October Market Outlook

Bullish

- Earnings forecasts for 2017 are higher. But, analysts are notorious for being too optimistic, especially as an economic and market cycle ages.

- For much of the year, earnings forecasts were constantly being lowered. Now they look like they're stabilizing – for now.

- Interest rates, inflation and oil prices remain low, and are good for the economy and asset prices.

- Credit spreads have improved:

- Merger and acquisition activity remains active (Microsoft & LinkedIn, Sherwin-Williams & Valspar, Fortis & ITC Holdings, Great Plains Energy & Westar Energy, ADT & Protection 1, Columbia Pipeline & Trans Canada, Starwood & Marriot, Agrium & Potash….)

- Company share buybacks continue, but at a slower pace.

- Global low to negative rates have helped global money gravitate to U.S. debt and equity markets.

Bearish

- Earnings are expected to be slightly negative for this reporting period (3^{rd} quarter), making it six quarters in a row.

- China and the global economy are slowing

- Brexit is making the global economic outlook cloudy. The repercussions are being felt in China, Japan, the Middle East, and the Americas, and especially in England and the British pound.

- Isis and the Middle East create uncertainty, instability and danger. The effort to drive out ISIS from Mosul could bring bad news (U.S. casualties, more refugees, more terrorists attacks).

- Markets are overvalued

- Global central banks, and especially ours, are running out of effective monetary bullets to help our economies, especially if we have a global recession or major financial crisis

- The collapse in oil prices is hurting many energy based economies (Russia, Mexico, Venezuela, Nigeria….). Low oil prices are also hurting the U.S. energy industry and we've seen layoffs, bankruptcies and loan defaults.
- This economic and market cycle is maturing and may enter a decline phase (some indexes and many stocks have entered decline, bear markets).
- U.S. elections are causing concerns among economists, analysts and investors. As we near November 8th, the outlook for the elections seems to be clearer.
- The Federal Reserve may raise rates in December.
- Capital spending has slowed to .5% due to the lack of confidence in global economic growth.

Earnings Forecast Trends

Below is the earnings trend for the Dow 30:

	2016	2017
4/18/16	1079.93	1217.96
4/25/16	1078.33	1217.21
5/9/16	1072.06	1213.97
5/16/16	1073.54	1212.23
5/23/16	1074.94	1213.14
5/30/16	1073.33	1212.85
6/6/16	1074.14	1213.71
6/13/16	1074.13	1213.61
6/20/16	1074.06	1214.05
6/27/16	1073.52	1214.16
7/4/16	1070.78	1212.88
7/18/16	1068.30	1209.55
7/25/16	1072.95	1212.01
8/1/16	1060.23	1211.51
8/15/16	1056.28	1209.08
8/22/16	1057.34	1209.88
8/29/16	1057.41	1210.01
9/5/16	1057.78	1210.14
9/12/16	1057.28	1210.02
9/19/16	1057.48	1209.93
9/26/16	1058.39	1210.03
10/3/16	1058.54	1209.11
10/10/16	1058.82	1207.80

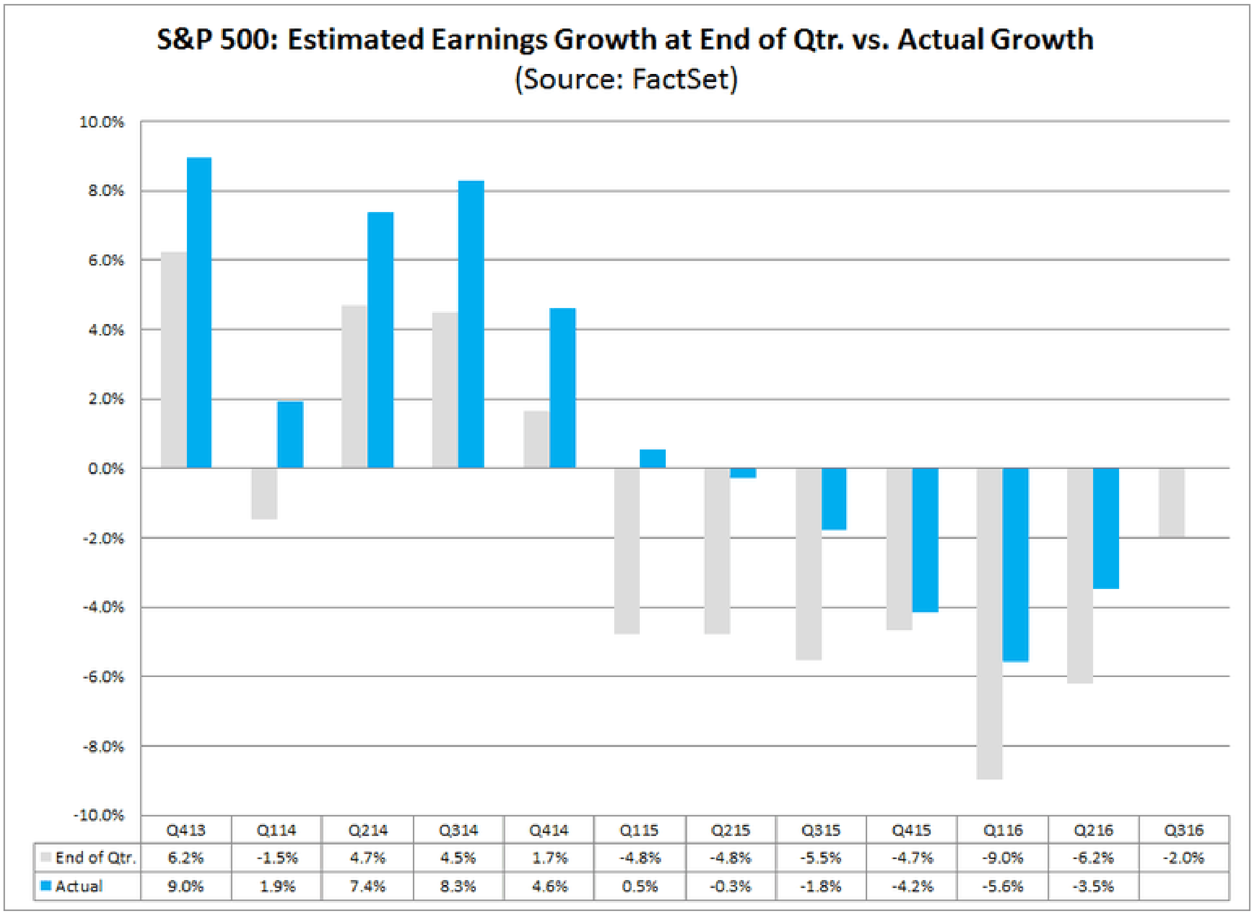
Source: Thomson Reuters, Barron's, Dan Hassey database

For 2016, earnings forecasts had been falling, but bottomed in the middle of August. The earnings forecast trends have stabilized and are slightly up.

For 2017, earnings forecasts seemed to find a bottom around August and started to stabilize, but the latest consensus forecast has dropped again. Falling earnings forecasts makes the markets, stocks vulnerable to the downside.

It is because of the changes in earnings forecasts is why I provide changes to my price projections for the S & P 500 and Dow 30.

Below is a trend for earnings forecasts, actual reported earnings for the S & P 500:



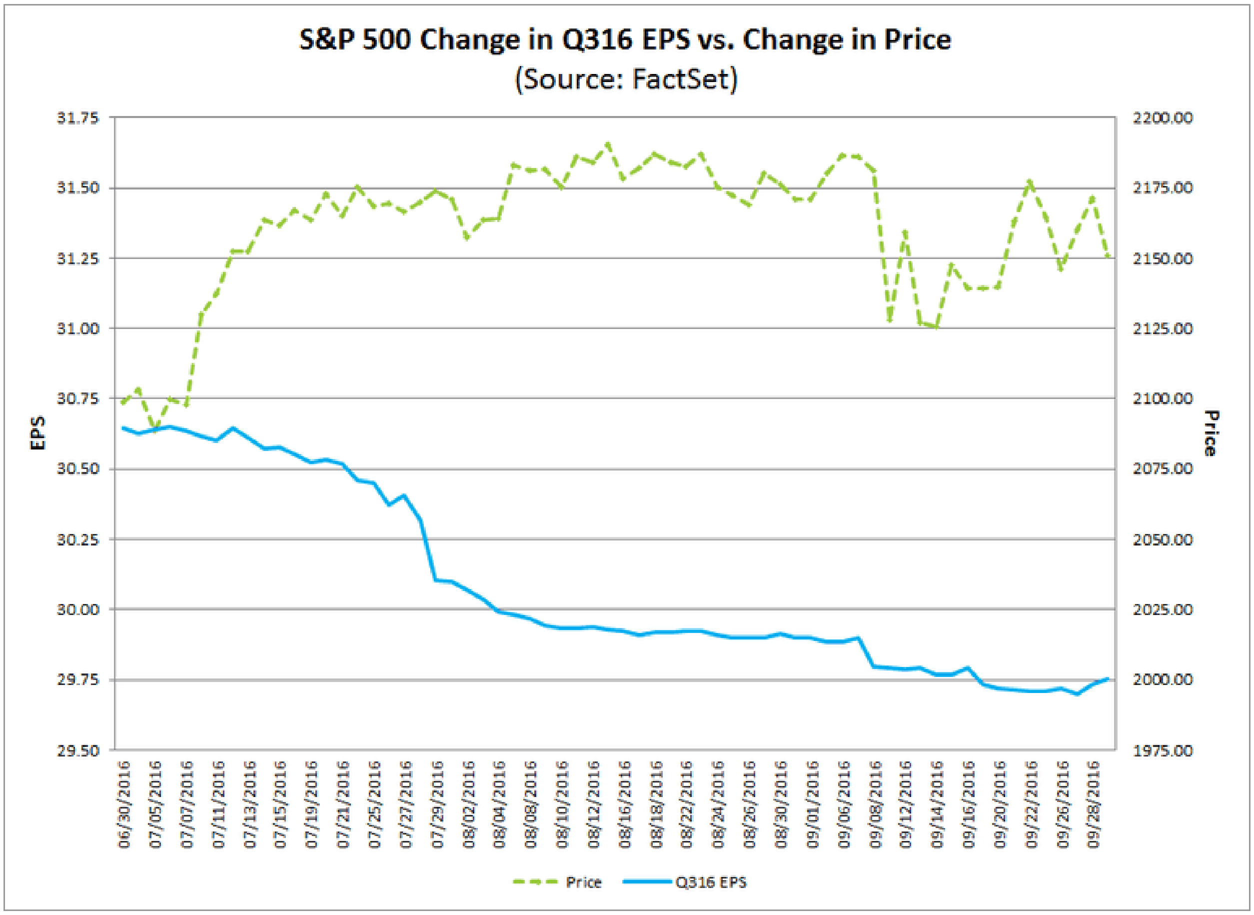
Source: FactSet

Analysts are forecasting a 2% decline for the 3rd quarter, the current reporting period.

The chart does show that reported earnings were better than forecasts. Another reason why the markets are doing better despite weak earnings.

It's surprising that the market is not down for the year reflecting the negative trend in earnings. Again, low to negative global interest rates are attracting global capital to U.S. equities keeping equity prices elevated.

Below is a chart showing the important relationship between earnings and market prices.



Despite earnings falling, prices have held up thanks to low global interest rates, and better than expected earnings.

Dow 30 and S & P 500 Price Targets

Below is my latest forecast based on recent consensus forecasted earnings for the S &P and Dow 30.

2016 FORECAST					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1058.82	15	**15,882.30**	18,167.00	-14.39%
SPX	120	16	**1,920.00**	2,140.00	-11.46%
2017 FORECAST					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1207.8	15	**18,117.00**	18,167.00	-0.28%
SPX	127	16	**2,032.00**	2,140.00	-5.31%
HIGHER P/E 2017					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1212.85	16	**19,405.60**	18,167.00	6.38%
SPX	127	17	**2,159.00**	2,140.00	0.88%

Earnings Forecast Source: Thomson Reuters, Barron's

I use a lower P/E where I would pay for these earnings and markets based on slower growth, rising risks, and as our economic and market cycle is aging. Using a prudent P/E the markets are overvalued this year and next. From an investment point of view, 2016 is essentially over.

For 2017, if we use a slightly higher P/E for next year, the Dow 30 does have some upside, if earnings estimates are met. The S & P is fairly valued using a higher than normal P/E.

The markets will probably remain in its trading range that it's been in for about the last two years. My next outlook will focus on the technicals, price analysis of the markets.

IF YOU ARE A RESIDENT OF CALIFORNIA, AND YOU WOULD LIKE HELP WITH YOUR PORTFOLIO, INCLUDING A SECOND OPINION REGARDING YOUR HOLDINGS, CONTACT DAN HASSEY AT dhassey@digeorgia.com.

Dan Hassey's passion for investing began over 30 years ago while getting his MBA from UCLA. Dan has worked for prominent investment firms including Merrill Lynch, Paine Webber, Fidelity Investments, and Charles Schwab. Click here to learn more about Dan Hassey's academic and investment background from his LinkedIn page.