The Trust Company of Virginia

Review & Outlook – 3Q 2017

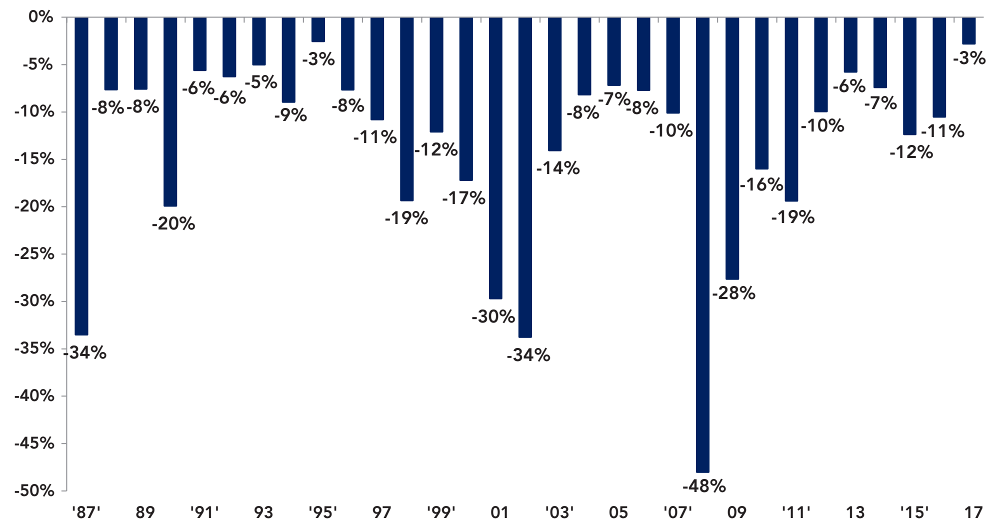
Nearing the end of the year creates a natural inclination to reflect on where the markets have been, where they are, and where they may be in the future. In the third quarter the song remained very much the same as previous quarters; the S&P 500 was positive and returned 4.5% for the quarter and up 14.2% for the year thus far. Entering the fourth quarter the historical uniqueness of this equity market has become well known but no less remarkable:

- The first year on record without a monthly negative return
- The smallest intra-year drawdown (-3%) in over 20 years
- Record high closings on 39 days
- 8 Consecutive positive quarters
- The smallest number of 1% daily moves in over 50 years

The situation today in equity markets and the economy is no different than it has been throughout 2017: political uncertainty remains in Washington, stocks appear expensive to some, yet the market keeps climbing… and with remarkably low volatility. One of the big under-reported stories this year has been that the six quarter long (1 ½ years) earnings recession of 2015/2016 ended in the fourth quarter of last year and corporate earnings growth has rebounded and accelerated nicely this year. This earnings growth is fueling equity returns without further expanding valuations. Also, today's low level of inflation (around 2%) has historically supported forward price/earnings ratios that are in line with the current market multiple.

The global cyclical recovery in developed and emerging economies is taking hold. Japanese economic data has beaten expectations, is showing improved economic growth, with rising consumption and a hint of inflation supported by the Governor of the Bank of Japan's pledge to pursue an accommodative monetary policy for "some time". A majority of emerging market central banks are also loosening monetary policy, with the exception of China. The Eurozone economies grew at a healthy 2.1% and the political situation in Europe appears to have stabilized. Angela Merkel won a fourth term as German Chancellor despite her party losing seats and the far-right AfD gaining representation in Parliament for the first time in 60 years, showing that populism is retreating though not quite extinguished.

S&P 500 Largest IntraYear Drawdowns



Diminishing global political risks and expansionary monetary policies have led the OECD to forecast that no major global economy will be in recession in 2018 which hasn't happened since before the recession of 2008. According to an Oxford Economics Global Risk Survey, investors see policy errors driving the U.S. into recession as the biggest potential global economic risk. The upcoming political calendar looks ominous with a debt ceiling raise scheduled for December, a tax plan being debated and mid-term elections just a year away. In addition, the Federal Reserve may raise interest rates in December and possibly three more times in 2018 while beginning to unwind its $4.5 trillion balance sheet despite inflation persistently below their 2% target. Policy risks certainly may cause a return of volatility in equity markets, which are overdue for a pullback, but we remain committed to our discipline: staying globally diversified and seeking companies with strong cash flows, competent management and dominant positions in their industries trading at reasonable prices.