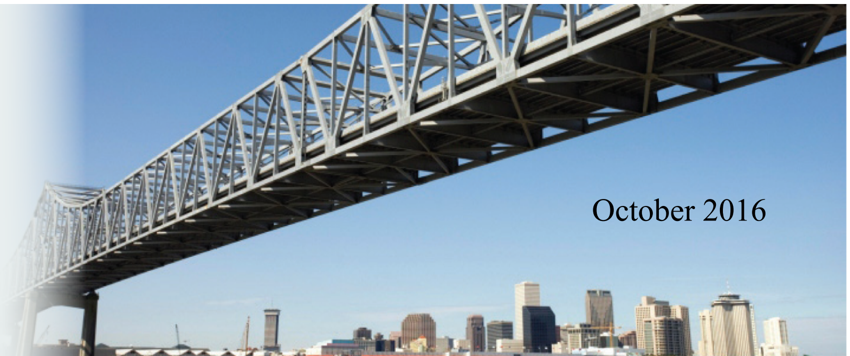

DELTA FINANCIAL ADVISORS

Investment Counsel

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Economic Comments

Coming as no surprise to most, the Federal Reserve left short-term interest rates unchanged following its late September meeting but also signaled its expectation that rates would be raised before year end. With policy makers deeply divided regarding the direction of interest rate policy, this solomonic decision created a temporary truce among officials over when and how to withdraw financial stimulus from the economy. On the one hand, some policy makers believe that the labor market has room for improvement. Allowing unemployment to fall further below its current levels would give more Americans a chance to rejoin the labor force.

The counterargument is that if the jobless rate is allowed to get too low, prices could surge, pushing the Fed to raise interest rates faster than targeted. This action could in turn trigger a downturn. The challenge is that nobody knows precisely when the Goldilocks moment will be achieved, i.e. the lowest level that unemployment can be sustained without causing inflation to uncontrollably accelerate. Current estimates from both the Federal Reserve and the Congressional Budget Office place this level, also known as the nonaccelerating inflation rate of unemployment, or Nairu, at 4.8%. Unfortunately, the only way to confirm this level is in hindsight – when policymakers would be scrambling to respond from having gone too far.

The recent meeting also had officials pare down their estimates for long-run economic growth, as well as for the anticipated path of interest rates. Policy makers now project only one additional rate increase this year, two next year and three each in both 2018 and 2019. Expectations for long-term economic growth were reduced to a 1.8% increase per year, down from 2.0% as recently as June. Despite this more tepid longer-term forecast, Fed Chair Janet Yellen offered a more upbeat assessment of the current economic outlook. She noted that growth has picked up after a dismal first half, with household incomes growing solidly and more workers rejoining the labor force.

To underscore this position, some economic gauges are at historically strong levels. The unemployment rate has been at or just under 5% for nearly a year. The 12-month moving average of job creation, at 204,000 a month, is above the long-run average. That being said, September's job growth was more modest at 156,000 jobs, although average wages did increase, thereby suggesting a more steady labor market. Separately, September's unemployment increased by a tenth of a percentage point to 5.0%. This slight increase was actually a positive as the increase came as 444,000 discouraged Americans rejoined the labor market by either finding jobs or resuming their job searches. With this jump, the labor force participation rate improved to 62.9%. While still near historic lows, this reading represents an improvement over levels seen last fall. Nonetheless, and even with the latest progress, millions in America remain underemployed with the share of residents who are jobless, involuntarily stuck in part-time work or too discouraged to look for a job standing at 9.7%.

While gross domestic product accelerated from the 1st

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Economic Comments continued from cover

quarter's 0.8% pace, the 2nd quarter's 1.4% increase was still slower than the roughly 2% annual rate averaged since the end of the recession following the Financial Crisis. Business investment remains one of the biggest drags on the economy as companies, squeezed by narrowing profits, have curtailed spending on equipment and structures. According to the U.S. Commerce Department, a closely watched measure of business spending, fixed nonresidential investment, has declined for the past three quarters. Additionally, a proxy for spending on new equipment — new orders for nondefense capital goods excluding aircraft — has declined on a year-over-year basis almost continuously for the past year and a half.

The lack of business investment is clearly reflected in diminished worker productivity. Labor productivity has recently undergone its longest slide since the late 1970s. Per the U.S. Labor Department, the nonfarm business productivity adjusted annual rate declined in the second quarter 0.4% from a year earlier. This represented the first annual decline in three years. That was a further step down from an already tepid average annual productivity growth of 1.3% from 2007 through 2015, itself just half the pace seen from 2000 through 2007.

Unfortunately, the trend shows little sign of reversing itself. The problem is that over time, persistently weak, or even declining, productivity will reduce individual Americans' living standards by restraining the economy's ability to grow quickly and generate higher incomes without stoking too much inflation.

With the economic data somewhat murky, so too is consumer confidence. Recent confidence surveys have yielded conflicting results lately with polarized political views playing a significant part in the outcomes. The influential Conference Board survey recently showed consumer confidence surging to a nine- year high while at least two other surveys showed many Americans convinced that the economy is getting worse rather than improving.

The economic script envisioned as 2016 started has certainly not played out as expected. While economic growth has continued, it has not accelerated. Signs of stronger inflation remain absent, and increasingly Fed officials have started to wonder whether the economic world has changed since the global Financial Crisis of 2008.

While some policy makers continue to express concern over the tightening labor market, which should lead to higher wages and prices, other central bankers believe that there remains plenty of time to react if inflation accelerates. The only certainty is that the consequences of policy makers' actions, or inactions, will be felt by all for years to come.

Analyst Corner

In the face of renewed concerns over interest rates, higher dividend paying stocks, such as AT&T *(NYSE: T),* have backed off from their recent highs. The largest U.S. telecom company, and one of the largest telecoms in the entire world, T sells traditional telecom services along with cellular and satellite services. With largely recurring revenue streams, the company's operations are remarkably stable. This stability allows the company to pay a large dividend which in turn helps make the stock less volatile. However, given T's large size and more mature markets, its revenue and profit growth is more modest and utility-like. Nonetheless, at current levels we believe that adding exposure to this stock could be a strong addition to many portfolios.

Market Comments

After a largely range-bound September, Wall Street closed out the 3rd quarter having clocked an almost 8% return year-to-date. On the back of the surge of energy prices to the upper $40/ barrel of oil, the energy sector has been leading the market with returns of almost 19% for 2016. The recent market laggard has been the healthcare sector with year to date gains of only 1.4%. In the face of political headwinds and continued challenges with Obamacare, the sector is now trading at a discount to the broader S&P 500 for only the second time in 25 years. Interestingly though, recently popular dividend stocks started to feel some wintery chill as the quarter closed with the hot utility and real estate sectors showing unusual and consistent losses in the last week of the quarter. Driving these shares' sell off appears to be investor desire to re-position their holdings in advance of anticipated interest rate increases.

On the interest rate front, the 10-year Treasury closed out the quarter at a 1.61% yield, having increased 8% over the prior quarter. In general, bond prices are tied closely to the outlook for growth and inflation in coming years. On face value, longer-term interest rates prevailing across the major developed economies should be consistent with a disastrous economic future. Global yields imply expectations of inflation remaining extraordinarily low for years to come and that economic growth will stay so weak that central banks will not raise rates for many years. In actuality, the current situation is by no means this dire as many purchasers of government bonds do so because they are required to hold these securities. Additionally, central banks have become the biggest overall buyers of bonds (as part of their quantitative easing efforts). As a result, bond demand has grown while supply has been more limited, as governments have generally been restrained in issuing large amounts of new bonds. The end result is strong demand for bonds coming from institutions that are willing to buy at almost any cost along with a relatively limited supply of government debt. So even though in normal times bond prices give useful information about the likely path of inflation and growth, we believe that in the current environment these indicators are less useful.

In the face of Brexit, a coup in Turkey, and an increasingly unstable American relationship with both China and Russia, stock investors have had plenty of cause to be nervous. Yet, Wall Street appears largely unconcerned. The VIX stock volatility index remains close to its recent historic lows and at least 25% beneath more normal historic levels. Investors appear confident that central bankers will once again ride to the rescue in the event of global turmoil. Already the easy-money central bank policies have provided key support for stocks' continued climb, even as corporate earnings have shrunk. In fact, many buyers of stock have been using the extremely low government bond yields as justification to buy more stocks in a search for yield, thereby pushing up major indexes.

Looking forward to the upcoming corporate earnings season, the third quarter was supposed to be when earnings growth finally returned to U.S. companies. However, the S&P 500 are now expected to report an earnings decline for the sixth consecutive quarter, according to analysts polled by FactSet. This earnings slump would be the longest since FactSet began tracking the data in 2008. As recently as three months ago, analysts estimated U.S. corporate earnings growth would return to positive territory by the third quarter. Current predictions are now for a 2.3% contraction from the year-earlier period. A key component of this slump is the energy sector with a projected 66% decline in year-over-year profit. If the projected decline occurs, it would mark the eighth consecutive quarter that energy companies in the index have reported a year-over-year fall in earnings. If the energy sector however, were to be excluded, S&P 500 earnings in four of the past five quarters would have been positive.

Looking forward, the fate of the broad 2016 rally that has lifted the prices of everything from American stocks to emerging markets will likely hinge on what happens this autumn to U.S. corporate profits and interest rates. About the only certainty we have is that investors should continue to have a financial plan and stick to the plan through both good and bad markets!

Performance as of 9/30/16

	Close	Month	YTD	1 Year
DJIA	18,240.49	-0.41%	7.21%	15.46%
S & P 500	2168.27	0.02%	7.84%	15.43%
NASDAQ Comp.	5312.00	1.89%	6.08%	14.97%

	Quarter end yield	Prior Year end yield	Yield 1 year ago
10 yr. U.S. Treasury	1.61%	2.27%	2.06%

Planning Thoughts

In the event of a sudden illness, keeping good financial records can be vitally important. In prior years, we have suggested a couple of different means to organize critical personal/financial information. One of the best resources currently available is “What if…..Workbook: Give the Gift of Preparedness to Your Loved Ones” by Gwen Morgan.

For those more electronically inclined, we had also recommended a website based organizer that can be found at Everplans.com. In the intervening 2 ½ years since our original recommendation, the Everplans site has only gotten better. We strongly recommend that you take a look at this website to see if it meets your needs.

Whether you choose to keep these vital records electronically or with a more traditional notebook/ folder organizer, we urge you take action now. Your loved ones will greatly appreciate this final gift to them from you!

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