long story short”, and “don’t give up your day job”. Finance even has its share of idioms, the most common being “don’t put all of your eggs in one basket”. This month, the Investment Strategy Committee’s discussion brings to mind “a picture is worth a thousand words”. With the market having gone straight up for the past several months, the Committee examined “pictures” of what previous US market tops looked like and compared them to today’s environment. To give our conclusion first, we found that previous market tops and today’s market look very different.

The price action of the market is the first thing that looks quite different. The chart at right compares the price action of the S&P 500 before and after the March 2000 market top (top panel) to the price action over the last several months (bottom panel). Notice the level of volatility in 2000 vs. the lack of volatility now. In fact, history tells us that strong uptrends do not typically reverse quickly, but are characterized by price swings as the market searches for direction. That is not the pattern we are seeing now as September and October were the two least volatile months on record.

The bond market typically features a few patterns near stock market tops. One of these is rising credit spreads. A credit spread is simply how much extra interest or spread the bond market requires to lend to a company as compared to the interest rate it requires to lend to the US government. Historically, the bond market has become more risk adverse ahead of a recession and a stock market top and has required corporate borrowers to pay increasingly higher interest rates. That is not the case now. In fact, the bond market is now requiring the least extra interest above treasury bonds that it has required at any time during this expansion. Another typical bond market pattern that is present around the top of the US stock market is falling long-term and short-term interest rates. The reason for this is that historically, near a long-term market top, the Fed has already finished its rate-hiking cycle. The Fed then realizes it has raised rates too far and begins to cut them. That is not the case today. The Fed is still committed to slowly raising rates, and short-term interest rates continue to rise while longer rates have moved sideways. Overall then, the bond market bears little resemblance to its typical pattern near a long-term peak in the stock market.



In terms of patterns from economic data, a good example is the jobs market in US. A typical pre-recession pattern involves a definitively rising unemployment rate combined with a rising four week average of initial unemployment claims. Neither of these are occurring now as both indicators are falling and the labor market continues to get tighter.

Overall, at the time of this writing the current financial market and economic environment paints a picture of continuing expansion. At some future point, the low volatility environment in which we find ourselves will end. As to the cause, your guess is as good as mine (to sneak in another idiom). Finally, I must note that calling a market top in advance is quite difficult. We feel though that the indicators above, combined with others we watch, should help to give us a sense of when to begin to position client portfolios more defensively. We will work diligently to follow the evidence that the market and the economy are giving us, and we will position our recommendations accordingly.

Investment Strategy

Looking out over the next several months and seeing little probability of a recession, we continue to favor stocks over bonds. In particular, we favor areas of the global market where valuations are lower such as emerging markets and companies that operate energy pipelines and storage facilities (energy infrastructure MLPs in the chart below). In the bond markets, we favor areas that tend to perform best during economic expansions such as preferred securities and corporate bonds.

We made no changes to our asset allocation recommendations this month. Please see our overall asset allocation recommendations on the next page.

Michael Haun, CFA, CFP®
Vice President, Investment Strategist

PeoplesBank Wealth Management Relative Asset Class Recommendations

As of 10/25/17

	Unattractive	Slightly Unattractive	Neutral	Slightly Attractive	Attractive
Stocks				X	
US Large Cap			X		
US Mid/Small Cap		X			
International Developed			X		
Emerging Markets					X
Energy Infrastructure MLPs					X
Bonds		X			
US Investment Grade				X	
Inflation Protected Securities (TIPS)		X			
High-Yield			X		
International Bonds	X				
Municipal Bonds				X	
Preferred Stocks					X
Real Assets					
Real Estate		X			

As of 10/25/17. Recommendations subject to change at any time without notice.

Investment Process

PeoplesBank Wealth Management's asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic recommendations are based upon how the Investment Strategy Committee believes investment portfolios should be positioned in a generally neutral market environment over the next five to seven years. The tactical recommendations are meant to highlight opportunities over the next one to two years where the Committee sees either increased opportunity or risk.

The Wealth Management Investment Strategy Committee (ISC) is responsible for establishing and updating both the strategic (long-term) and tactical (short-term) asset allocation for Wealth Management's investment management and trust relationships. The committee is comprised of the senior members of Wealth Management and is chaired by Michael Haun, our Investment Strategist. The committee is also responsible for monitoring and updating strategies, managers, and funds within client portfolios. The ISC meets on a monthly basis.

If you have any questions or would like to discuss PeoplesBank Wealth Management's outlook further, please call Michael Haun at 717.747.2419 or email him at mhaun@peoplesbanknet.com.

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