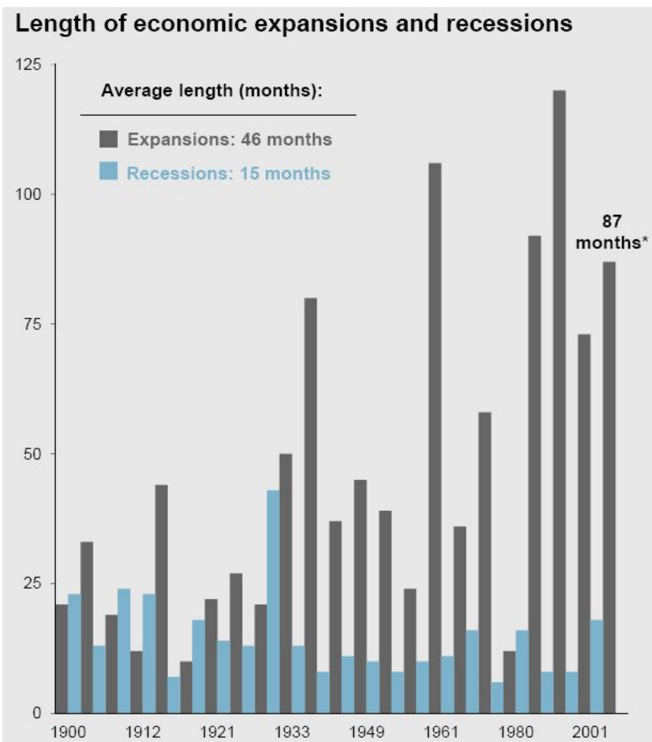
All Along the Watchtower

"There must be some kind of way out of here," Nobel Laureate Bob Dylan's iconic ballad begins, perfectly matching the seeming malaise that has settled over our country in these past few months. "There's too much confusion," the song continues, "I can't get no relief."

The Markets

The current economic expansion has reigned as one of the longest in US history – nearly twice as long as the 46 month average. It has also been among the weakest, with GDP hovering around 2%. See the chart below.



Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through September 2016, lasting 87 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/cycles/ and reflect information through September 2016. Guide to the Markets – U.S. Data are as of September 30, 2016.

However, though not robust, the economy is chugging along pretty well. By the numbers, both corporate and personal balance sheets are generally in very good shape. Historically low interest rates have enabled corporations to lower debt costs, and corporate cash as a percent of current assets is twice as much as it was in 2000. The household debt service ratio has declined and average household net worth has increased nicely. Home prices have been slow to recover, but recently seem to have gained a footing. Petroleum prices have also stabilized for the time being. The unemployment rate is seemingly under control at just under the 5% target and it appears that the Fed is now poised to begin a measured regimen of increasing rates, likely after the presidential election.

The US markets have followed with impressive results. The 5- and 7-year annualized returns for the S&P 500 are 16% and 13%, respectively. So, what's the worry?

Growing Disparity

This all sounds great, but looking deeper into the economic recovery, we see a different picture. While unemployment has improved, the average numbers don't tell the whole story. The unemployment rate for those with less than a high school education has declined from a high of nearly 16% to 7.2%. This is improvement, but a painful reality nonetheless. In contrast, unemployment among those with college education or greater peaked at just over 4% and now lies at 2.7%. And, even as profits have increased, labor's share has not kept up. Wage growth has also been much slower for the undereducated, and there is growing income disparity between the educated and the undereducated.

Technology Transformation and Globalization

Additionally, over the past 20 years, technological improvements have transformed the nature of our economy and dramatically changed the way we live and work. Many of the changes are for the better. What would we do now without our "smart devices?" Technology brings the world closer together and has accelerated a globalized economy. Those with an entrepreneurial spirit have flourished.

However, not everyone has benefited from globalization. The shift from labor intensive manufacturing to a high tech service oriented economy has caused pockets of our population to be displaced, creating feelings of disempowerment and alienation. For those left behind, "the system" isn't working. The middle class dream of owning a home and supporting one's family has been challenged. The Great Financial Crisis literally "hit home," wiping out equity for many whose homes were their major financial asset. As a result, the great middle class has become fractured and, while some have been more fortunate to rise to the ranks of the "haves," more have fallen in with the "have nots."

Headwinds

In spite of recent strong market performance, it can feel like we are going nowhere fast. Since 2000, the annualized total return for the S&P 500 index is 4.1%. This is disconcerting to the large number of baby boomers who remember the Good Ol' Days when annual returns were double the current number. This group is now nervous as they enter or contemplate retirement, expecting to live off their life savings.

Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of September 30, 2016.

Looking at the chart to the right, with the ups and downs of the market, it is no wonder we are waiting for the next shoe to drop. Since 2000, we have suffered the "Tech Bust", "9/11" and "The Great Financial Crisis," reasons enough for us to suffer from post-traumatic stress. However, protracted markets that stay "lower for longer"and move "slow and steady," might not be so bad. As long as inflation stays low, real returns will be reasonable. While there could be headwinds – such as rising interest rates and pressure to reduce our federal debt, if handled in a measured way we should be able to manage. And while there may be additional black swans lurking in the wings, we will be armored with all-weather portfolios, ready to win and prosper in the long run as we have done through all of the previous periods of turbulence.

The Presidential Election

Perhaps the biggest contributor to our country's malaise is the negative, contentious and uncivil tone of the presidential campaign, a situation disheartening to folks on both sides of the aisle. From a market perspective, however, there has actually been little reaction to the campaign turmoil. The large cap index (S&P 500) was up 3.9% and small cap index (Russell 2000) was up 9.1% in the third quarter. While we may experience volatility around the uncertainty of the election, it typically settles down once a decision is made. Both parties, as well as independents, will have a voice outside the oval office and election promises don't necessarily result in policy implementation. The good news is that historically presidential elections have had little impact on long-term market performance.

"No Reason to Get Excited"

In spite of the unusually harsh rhetoric of the current campaign, our hope is that when it is all done and over, all factions will recognize that continued polarization will not serve our country or the world well and that everyone will come to the table in the spirit of unified values and in the best interest of our great country.

And while we understand that it is difficult to maintain an unbiased perspective in the midst of all of this current unpleasantness, we want to reassure you that taking the long view remains the best course of action. On our end, we will continue to thoughtfully monitor our portfolios and will look to take advantage of dislocations that may occur in the markets.