After another summer has just flown by, those back-to-school days are right around the corner yet again. Any parent with a young one headed to the classroom who is just getting into reading is likely familiar with some form of “The Three Bears” and the story’s main character, the young girl Goldilocks. In the midst of some “playful” breaking and entering, Goldilocks encounters a series of items that are either at one extreme end of the scale (e.g., “too hot” or “too cold”) or safely in the middle. Those in the middle are deemed to be “just right,” which also seems like a fair evaluation for the current state of affairs for equity markets.

There’s not much in today’s environment that would lead us to forecast an extreme upside; Domestic indexes are fairly valued, the employment situation remains strong and the U.S. economy continues to plod along with positive, albeit unspectacular, growth. Nor do we see overwhelming evidence for the bear-market case either; Interest rates remain at extreme lows, inflation is tepid and the solid possibility of a market-preferred U.S. election outcome that would leave the White House and Congress divided remains.

For the time being, we believe it seems most likely that markets and the economy could continue to float along in the middle.
Moving Past Brexit: Quick reversals have been keeping investors on their toes since the June 23 Brexit referendum. Now about two-thirds of the way through earnings season, over 70% of companies reporting have beaten their mean analyst estimate and top-line revenue growth is projected to turn positive for the first time in six quarters.

What Do Asset Flows Tell Us? Flows out of mutual funds and ETFs immediately following Brexit were high, yet it took only six trading days for a basic 60/40 mix of U.S. stocks and bonds to recover.

Supportive Scenario for Markets: We’re in an environment that could be supportive of equities in the near term, and other asset classes such as corporate bonds may be considered to be in the “sweet spot.” Longer-term, we believe both equity and bond returns could remain muted.

U.S. Election and Its Market Impact: Election years have historically been positive for U.S. equities. If the current level holds, 2016 would go down as the 17th positive election year for the S&P 500 going back over the past 20 presidential elections.

All Tortoise and No Hare: Slower-than-historical-average GDP (gross domestic product) growth has become the norm over the past decade and a half. The recent reduction in inventory levels may be a positive sign for future growth, as excessive inventory buildup can signal slowing demand.

U.S. Consumer Doing All Right: The U.S. consumer has kicked it back into high gear: We’re seeing signs that wage growth continues to advance, unemployment keeps falling and confidence is solid.

Elections and the Economy: Little correlation can be found between the party in the White House and real GDP growth, inflation or interest rates. In fact, we don’t believe the party sitting in the Oval Office would have a major influence on your portfolio and long-term plan.

Brexit Impact: The economic impact of Brexit will play out over months and years; we’ve seen the Bank of England cut its official interest rate and implement several other easing measures, while the European Central Bank continues its quantitative easing program, hoping to boost growth.

Staying the Course: In May, we were concerned about the multitude of domestic and global events that markets would have to overcome in the summer months, such as the Brexit referendum. Just when markets had fully positioned for the UK to remain in the European Union, the actual vote came in to leave. However, it was less than a week before things settled down and both bond and equity markets came back to new highs. Both major party candidates in the U.S. presidential election may have negative favorability ratings, but divided control between the White House and Congress remains a strong probability that could be welcome by markets. Finally, we’ve seen oil prices come down from June highs and enter into a technical bear market, but we’ve also seen equities disconnect from the commodity and rally to new highs.

For now, our outlook on the market, economic and political environment is that things could continue to float along in the middle. This can be a frustrating environment for investors, but as asset flows and their impact on returns show, staying the course usually should be your best bet from a long-term perspective.
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