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The third quarter of 2016 proved to have the volatility we have become accustomed to at this time of year, with a few twists thrown in for good measure. As we get closer to the U.S. election, and to an increase in the Fed Funds rate sometime this year, we expect additional volatility in the equity and fixed income markets. For the quarter, the Dow was +2.1%, the S&P was +3.3%, the NASDAQ finished + 9.7%, while the benchmark 10-year Treasury Bond closed out the quarter at 1.60 %.

There were some interesting developments at the end of the quarter which are worth mentioning because of their potential impact on the fourth quarter and perhaps into 2017. Against the consensus opinion, OPEC came to an agreement to curtail output for the first time in eight years. This caused the per barrel price of oil to close near the $48 level. This may have created a floor for oil, though supply from the U.S. and other non-OPEC countries, as well as diminished demand around the world, will likely keep oil in a tight range between $45 - $55 for the next 12 months. In addition, during the second quarter, the United Kingdom voted to leave the European Union. This created a short term downdraft in the equity markets at home and abroad. Many investors expected Britain's economy to immediately plunge into a recession. However, after an initial slowing of economic activity, the U.K. economy has rebounded smartly in the third quarter. It will take a few years to assess the ultimate result of the separation, but it may in retrospect look like a good decision.

This quarter we have also witnessed German and Italian banks struggling with capital and liquidity issues. The latest news about Deutsche Bank, its potential lack of liquidity and possible need for a government bailout has unsettled global financial markets, and has reminded us about the downside of global financial interconnectivity. We think for now the Deutsche Bank issues will be resolved, and the probability is low that it will turn into a Lehman Brothers event. However, the situation warrants monitoring.

As we look toward the fourth quarter, there are a number of forces that will dictate the direction of interest rates and the equity market. The United States will elect a new President. The Federal Reserve will raise interest rates. Domestic mutual funds will take gains and losses as they reposition their portfolios and look to close out their books for year end. Overseas, negative interest rates and questions about the stability of the European banking system will linger. Violence in the Middle East will continue to drive more immigrants into Turkey and Europe adding to instability in the region. Russia will add to the violence and destabilization of both Eastern Europe and the Middle East, and the Asia Pacific region will be dominated by news of China's aggression in the South China Sea, and the "testing" of ballistic missiles by North Korea.

What we will watch for most closely is the likelihood of having any of the aforementioned challenges, or some other exogenous event, tip the U.S. economy into a recession since we have had such a tepid rate of growth during this recovery. Please call with any questions or if you would like to set up a meeting to discuss your portfolio and objectives.

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