

PeoplesBank Wealth Management Economic & Investment Strategy Outlook January 30, 2018

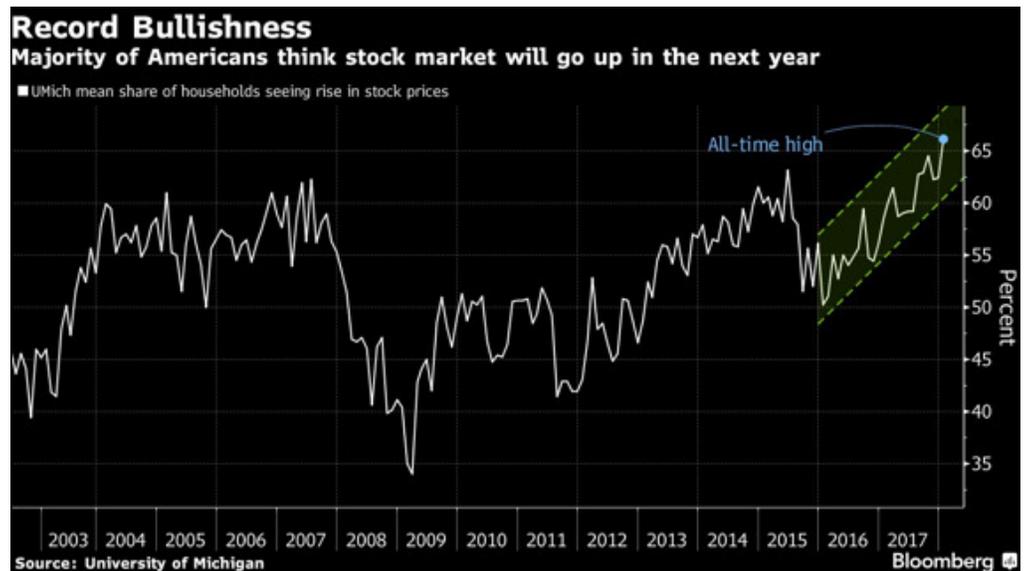
Economic Outlook

People are always fascinated by the extreme. Guinness World Records is the most famous example of this. The company is a global brand focused around extreme record-breaking. The record that I find the most memorable from my childhood is the record for the longest fingernails. The picture at right features Lee Redmond, who according to Guinness is the current record holder for longest fingernails on a pair of female hands (yes, those are really her fingernails). At their peak length in 2008, her fingernails in total reached a length of 28 feet, 4 inches. Her right thumbnail alone was 2 feet, 11 inches long. According to the Guinness World Records' website, she applied a bottle and a half of nail hardener to each fingernail daily. It is hard to imagine how she even got dressed having nails that long, but according to Guinness, she was able to lead a normal life. Speaking of extremes, the US stock market has also reached some extremes in terms of both length of time without a meaningful correction and investors' enthusiasm. With that backdrop, this month the Investment Strategy Committee debated whether the relatively positive outlook we have held for many months regarding the economy and the stock market is still appropriate.



If Guinness World Records kept the record for the longest S&P 500 streak without a 3% correction, as of the time of this writing, the current streak would be setting that record at 310 days and counting. The previous record was 257 days which ended in December 1995. This market is also only a few days away from setting the record for the longest streak without a 5% correction. The current count is just under 400 days. Clearly, this level of market stability is historically abnormal, and we would expect volatility to return to the market sometime this year.

Also setting records is investors' enthusiasm for owning US stocks. We have seen several examples of this including record levels of equity trading at brokerage firms like E*Trade which cater to do-it-yourself investors. Another example is featured at right. The University of Michigan conducts a monthly survey of consumer sentiment which is widely quoted and followed. As part of the survey, respondents are asked for their opinion on whether the stock market will be higher or lower over the next year. As shown in the chart, a record percentage of respondents now expect the stock market to be higher over the next twelve months.



Combining the market's record streak without a meaningful correction and investor's excessive enthusiasm for owning stocks, we think that the market has gotten a bit ahead of itself. As I wrote in our outlook last month, we continue to expect to see a normal 10% correction at some point in 2018.

Investment Strategy

Despite our view expressed in the first section, we continue to remain cautiously optimistic about the economy and the stock market. On the optimistic side, we continue to see little probability of a US recession on the horizon. Also, the global economic expansion continues to be broad-based with Europe growing faster than the US last quarter. We also continue to view US corporate earnings growth positively. Approximately one-quarter of S&P 500 companies have reported earnings so far for 2017's fourth quarter. In aggregate, earnings are expected to have grown 12% on a year-over-year basis. Also, based upon on companies' guidance, Wall Street analysts continue to revise their earnings estimates upward for 2018. Therefore, we continue to recommend an overweight to stocks versus bonds in client portfolios.

On the cautious side of our outlook, we continue to watch developments in the bond market. Longer-term interest rates have increased over the past few weeks, and the yield on the 10-year treasury bond now stands at its highest level since 2013. Given the continued combination of a steadily-growing economy, the Federal Reserve buying fewer government bonds in the future (less demand), and the government's need to issue more bonds to fund its growing budget deficit (more supply), we have for some time expected longer-term interest rates rise. Now that rates finally seem to have begun to rise, the important questions are how far rates will rise and how fast will the rate increase happen. We feel that markets can handle a slow rise, but a quick increase in interest rates could potentially be harmful for the stock and bond markets. Our expectation currently is for a slow rise, but we prefer areas of the bond market that are generally less sensitive to interest rates such as preferred securities and short-term high yield bonds.

We made no changes to our asset allocation recommendations this month. Please see our overall asset allocation recommendations below.

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

PeoplesBank Wealth Management Relative Asset Class Recommendations

As of 1/30/18

	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 1/30/18. 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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