The Cobblestone Advisor

Investment Brief

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COBBLESTONE CAPITAL ADVISORS

Two Movies on the Same Screen

Americans can hardly be blamed for waking up some mornings and feeling as if they are being asked to watch two different movies playing on the same screen. Beyond the normal cognitive dissonance that can be induced by our increasingly partisan politics, there are real and historically unprecedented divergences between opinions about the policies of our government and our perception of the overall economic health of the nation.

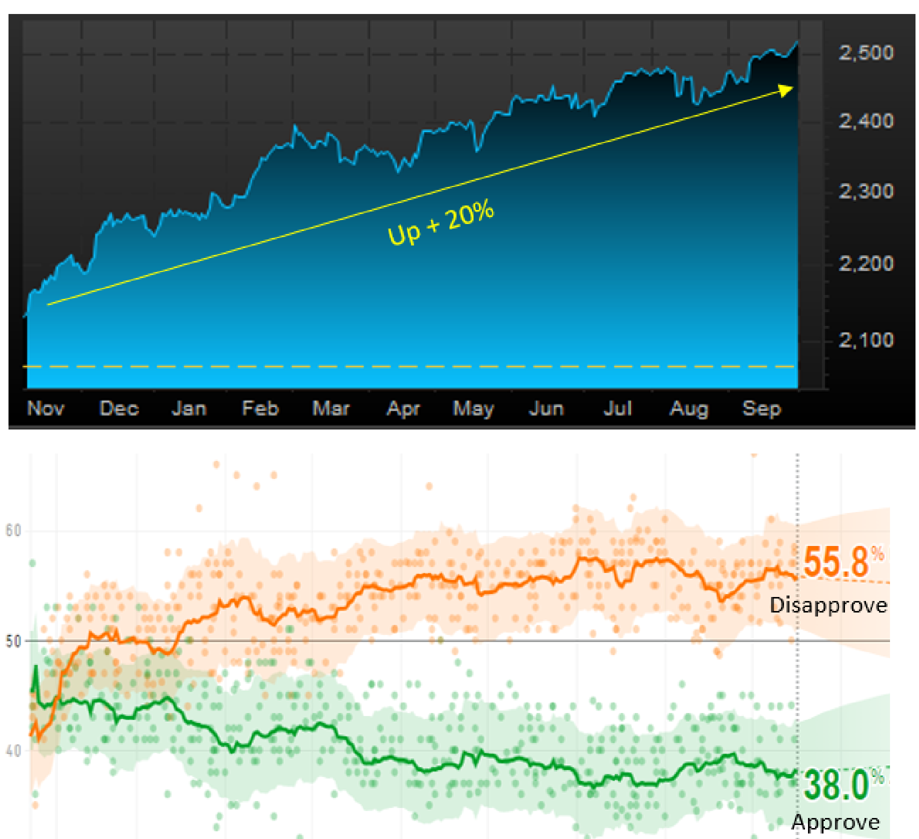
On the one hand, there is an increasingly unpopular President and Congress that struggle to advance policy changes, even when these changes are broadly favored by both sides of the aisle (see: *sensible tax reform*). At the same time, the situation in both North Korea and Iran seemingly makes the possibility of a nuclear conflict as real as at any time since the end of the Cold War. On top of that, we have the recent tragedies in Las Vegas and Charlottesville, destructive hurricanes and wildfires, and controversial policies on things like immigration and climate change. The result is a country that is as deeply divided and nervous as at any time in recent memory. It's not surprising, then, that a recent poll by the Associated Press showed that just 24% of Americans believe the country is headed in the right direction.

On the other hand, Americans are surprisingly upbeat about the prospects for the economy.   While President Trump is the first President in modern history to have his term begin without a single poll showing a majority of citizens approving of his overall job performance, the percentage of Americans that respond that they approve of his "handling of the economy" is slightly larger than those that disapprove. Incongruously, as the graphic on this page illustrates, the S&P 500 has continued to climb, now up 20% since Election Day, despite a steady decline in the President's already politically disastrous approval ratings.

"It's the Economy, Stupid"

Even with this dichotomy as the backdrop, the stock market advance that started shortly after the 2016

S&P 500 Returns vs. President Trump Approval Since Election



Source: Factset, fivethirtyeight.com

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Presidential Election continued its uninterrupted climb in the third quarter. Domestically, the S&P 500 was up +4.5% for the quarter and is now up 14.5% year-to-date through September 30th. After lagging large-cap stocks from the beginning of this rally, more cyclical small-cap stocks showed welcome signs of relative strength by increasing +5.7% in the quarter. International returns remain even more robust. With developed markets up +5.4% (+ 20.0% YTD) and emerging markets up +7.9% (+27.8% YTD), the benefits of owning international equities as part of a diversified portfolio are once again becoming apparent after years of being called into question.

What's more, this rise in stocks has been incredibly smooth by historical standards. Whether looking the CBOE VIX "fear gauge", which is sitting at multi-decade lows, or a very small maximum intra-year S&P 500 decline of approximately 3% so far in 2017, it is clear that the current market rally has been one of the least volatile of all time.

So, in a world where we are bombarded by Presidential tweets and scorching, bombastic "takes" from both sides of the political spectrum, perspective can be gained by reflecting back on the simple axiom of James Carville, the famous strategist for Bill Clinton's 1992 Presidential campaign, regarding what really matters to both people and markets: "It's the economy, stupid!"

And, indeed, when viewed through that prism, the recent "steady as she goes" market ascent starts to make a lot more sense. Important leading economic indicators have ticked up in recent months, resulting in expectations for a reacceleration of GDP growth in late 2017 and into 2018. Likewise, employment data has been very strong. The unemployment rate made a cycle low of 4.2% in September, despite signs that more people are reentering the work force than at any point during this economic cycle. At the same time, inflation remains in check, average hourly earnings are spiking higher, and consumer confidence remains at elevated levels. So, in summary, we have a strengthening economy that is leading to more people getting better paying jobs. What's not to like about that? Not much. Which is why, despite very real political concerns, the stock market marches higher and the average citizen remains quite optimistic about the direction of the economy.

In this environment, however, we view the current economic and market conditions in the context of an economic cycle that is starting to get a little long in the tooth. So while we remain neutral in our outlook for stocks right now, it is not because of the political environment. Rather, we anticipate volatility returning to the market and continue to be guided by data that indicates where the economy is actually headed from here.

Total Return Ending 9/30/2017				Annualized		
	Qtr	YTD	1 Year	3 Years	5 Years	10 Years
MSCI All Country World Index	**5.18%**	**17.25%**	**18.65%**	**7.40%**	**10.16%**	**3.87%**
Russell 3000 Stock Index	4.57%	13.91%	18.71%	10.69%	14.17%	7.54%
S&P 500 Stock Index	**4.48%**	**14.24%**	**18.61%**	**10.77%**	**14.17%**	**7.41%**
Russell 2000 (Small Cap Stocks)	5.67%	10.94%	20.74%	12.13%	13.74%	7.82%
MSCI EAFE (International Stocks)	**5.40%**	**19.96%**	**19.10%**	**5.02%**	**8.35%**	**1.33%**
MSCI EMF (Emerging Markets)	7.89%	27.78%	22.46%	4.88%	3.97%	1.31%
Barclays US Aggregate Index	**0.85%**	**3.14%**	**0.07%**	**2.70%**	**2.06%**	**4.26%**
FTSE NAREIT All Equity REITs	1.11%	6.04%	2.57%	10.14%	9.93%	6.03%

CPI (through September 2017)	**0.9%**	**2.2%**	**2.2%**	**1.2%**	**1.3%**	**1.8%**