KNOX & DOWNING
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Perhaps it is the first blaze of color in the hardwoods, a dusting of snow in the mountains or a touch of frost on the grass that means October in Maine to most. To the less prosaic of us in the investment business, October often seems to mean market uncertainty and volatility as we greet the last quarter of the year. Having experienced the October drama of 1987 and 2008 in the stock market during our careers, the month is always met with some trepidation.

Younger investors have also been given a few reasons to be uncomfortable in October as last year's collapse in the stock market in the fourth quarter seems to be repeating itself in the first few trading days of this year's final three months. The enthusiasm of a year to date advance of 20.6% in the S&P 500 as of September 30th has been muted by the fact that the market is only a few percentage points above where it was at this time last year. A lot of the rally in 2019 was expended in gaining back what was lost in the fourth quarter of 2018.

While we all place more weight on our most recent experiences, like last year's fourth quarter decline, it is important to remember that the average fourth quarter performance of the S&P 500 since 1980 has been an advance of 4.1% according to Argus Research. While the fourth quarter has historically been the best quarter of the year for the S&P 500 it seems that a lot of dramatic events for the market have occurred in this period as institutional investors book gains and losses for the current year and adapt their forecasts for the upcoming year.

There are certainly issues of concern to investors as we enter the fourth quarter this year. On the political front we have the dueling dramas of a presidential election and possible impeachment. One would be more than enough to rattle investors as the election, while more than a year away, will probably pit two starkly opposing economic views against one another. The prospect of impeachment lends an air of uncertainty to any number of issues including the possible resolution of the trade and tariff dispute with China.

In addition to the political turmoil, recent economic data has been troubling as the ISM manufacturing index has registered consecutive monthly readings under 50% indicating a contraction in manufacturing. How much of this contraction is due to trade policies or the general worldwide economic slowdown is uncertain. In addition, the growth in the service sector of the economy is also slowing according to ISM data. The September reading of 52.6, while still representing growth in the sector, is the lowest reading in 3 years. Combined with the manufacturing decline the reduced growth rate in the service sector only increases recession fears.

There are more than enough gloomy headlines to justify the fear of a repeat of last year's fourth quarter decline in the stock market but there are some positive factors as well.

According to Argus Research the yield on the 10-year U.S. Treasury Note in October of 2018 was 3.25% and the Federal Reserve (Fed) was in the process of raising interest rates with the final boost coming in December of 2018. The Fed is now decreasing interest rates and the 10-year U.S. Treasury Note is yielding about 1.6%. While this decrease is bad for savers it is generally good for borrowers and stock market investors.

Corporate earnings, while growing at a far slower rate than in 2018, are still positive for the year and valuations in the stock market do not seem extreme. Earnings per share estimates for the S&P 500 in 2020 are in the $175 range giving the S&P 500 a forward price/earnings ratio of about 16X according to Leon Cooperman of Omega Advisors. With the 10-year U.S. Treasury yield at 1.6% or so, a stock market at 16 times earnings with a yield of about 2% isn't overly expensive in our view. Many stocks selling at reasonable valuations offer yields well in excess of 2% and a good record of dividend increases, so there are pockets of value in the stock market.

The tendency in quarterly investment newsletters is often to focus on both the recent past and immediate future while for most long-term investors the quarterly fluctuations in the markets are far less important than adhering to long term strategies. We have enjoyed a relatively strong stock market since the recession of 2008-2009 and coupled with the length of the economic recovery it is certainly reasonable to expect some sort of slow down and perhaps more modest returns from stocks. At times like this, it is important to review long term asset allocation targets, possible cash needs over the next few years and overall risk tolerance.

We don't know how the stock market will fare in this tumultuous October, but we believe with adequate preparation investors can weather the approach of winter. We still have glorious fall days ahead as the foliage reaches its peak and the last warm breezes of summer fade.

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