KALOS *Market Commentary*

November, 2016

Uncertainty of U.S. Presidential Election; Third-period Economy Up; Job Growth Looks Good

As the Presidential election draws nearer, the strange and strained campaign seems to grow even weirder if that's possible. While focus on issues seems to have been limited over the past many months in favor of personal attacks, there clearly are very large differences on nearly all major issues such as taxes, health care, regulations, energy, immigration, international policy and likely supreme court nominations.

More recently, Trump's struggles have prompted some to suggest that Republicans could lose both the Senate and House, opening the way for a Clinton presidency to pass sweeping legislation hostile to business and the economy. Yet, this possibility remains highly unlikely, and the recent resurfacing of problem Clinton emails suggest even a Clinton presidency is far from a sure thing.

If Clinton wins, we are likely to see a continuation of the gridlock of the last six years, which started with the Republican assumption of control of the House in 2010. Major legislation would be scarce and few significant policy changes would result. While the gridlock is clearly frustrating to many Americans given recent poll results, that lack of major change tends to be highly positive for business and markets.

A Trump win would likely introduce significantly more volatility because of greater uncertainty. Trump's campaign and his policy promises have been anything but normal, and markets will likely struggle more to understand and adjust to his presidency. We could see both euphoria and distress by investors with markets reacting unpredictably. Longer term, markets would likely react positively given a more business friendly agenda, but the progress would likely be uneven and much less predictable.

There has also been some concern that markets could struggle with a Trump loss given his promises to fight the result. Still, while a Trump loss would obviously anger some, it seems highly unlikely that legal challenges or social unrest would be significant enough to rattle markets. Our legal system and election process, while often highly frustrating, remains exceedingly solid, and any challenge to the results should quickly devolve into sideshow.

Looking more at economic fundamentals, the pullback in profits over the last year, largely driven by struggles in the energy sector, should end in the third quarter. The reversal should pick up speed with year-over-year growth of 7 percent in the fourth quarter, followed by an even better 13 percent annual growth first quarter of 2017. Various sectors should experience improvements including finance, real estate, materials and technology, but energy companies should be the primary driver as oil prices have rebounded from a bottom of $26 per barrel early this year to around $50 per barrel.

Equity valuations are still somewhat high at around a 17 or 18 price/earnings ratio, but an increase in profits will lower valuations, and much money remains on the sidelines waiting to buy if the market drops. In addition, rising interest rates make bonds less attractive, which should drive more money toward equities.

Economic growth in the third quarter picked up, with GDP growth hitting an annualized 2.9%. Stabilizing oil and commodity prices are spurring business spending and corporate investment is projected to grow 4% in 2017.

U.S. factories ramped up activity in September, reversing a one-month contraction that also appears to show that America is resisting the downward pull of the weakening global economy. Machinery orders are also steadily recovering from the steep decline in manufacturing triggered by the strong dollar and oil bust. Net exports added to economic growth in the second quarter and The Institute of Supply Management's late October report indicated factories' future sales should increase.

The slow expansion which took quite a while to pick up speed has now delivered jobs growth for the longest period on record, spurring many Americans to rejoin the labor force. The total number of people employed plus those actively seeking work grew by 444,000 last month and a whopping 3 million over the past year. The 12-month labor-force participation rate gain, the biggest gain since the 2000 tech boom, drove the labor force participation up half a percentage point over the past year to 62.9%. The expanding labor market is finally benefitting a larger share of workers and wages are starting to increase too, a welcome trend that should boost the economy in the future.

Still, while various trends in the US continue to look attractive, there are always some clouds on the horizon. Today, one of the more serious long-term challenges likely comes through global politics and the rise in populism.

The protectionist policies often sound attractive because specific losers of global trade can always be easily highlighted. But a reversal of the post WWII free trade integration that has spurred tremendous increases in wealth has the potential to devastate global growth, suppress investment and further increase political risk.

As Roberto Azevedo, director general of the World Trade Organization says, "Too many politicians are backing trade barriers in a misguided effort to boost national growth in the short term…. The medicine that is being often prescribed is protectionism, and that is exactly the kind of medicine that is going to hurt the patient, not help him."

A dangerous cycle could develop as highlighted by the International Monetary Fund (IMF). More weak growth encourages more protectionism which fuels a stronger backlash against trade that would further depress output. Officials from around the world have voiced deep worries about the trend already emerging. Those of you who are students of economics will recognize that similar circumstances and the ensuing bad policy choices launched the 1930's depression. We are not there yet, but the dangerous trend bears watching.

Still, while the post-2008 recovery has now moved well beyond the average expansion duration at 86 months versus a post-war average of 58 months, it should continue. Expansions do not die of old age, they nearly always die of excess in the form of inflation, monetary policy, capital spending, capacity utilization, debt, or some other trigger. Essentially, a bubble of some sort pops. While no one may have wanted our slow, anemic recovery that has never really launched, one clear benefit is its complete lack of excess. With no bubble to pop, the slow plodding expansion should keep moving forward, and take markets with it, albeit at a likely modest pace.

Daniel Wildermuth
Kalos Management, Inc.
CEO

The opinions in the preceding commentary are as of the date of publication and are subject to change. Information has been obtained from third-party sources we consider reliable, but we do not guarantee that the facts cited are accurate or complete. This material is not intended to be relied upon as a forecast or investment advice regarding a particular investment or the markets in general, nor is it intended to predict or depict performance of any investment. We may execute transactions in securities that may not be consistent with the report's conclusions. Investors should consult their financial advisor on the strategy best for them. Past performance is not a guarantee of future results.

Securities offered through Kalos Capital, Inc., Member FINRA/SIPC/MSRB. Investment advisory services offered through Kalos Management, Inc., an SEC Registered Investment Adviser. Insurance products offered through Kalos Financial, Inc., a licensed insurance agency. These members of the Kalos Family of Companies are separate affiliated firms that share common ownership and are represented by the Kalos Financial service mark.

11525 Park Woods Circle, Alpharetta, GA 30005
Phone: 678.356.1100, Toll Free: 866.525.6726,
Facsimile: 678.356.1105,
ClientServices@KalosFinancial.com

KALOS MANAGEMENT