In a unanimous and widely expected decision, the Federal Reserve voted in September to raise its benchmark fed funds rate a quarter point to a target range of 2%-2.25%. This marks the Fed's third rate hike this year, and the eighth since ending its zero interest-rate policy in December 2015.

What caught the attention of many analysts was the Fed's accompanying statement, in which it removed the phrase, "monetary policy remains accommodative." Fed chairman Powell downplayed the significance of the omission, stating only that the phrase was no longer useful and that there was no change in the path of Fed policy. Hopefully, the phrase's removal signals nothing more than that the Fed's target rate is approaching neutral, and that the Fed will need a solid reason for continuing to tighten above neutral, thereby actively restraining the economy. Recessions have often followed periods in which the Fed continued to tighten beyond the point necessary to control prices. Consensus market expectations are for another quarter point hike in December, bringing the upper band of the fed funds rate up to 2.5%, and only two more hikes in 2019, stopping at 3% by mid-year. The major risk here is that the Fed continues to over-tighten rates into 2020 just as the economy's growth is topping out, causing bond vigilantes to push long term interest rates down, thereby inverting the yield curve and hastening a recession. But that is next year's concern.

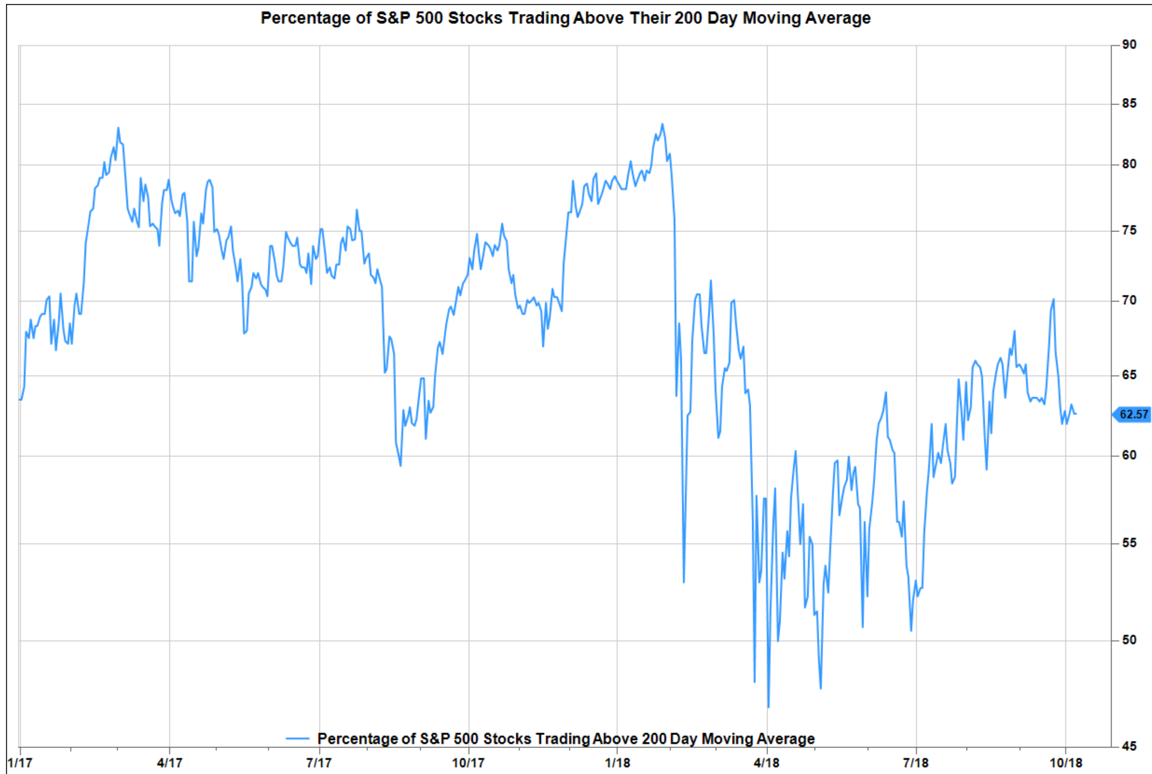
For now, the economy continues to strengthen. The Fed raised its forecast for GDP growth in 2018 to 3.1%, up from its June forecast of 2.8%. For 2019, however, the Fed merely inched up its forecast to 2.5% from 2.4% in June. Consumer confidence hit an 18-year high in September, and CEO confidence remains near a 7-year high, consistent with upwardly revised economic growth estimates. And upwardly revised jobs reports for July and August indicate that the jobs market is stronger than at any time since Neil Armstrong walked on the moon in 1969. The unemployment rate has dipped to 3.7%, in an economy for which 4% is considered full employment.

The strong economy continues to translate into excellent earnings growth, with the bulk of the gains now coming from basic business success, not tax cuts. Obviously, tax cuts served as a "jump start" for 2018 earnings, but sales growth was the primary driver of 2nd quarter earnings across a majority of S&P sectors, expanding operating margins and accelerating growth from core business operations. Wall Street analysts are forecasting earnings gains of 21% and 17.7% for the 3rd and 4th quarters, respectively.

These lofty expectations serve to moderate valuations, with the S&P now trading at slightly under 17 times forward year's elevated earnings estimates, but as we have indicated in previous *Outlooks*, investors should exercise caution before taking comfort from such an apparently modest multiple. First, these are, by any historical measure, late cycle earnings, which should not be valued as highly as early cycle earnings. Second, these are *expected* earnings, not actual earnings, and rising expectations can lead to disappointment when they rise to unattainable levels. The market is trading at more than 20 times actual earnings,

down slightly from the beginning of the year when prices soared with passage of the tax cuts, but still near the highest level since the dot com bubble early in this century.

Technically, the market is giving mixed signals. With the major market indices near all-time highs, barely 50% of all stocks are above their 30-week moving averages. Looking at just the 500 issues that comprise the S&P 500 Index, the number of stocks above their



moving average has fallen to barely 62% from 70% just a month ago. Amazingly, just 5 stocks - Amazon, Apple, Microsoft, Alphabet (Google), and Netflix – have accounted for nearly half of the S&P 500's year-to-date return! So despite the positive headlines, the lack of breadth means that many investors have yet to feel the glow. In a way this is a positive, as it means that the irrational exuberance that normally precedes market tops has yet to manifest itself.

Finally, with less than 6 weeks left before the midterm elections, we have found this fascinating tidbit to share: the S&P 500 has not declined in the twelve months following a midterm election since 1946. Skeptics may question the usefulness of this factoid, but it *has* worked 35 times in a row. It is doubtful that any other predictor has done as well.

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