



STOCK MARKET OUTLOOK

FORECASTS OF FUTURE ASSET CLASS RETURNS

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COMMENTARY

*1. Zacks October View on Equity Markets***U.S. Markets**

I am going to start this U.S. overview with Eurozone budget data. Eurozone data you ask? Shouldn't that be in the global overview? Not this month. This month, I will have USA and Mainland China trade data in the global section.

What am I thinking harder about? The big policy issues most investors to this publication would like to know more about? -- U.S. trade and tax decisions.

What does this PhD economist need to do first? Cover tax changes. To start, I don't know much of what is going to actually happen on the Federal budget. The House and Senate both must approve a finalized tax plan. That's where the rubber meets the runway.

Tax plans come with joint decisions on personal and business taxes, debt financed spending, and revenue sent to Federal programs to fund needed operations -- like national defense, Medicare, and interest on the huge accrued debt.

A core matter then concerns annual Macroeconomic Balances. I want to share more on that in this letter. There's a logical structure. Most of you are not aware of it. That is the relationship trade balances and their financial sister --current account balances-- have with Federal budget balances. You cannot violate this.

All economies --regardless of size-- function under Macroeconomic Identities.

Aggregate Demand (Spending) = Aggregate Supply (Output)

which implies

$$\begin{array}{lcl} \text{Consumption(C) +} & & \text{Domestic Production of} \\ \text{Investment (I) +} & = & \text{Goods and Services +} \\ \text{Government (G) +} & & \text{Imports} \\ \text{Net Exports (NX)} & & \end{array}$$

Below: The latest Consensus Economics macro balances for the Eurozone.

	Current Account Balance (% of GDP)		Budget Balance (also % of GDP)	
	2017	2018	2017	2018
Netherlands	9.9%	10.3%	0.8	0.9
Germany	8.4%	8.6%	0.7	0.6
Ireland	5.7%	4.7%	-0.6	-0.6

Austria	2.0%	2.0%	-1.2	-0.9
Finland	0.0%	-0.1%	-2.3	-1.8
Italy	2.5%	2.5%	-2.3	-2.0
Portugal	0.6%	0.4%	-2.0	-2.2
Belgium	0.1%	-0.1%	-2.2	-2.3
Spain	1.8%	1.9%	-2.5	-2.5
France	-1.2%	-1.2%	-3.3	-3.1

Study this table of twin balances closely. See the relationships? Macro Identities predict.

Tight countries with bigger Budget Surpluses (the Netherlands, Germany & Ireland) run bigger Current Account Surpluses (identical to Trade Surpluses). Loose countries at the bottom (France, Spain, Belgium, Portugal & Italy) run the largest Budget Deficits. The identical countries also accrue the biggest Trade Deficits.

This is a key point I want to make -- on the USA-- and any other country.

The bigger your Federal budget deficit, the bigger is your national trade deficit.

I will re-state that final identity/equality. Closely inspect this key relationship—

Consumption + Investment + Government + Exports = Domestic Output + Imports

When the USA --or any other country—is at full employment (4.2% in an unemployment rate is clean evidence of that), running a Federal deficit means over-spending on the ability of the domestic economy to supply the excess demand -- created by the visible excess seen in government budgets

In times of deep stress -- like a recession or depression in private domestic spending -- John Maynard Keynes in the 1930s argued very effectively to get the Federal government to spend, when the private consumer and businesses cannot. That is persuasive. Running and asking for enlarged Federal budget deficits in times of deep private macro stress is forever called “Keynesian”.

However, what about an economy that is at full employment? That will mean internal domestic spending, however created, has fully engaged the capacity of the domestic economy to supply it.

At full employment of domestic resources, any Federal overspending is balanced by production shipped in from abroad (aka Imports). That means this: Larger Federal Budget problems must lead directly to larger Federal Trade Deficits.

So what, you say? Realize: the current USA Federal government is attempting to deal with lowering trade deficits. It is re-negotiating trade deals with Canada, Mexico, and Mainland China, among others. Then, the same USA Federal government proposes to increase the Federal budget deficit with tax cuts?

Ensuing larger Federal budget deficits will surely DRIVE UP the U.S. trade deficit!

That's a BIG point.

It is an undisputable one, from both the point of view of Macro Identities and the recent macro data I showed you from the Eurozone (or any other sovereign for the matter).

If you want to cut your overall trade deficit, you **MUST CUT** your budget deficit!

Why USA politicians try and violate Macro Identities? I do not know.

Global Markets

For a Global Outlook, I will present the freshest trade data for the USA and China.

In 2016, the U.S. exported \$1.45T and imported \$2.19T, leaving a trade deficit of \$735B. The U.S. had an \$18.6T economy. The trade deficit in % of annual GDP is then -3.95%.

In 2016, in comparison, Mainland China was nearly a mirror image. China exported \$2.1T and imported \$1.59T, leaving a surplus of \$510B. China had an \$11.2T economy. The trade surplus in % terms of annual GDP is +4.5%.

USA Trade (in \$ 2016 Billions)	Exports to:	Imports from:	Trade Balance
United Kingdom	55.4	54.3	1.1
Canada	266.0	278.1	-12.1
Mexico	231.0	294.2	-63.2
Germany	49.3	114.2	-64.9
Japan	63.3	132.2	-68.9
China	115.8	462.8	-347.0

The US-China mirror image is no artifact of statistics. It is real. Also pay attention to the statistics on the US's major trading partners. The US runs chronic trade deficits with ALL of its major trading partners, sans our mother in history, the United Kingdom.

What's my big point? Our Federal budget deficit creates our overall trade deficit! U.S. general government borrowing/lending is -4.4% of GDP in 2016. Now, consult the trading partners of China. Lo and behold, Hong Kong and the US see these huge trade surpluses.

Hong Kong is an entrepôt. An **entrepôt** or transshipment port is a port, city, or trading post where merchandise may be imported, stored or traded, usually to be exported again. These commercial cities are spawned due to the growth of long-distance trade. Japan, Germany, South Korea and Taiwan? All of these high-income countries currently import much more than they export to China. Really!!! They don't display the US story, at all. It's the reverse.

China Trade (in 2016 \$ Billions)	Exports to:	Imports from:	Trade Balance
Hong Kong	294.0	18.7	275.3
USA	389.7	135.7	254.0
Japan	129.6	145.5	-15.9
Germany	66.0	86.4	-20.4
South Korea	95.8	159.2	-63.4
Taiwan	40.4	140.1	-99.7

Current Republican Senator from Tennessee Bob Corker, and a member of the Senate Budget Committee, summed up this situation succinctly.

“I think the greatest threat to our nation is us. The way we handle our finances, we as a nation are the greatest threat to our nation. It’s not ISIS. It’s not North Korea. It’s not ascendant China. It’s not Russia. We are the greatest threat.” --Sept. 29th. 2017

2. U.S. Macro Outlook-- San Francisco Fed “Fed Views”

Nicolas Petrosky-Nadeau, research advisor at the Fed of San Francisco, stated his views on the current economy and the outlook as of September 14th, 2017.

The estimate of gross domestic product (GDP) growth in the second quarter of 2017 was revised up to +3.1% at an annualized rate, primarily due to greater consumption expenditure and nonresidential fixed investment. We forecast that GDP growth will fall to an annualized rate of 2.1% in the third quarter due to the effects of Hurricanes Harvey and Irma, but will rise to 3.0% in the fourth quarter as a result of post-hurricane rebuilding.

Financial conditions remain supportive of moderate growth, as long-term interest rates have declined since the beginning of the year. Both ten-year Treasury bills and 30-year fixed rate mortgages, are near historic lows, at 2.14% and 3.81%, respectively. Over the longer-term, we expect annual GDP growth to fall back to our estimate of potential output growth of around 1½ to 1¾% in 2018 and 2019.

Both the headline and core price indexes for personal consumption expenditures each rose 1.4% in July, and continue to remain below the FOMC’s 2% target. We maintain that inflation has been dampened by transitory factors and other special considerations, such as lower administered prices in the health sector. The two hurricanes are expected to have a modest positive effect on inflation through the end of the year. As the economy continues to tighten, we expect that inflation will rise further over the next two years, reaching the FOMC’s target in 2019.

The economy added 169+ jobs in August, following gains in June and July of 210,000 and 138,000, respectively. The pace of hiring remains well above the estimated level of 80,000 to 100,000 new jobs that are needed to absorb new labor force entrants and to keep unemployment stable.

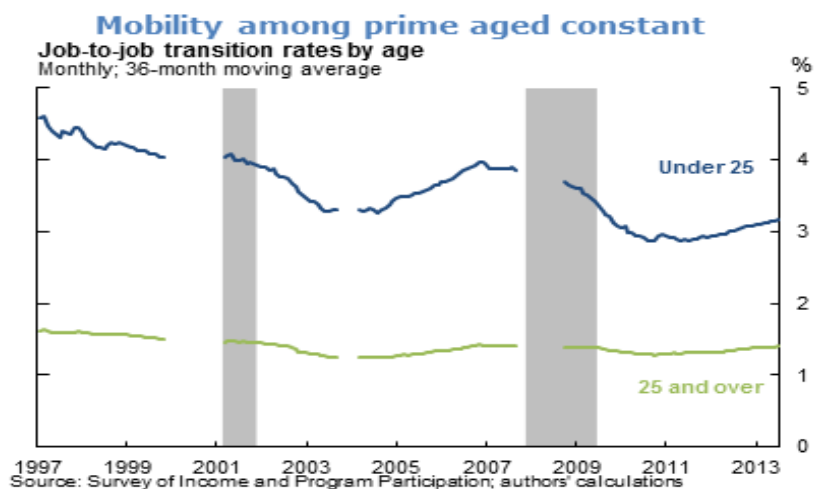
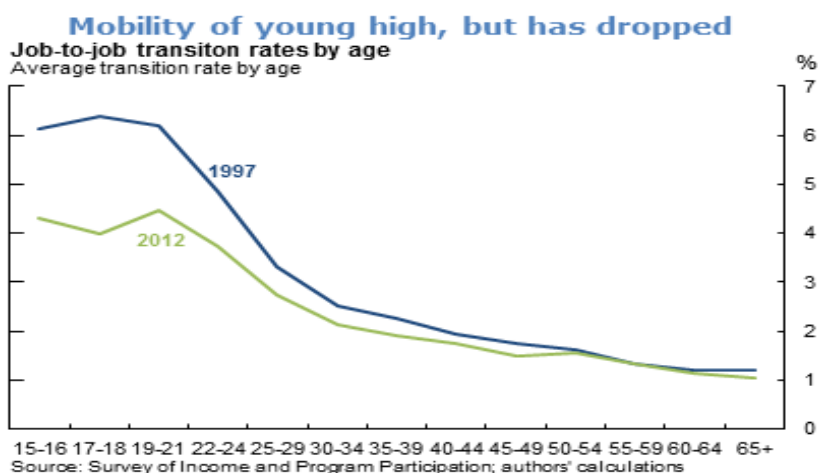
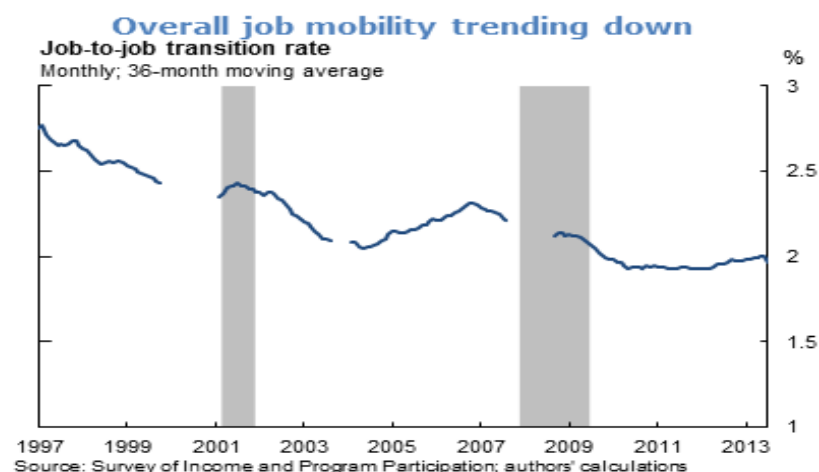
The unemployment rate rose slightly to 4.4% in August, up from 4.3% in July. We anticipate that it will decline further, bottoming out in the latter half of 2018, before reverting upwards in 2019 towards our estimate of the natural rate of unemployment, 4.8%.

There are many other measures indicating improving labor market conditions, including the level of job openings which continues to grow beyond its pre-recession peak. Moreover, rising voluntary quit rates are providing a clear signal of a strengthening labor market. In addition, average hourly earnings grew at 2.5% in the 12 months through August.

However, over the last two decades the rate of job mobility, defined as the proportion of employed workers who were in a different job compared to the month before has steadily declined. This trend has raised concerns about whether the economy is experiencing diminishing dynamism, despite the return of many labor market conditions to their pre-recession levels.

Disaggregating the data by age reveals that job mobility is greater early in life, with transitions three times as frequent among workers in their early 20s as compared to those in their early 40s. However, over the past two decades, the high rate of job switching among the young has declined substantially. By contrast, the rate of job switching among prime age workers has remained constant.

Thus, the decline in job mobility in the United States is mainly attributable to the changing labor market behavior of young workers. For workers aged 25 and older, the bulk of the workforce, the labor market is essentially as dynamic today as it was 20 years ago.



3. Zacks Forecasts at a Glance

Top-Down S&P500 2017 Yearend Targets

Early in 2017, the sell-side had the S&P500 heading up +2% to +9%. In October 2017, the buy-side watches an excellent bull market performance unfold.

Global growth keeps picking up, with Mainland China the source. The mid-October party summit offering a new 5-year plan is driving it. U.S. traders are sanguine on U.S. GDP growth, showing third quarter optimism, despite hurricanes. Sentiment about Trump has waned, though the generals have shored up the administration since a Labor Day low.

Oil prices are perking up a bit. Saudi cuts were affirmed on May 25th and in September. But cuts incentivize U.S. shale producers to add rigs. Don't expect a WTI above \$55 a barrel in 2017.

What's 'excellent'? I see 2017 returns better than last year. In 2016, U.S. stocks rose +12%. In 2015, they rose +1.4%. In 2014, U.S. stocks rose +14%. 2013 saw +32%.

I see 1 more Fed hike in December. Weak inflation is the issue. A Trump tax cut, infrastructure spending, or health care reform isn't happening in 2017. Maybe 2018...Maybe!

Currency consensus moves with Trump sentiment. To early September, the U.S. dollar was weakening against the euro, the Canadian loonie, and the Japanese Yen. This reversed (temporarily?) with a slight rise in the approval of the President.

Wall Street strategists thought divergent central-bank policies — a tighter Fed and ongoing ECB easing — would boost the U.S. dollar and pressure earnings of U.S. companies doing business abroad. It didn't.

In Q1-17 and Q2, the announcement of QE tapering by the ECB, and chaos at the White House, changed the narrative. There is a future rate pull to Europe now, and a risk premium tied to the USA. Generals in the White House are the source of durable U.S. policy stability now.

A weaker renminbi/dollar cross remains consensus. This stays as the call for 2H-17. That has indeed helped China manufacturing. The latest manufacturing expansion data there got better.

What produces 2017 U.S. optimism now?

Trump confidence is still a positive driver. Yet more tangible, a low 4.2% U.S. unemployment rate keeps default and other credit risks down. Ever-higher stock and home real estate prices support discretionary consumer spending, on multiple fronts.

The U.S. does own lukewarm facts. Demographics can build Health Care long-term, but there will be no policy changes. Housing permits and starts & office construction data have gotten stronger, but starts are historically below trend, forcing home prices to new record highs. That cuts down the reach of incomes. For banks, fewer rate hikes are over the horizon. That means less interest rate-driven profits.

What's alive for pessimists?

High stock valuations keep the elephant in the room. Tech can be volatile, and Trump is starting to attack NAFTA trade and China, which hurts Tech. The U.S. dollar, though weakening the last five months, is still a headwind. Recession worry centers on too many real estate cranes in our cities. Apartments are the biggest overbuilding concern. A bubble popping is

possible. Look at Toronto, Canada, for one that may pop soonest.

Traders price across 2018 now-- as they attempt to set fair value on stocks. Look for waxing and waning on sentiment. A waning cycle can begin in October, on short-term concern about too high valuations, or a ramp up in politics.

Is it time to buy the U.S. in October?

With a 2,550 print, keep 2,500 as a Year End fair value, or reference point.

The October 2017 S&P500 index trades at 17.7x forward earnings. The five-year S&P500 average is 15.6x. The S&P500 has a 10-year average of 14.1x. An S&P500 at 2,300 would be a -10% correction. That's a 17 P/E.

Zacks strategists (including me) stay bullish. We see the S&P500 around a 2,500 level by YE, acknowledging a 10% chance of a Q4-17 and a 14% chance of Q1-18 U.S. recession.

- Bulls note cyclical U.S. upside in earnings reports. Super strong Q1 and Q2 earnings confirmed. Q3 EPS is solid. The ECB still buys substantial long bonds. It and the BoJ use negative rates. The euro trades under \$1.20. Europe and China's growth should pick up more in 2018.
- Bears (-10% to -20% downside) focus on rich U.S. share valuations. They see a Q3 top in quarterly earnings growth rates. They can see 2018 Fed rate hikes (or something else) tipping over too rich valuations. Finally, they see building negatives inside currency markets, in particular the subtle political risk premium accruing to U.S. sovereign debt.
- Range-bound sages note a 9.1% European unemployment rate, stable this month, but high. A range-bound commodity & oil price recovery is mostly the norm. 10-year U.S. rates are sideways. Europe QE and Japan's negative rates keep the U.S. 10-year Treasury rate down. Weak inflation, stagnant wage growth, and little productivity gain in the US are muddle-through evidence. Non-U.S. indexes offer more attractive valuations.

The positives: Info tech semis are HOT. Industrials move the earnings needle across a wider platform of industries. A U.S. 4.2% unemployment rate was last seen in December 2000. A new low unemployment rate feeds cyclical consumer spending. That shows capacity constraints.

The negatives: Any oil price climb can reverse quickly, with 'fracker' drilling picking up. Trump is unpredictable and unpopular. That reduced the number of stock catalysts and adds risk.

What of U.S. GDP growth? This should be a top-of-mind fundamental.

On Oct. 2nd, GDPNow for Q3 was +2.7% (better than most expected after the hurricanes). Final Q2 came in at +3.1%. Final Q1-17 GDP showed modest +1.4% growth.

- 2017 looks stronger than 2016. The U.S. scored final +1.9% growth for Q4-16 GDP. Q3 saw +3.2%. Q2 was +1.4%. Q1 was +0.8%.
- 2017 looks similar to 2015. Q4-15 GDP came in at +1.0%. Q3-15 came in at +2.1%. Q2-15 GDP grew +3.9%. For reference, winter Q1-15 was +0.6%. Winter Q1-14 GDP was -2.1%.

"Muddle Through" +2.2% U.S. GDP growth is our call on 2017 and +2.3% is where 2018 stands.

Sound U.S. earnings growth and low U.S. unemployment claims say: “Don’t worry”.

Q3-17 looks for +4.2% EPS growth. Q4-17 is at +11.1%. Q2 gave us +10.3%. Strong Q1 and Q2 earnings seasons were supportive. Earnings and revenue growth went positive in Q3-16.

However, the new U.S. administration ignores uncomfortable macro facts. There should be a higher level of trader concern, particularly on emerging trade wars, North Korea, presidential credibility, and legislative gridlock.

The U.S. is in a 100-month expansion. Sept’s hurricane-altered data was -33K. After revisions, the rest of the monthly labor market evidence is as follows. The U.S. created +169K in August, +138K in July, +210K in June, +145 in May, +207K in APRIL, +50K in MAR, +232K jobs in FEB and +216K jobs in JAN. Recall: June was the biggest job addition month last year.

U.S. unemployment was 4.2% in SEPTEMBER. This is ‘frictional’ or ‘natural’ unemployment.

+1.0% in GDP growth over a year is when recession selling triggers. Ample jobs at full employment tell us rising U.S. stock indexes remain the base case across 2018.

October Zacks Industry Ranks showed the discretionary consumer and motivated info tech buyers were biggest drivers to added earnings growth.

Info Tech (the semis of course) and the Industrials are Very Attractive. Ditto Consumer Discretionary, another major strong spot. Health Care looks good.

Non-U.S. remains on an upward growth path, shown best via Info Tech rankings.

- Materials are middle of the road, with Paper strength. Hope for U.S. buying for infrastructure projects have dimmed, sending the Steel outlook down. But industrial production in China and Japan looks strong. So Metals Non-ferrous is solid.
- Financials are treading water, at Market. Only 1 rate hike in Dec-17 and 2 in 2018.
- Energy is Market. Coal and Alternates are the best bets. Oil & gas muddle through.

Bottoms-up strategists value S&P500 earnings at \$131.37 in 2017. Tie on a 16 forward P/E to do that “fair value” math. Hence, 2,109 on the S&P500 marks backward looking “fair value”. We trade 25 points over 2,500. It’s a richly valued market. For 2018, it is \$146.

Turn the P/E ratio on its head to attain a stock indexes’ earnings yield. Divide \$132 in projected earnings for 2017 by an S&P 500 trading at 2525. That begets a 5.2% earnings yield.

After a +32% rally in 2013, and +12% returns in 2014, +1.4% in 2015 and +12% in 2016, evidence is on share index undervaluation is all about looking ahead -- very bullishly.

KEY restraints to long-term US risk-free rates in 2H-17:

Europe “QE” and negative rates in Japan endure. These two big macro players pin down long-term rates. 10-year U.S. Treasuries offered 2.35% in October, 2.08% in September, 2.26% in August, 2.36% in July vs. 2.18% in early June. A 1.80% rate was here on Nov. 1st, 2016. Historically, a stock earnings yield is +3% higher than this 10-year U.S. Treasury rate.

The Russell 2000 (RUT) trades at 1510 in early October. I was bullish on the RUT, and my bullishness paid off in September. As large caps led for months, the relative attractiveness became centered on small and mid caps. “Risk-on” rallies usually show small cap and international stock indexes move together. International is going up with the RUT now.

Zacks Outlook: Traders should price a 2018 view to set fair value.

2018 is fully in view.

- Ever the optimists, the “High End” bulls say the chance of a U.S. recession looks remote. U.S. valuation expansion on renewed EPS growth supports more momentum.
- High-End Bulls at Zacks use \$146 in earnings for 2018 (and a 16 P/E ratio). This computes to an S&P500 index at 2340. This is the latest fair value lower bound.
- Low-End Bull pessimists think the S&P500 at 2160 can revisit this market.

Q4 2017 earnings forecasts have indeed moved up on a China-led industrial and U.S. discretionary consumer-spending upturn; rates should remain close to historic lows. The bull can run more. What if markets get the 10-year risk-free rate start to ascend towards a 3.0% rate? Relative bond/stock valuations get tight. Watch that closely!

In sum, stocks should deliver to YE 2017. Q1 earnings surprised to the upside. Q2 surprised more dramatically to the upside. Q3 looks solid. Q4 is tagged as a blockbuster quarter.

Stocks can stay above 2,500 – as long as Trump’s international actions don’t cause a shock.

S&P500 Earnings Outlooks

Consensus sees a stiff +11.1% annual EPS growth in 2018 and +9.6% for 2017. In 2016, the S&P500 garnered +0.5%. In 2015, the S&P500 saw -0.8%. In 2014, it saw +5.1%. Consensus uses +5.1% for 2018 and +5.7% for 2017 in the latest revenue growth comps.

Q3-17 earnings growth is at +4.2%. Q2-17 was at +10.3%. Q1-17 was +13.9%.

Q4-16 marked +5.0% y/y growth. The S&P500 EPS growth recession ended in Q3-16.

Four S&P500 sectors lead a +9.6% 2017 EPS outlook – Energy (+242.8%), Materials (+23.3%), rate-driven Financials (+11.0%) and Info Tech (+10.9%). Then, it is Consumer Discretionary (+3.5%), Industrials (+5.3%), Health Care (+5.4%) and Consumer Staples (+2.6%). Telcos (-0.7%) and Utilities (2.1%) are at the back, where deep cyclical defensives typically are found.

Investors – Stay optimistic on S&P500 2018 EPS. As EPS drivers, 2018 rate hikes lift bank profits; a turn in commodity demand indirectly lifts Industrials; a stable world manufacturer – aka Mainland China supports Materials; IT consumers spend strongly. Consumer spirits are high.

The Institute for Supply Management (ISM) told us The September PMI registered 60.8 percent, an increase of 2 percentage points from the August reading of 58.8 percent.

Comments from the panel reflect expanding business conditions, with new orders, production, employment, order backlogs and export orders all growing in September; as well as, supplier deliveries slowing (improving) and inventories growing at a slower rate during the period. The Customers’ Inventories Index remains at low levels.

What ISM Respondents Are Saying

- “Hurricanes causing supply chain and pricing issues.” (Chemical Products)
- “Business levels continue [to be] strong; usually by now, a seasonal downturn begins.” (Machinery)
- “Energy sector (oil and gas) continues to be strong. Price of oil appears to be beginning to stabilize.” (Computer & Electronic Products)
- “We’ve had a very good year and we are forecasting continued strong demand for our product in 2018.” (Miscellaneous Manufacturing)
- “Business is strong. However, we are concerned about price increases due to the hurricanes.” (Plastics & Rubber Products)
- “We are closely watching the Houston events as many of our production chemicals are produced in the Gulf region. Some tightening of supply and/or price increases expected.” (Paper Products)
- “Labor shortages continue to haunt operational capacity both at [the] local plant [level] and up and down the supply chain.” (Transportation Equipment)
- “Hurricanes Harvey and Irma will have significant effects on input costs. Disruption in supply chain. Concerns of transportation.” (Food, Beverage & Tobacco Products)
- “Hurricane Harvey, and now Irma, have impacted the business (building materials). Increasing sales but also causing significant price increases on input raw materials, (Nonmetallic Mineral Products)
- “Lumber prices starting to drop, and log prices starting to increase. Not the best combination (Wood Products)

The overall ISM September PMI indicated U.S. growth for the 100th consecutive month in the overall economy, and indicated growth in the manufacturing sector for the 13th consecutive month. Of 18 manufacturing industries, 17 reported growth in September.

How about non-U.S. earnings? S&P500 companies get 32% of revenues abroad.

Note: In 2016, 56.8% of S&P500 revenues come from the US. Outside the US, it is 43.16%, with 8.13% from Europe, 8.46% from Asia, 3.97% from Africa, 3.34% from North America, 1.68% from South America and 17.51% from ‘foreign countries that is not specified.

The global manufacturing economy continued to expand at a solid and steady pace during September. The J.P.Morgan Global Manufacturing PMI posted 53.2, unchanged from August’s 75-month high.

PMI readings for the worldwide consumer, intermediate and investment goods sectors signaled further expansion in September. Rates of improvement remained broadly similar across all three. Growth accelerated at intermediate goods producers, but slowed in the consumer and investment goods categories.

National PMI indices signaled expansion in almost all of the nations covered. Among the largest industrial regions covered by the survey, growth accelerated in the Eurozone (79-month high), the USA and Japan (a four-month high), but slowed slightly in China, the UK and Taiwan. The South Korea PMI moved back into expansion territory. The upturn in the euro area was again led by Germany, the Netherlands and Austria.

Manufacturing production rose at the quickest pace in six months, underpinned by further increases in both total new orders and international trade volumes. The continued upturn in new order inflows exerted further pressure on capacity, leading to one of the steepest increases in backlogs of work over the past three-and-a-half years. This in turn encouraged manufacturers to raise employment to the greatest extent since May 2011.

“The global manufacturing sector continued to expand at a solid and stable clip in September, as output growth ticked higher and new orders continued to rise at one of the best rates over the past three years. The sector looks to have sufficient momentum to see growth continue through to year-end, even in the face of a recent revival in cost inflationary pressures.”

—David Hensley, JP Morgan, September 1st 2017.

(1) Europe sees building GDP growth. Its unemployment rate was flat at 9.1%.

The eurozone economy ended the third quarter on a strong note, with growth of business activity picking up to its highest since May to register one of the strongest gains seen over the past six years. The headline IHS Markit Eurozone PMI rose to 56.7 in September, according to the preliminary ‘flash’ estimate (based on approximately 85% of replies), up from 55.7 in August.

Growth accelerated in both manufacturing and services, with the former leading the expansion.

(2) In Japan, the safe haven yen is up to 113 in October after a 109 print in September. It was 113 in early July, similar to 112 in early May. The yen hit a low of 100 after Brexit. The yen hit a high of 125 in June 2015.

(3) China beat its +6.5% GDP growth target in the most recent data. The fundamental outlook has improved. Housing prices have ripped ahead in major cities. Services growth looks strong.

Manufacturing operating conditions in China continued to improve at the end of Q3, albeit only marginally. Production and new orders both expanded at softer rates, with firms also signaling slower growth in export sales. As a result, purchasing activity increased at a weaker pace while staffing levels continued on a downward trend. Environmental inspection policies meanwhile weighed on supplier performance, with delivery times lengthening to the greatest extent since January. At the same time, inflationary pressures picked up, with average input costs and output prices both rising sharply.

The latest official manufacturing PMI surprised to the upside. The NBS Manufacturing PMI in China jumped to 52.4 in September, after printing 51.7 in August, 51.4 in July, 51.7 in June,

This NBS Manufacturing PMI in China averaged 49.58 from 2011 until 2017, reaching an all time high of 52.30 in January of 2013 and a record low of 47.20 in September of 2015.

As I discussed, Modi’s India struggles with his increasingly autocratic performance. India may grow +7.3% in 2017. Other calls? Manufacturing PMIs are up in Russia (a 6 month high in July). But a bank run in Russia is concerning. Brazil left recession (barely) in Q1. Corruption there is bad.

Other Asset Class Summaries

DJIA Similar to the S&P500, the Dow move did tack to a new record high. Post- Presidential election years usually have blue skies for markets.

NASDAQ I stay positive on IT. Info Tech remains in the top quarter of Zacks Industry Ranks. Q2 EPS was at +15.1% and Q3 is at +8.8%. Q1-17 showed a super strong +17.6% EPS growth. Across 2017, IT tallies +10.9% EPS growth and +9.0% revenue growth. Zacks #1 Rank IT stocks remain well worth buying.

AAPL stock is a disproportionate part of the QQQs. Q2 gave up an excellent report, sending shares to \$157. In October, they are \$153. Amazingly, shares priced at \$90 a share in May 2015. AAPL shares hit \$120 first in October 2016. The S&P500 and QQQs can rise without AAPL, but a noted turn up on this big stock (and the other FANG stocks) helps.

Russell 2000

Russell 2000 stocks lead -- while markets go "Risk-on". Finally, that became the case in late 2017. A further YE 2017 "risk-on" rally is my call. A good time to buy small caps at 1200 and 1300 is history. 1400 is behind us too. The backdrop: Always be mindful of illiquid small cap shorting. In 'Risk-off' trading, shorts can cut many small cap shares down by -50%.

Fed Funds

A final rate hike should land in December. A 25 bps FOMC hike hit in March and June. Odds stay data dependent in 2017. It's never a pre-set course. U.S. inflation data is much more important than payroll additions. Global growth and S&P500 EPS upgrades support U.S. stocks and GDP growth. The FOMC holds off if stocks get hit hard; Trump does real damage and the USD shows the negative effects; such as when U.S. exports fall far too much.

10-yr Treasury

Europe "QE" is alive and well into 2018. A 10-year rate from +2.5% to +3.5% showed the uncertainty I had in hand early in 2017. Right now, 2.3% is here. A rising 10-year consensus has usually disappointed by mid-year. It has again, this year. 2018 looks like more of the same.

Corporate High Yield and Investment Grade Bonds

IG corporates offer the solid coupons. Less attractive risk-free rates drive corporate bond demand. Cash on balance sheets remains impressive. Investors should own these bonds. However, a 3.5% to 4.5% total return may be what is delivered this year. In our August 2017 poll, CIOs thought High Yield spreads would widen (they are historically tight right now) but IG spreads would remain unchanged.

Municipal Bonds

State tax efficient munis look best for income investors. Having written that, all bond classes get sold with rising Fed rates. Hold to maturity if U.S. rates rise. Note: In our poll, CIOs were neutral on munis in August 2017.

WTI Oil

Look for \$52.47 a barrel by Dec. 2018. That's +5% from where we are now. February 2016 put an oil bottom in at \$26 a barrel. We saw \$53 by mid-2016. Our oil price outlook is tied to OPEC, to U.S. "fracker" rig counts, and to global demand for cheap gasoline.

Gold

Gold price downside hails from a low U.S. 4.4% unemployment rate and on improvement to the global GDP outlook. Gold price upside hails mostly from financial scares (consider the low 10-yr rate right now). Also think about a financial contagion. Zero and negative rate actions are the biggest upside catalysts.

NOTE: About Zacks Rank Sector & Industry Forecasts Coming Up Next --

Zacks Research System (ZRS) updates the Zacks Ranking System regularly; and groups each company into three aggregates. Each of the ranking aggregates still apply the standard proprietary Earnings Estimate Revisions system, but they help sort things out within a top-down context.

Zack aggregates are:

- A 16 Sector grouping (versus the S&P500's 10 sector groups),
- A 60 mezzanine grouping, known as "Middle" or Zacks M-Rank.
- And finally, a 250+ industry grouping, we refer to internally as the X- Rank.

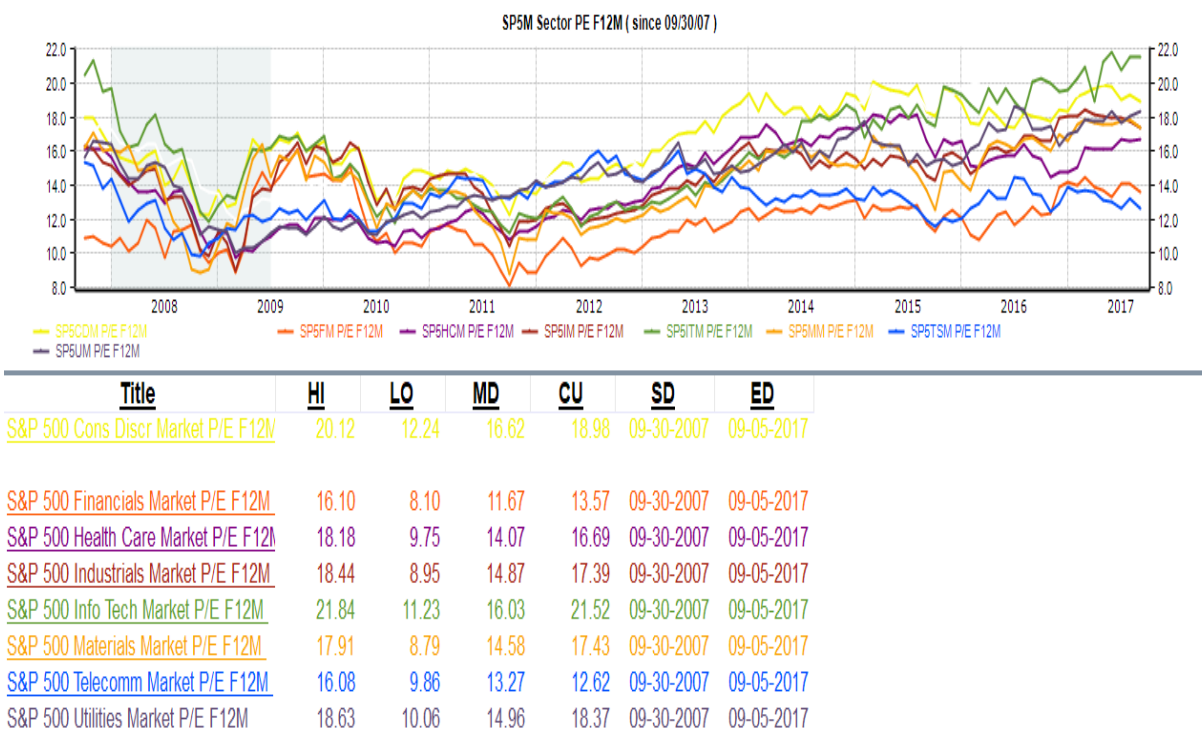
The table in section 6, running four pages long, applied the consolidated ranking information from the 60-industry, Zacks Middle, or M-Rank.

Industries titles listed along with the Zacks Middle Industries are S&P500 Industries, with revisions and additions to reflect specific Zacks industries

TOP-DOWN ZACKS RANK

4. ZRS Chart of the Month

Let's study the forward 12-month sector Price to Earnings (P/E) valuations over 10 years. The chart shows this ratio over the past 10 years done Sept. 6th, 2017.



TOP: IT and Consumer stocks. The **Info Tech** forward 12-month P/S is a green line. It is currently at 21.52.

Consumer Staples (a white line you can't see) is at 19.52. Next, the **Consumer Discretionary** (bright yellow at top of list) P/E ratio is 18.58.

MIDDLE: **Utilities** are purple and are at a P/E of 18.37. **Materials** are Orange and are at 17.43. **Industrials** are in Rust Red, and show a forward P/E ratio of 17.39.

BOTTOM: Moderate defensives. **Health Care** is a brighter purple and is 16.69. **Financials** in bright orange are at 13.57. **Telcos** are bright blue and are at 12.62.

Do I see opportunities? I would say **Health Care** looks undervalued.

5. *Zacks Rank S&P500 Sector Picks*

See the next four pages for all of the details...

Fall is the season. The sector leaders are clear. It should be no surprise to see Info Tech lead. The global economy is heating up.

A strong pro-cyclical domestic bid is on, too, shown by Very Attractive Consumer Discretionary and Industrial sectors. Health Care stays Attractive. U.S. jobs are plentiful and large and small cap stock markets are moving up.

The middle of the road has Energy and Materials, and the Financials companies. Less rate hikes in 2018 show up here.

For the laggards, look to the usual cyclical Defensives of Telcos and Utilities. This all sounds fairly typical {mid-cycle), in its arrangement.

(1) **Info Tech** is, once again, a Very Attractive Sector. The Semiconductors lead, and Electronics is tops too. Computer-Software-Services, and Misc. Tech are good.

(2) **Consumer Discretionary** stays a Very Attractive Sector. The leaders are Consumer Electronics, Autos/Tires/Trucks and Other Consumer Discretionary.

(3) **Industrials** rise to Very Attractive from Attractive. The leaders are Machinery-Electrical, Business Services, and Machinery. Airlines look the worst.

(4) **Health Care** stays an Attractive Sector. The leader, again, is Medical Care.

(5) **Consumer Staples** falls back to a Market Weight. The leader is Soaps & Cosmetics.

(6) **Energy** is a Market Weight. The 2 leaders are Coal and Energy-Alternates. The Oil & Gas groups are Underweight.

(7) **Materials** are a Market Weight. The leader is Paper. The Metals Non-Ferrous business looks good too. Yet, Steel is a middle of the road group.

(8) **Financials** fall to Unattractive. The sole leader is the Banks-Major. The loser is Insurance (with Hurricanes). Most industries cluster in the middle ranks.

(9) **Telcom Services** are now Unattractive, and serve as the usual defensive sector. The best is Telco Services at market which is attractive.

(10) **Utilities** are Unattractive too. Utilities Gas Distribution is best.

6. Zacks Rank October Industry Tables

Zacks Forecasts for S&P 500 Industries (September 30, 2017)

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.81 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Consumer Staples MARKET WEIGHT	Soaps & Cosmetics (2.50)	<u>Beverages</u> Soft Drinks, Brewers Distillers & Vintners (2.77)	Agri-business (2.95)	Tobacco (3.02) <u>Food/Drug Retail</u> Hypermarkets & Supercenters (3.02) Cons Prod-Misc. Staples (3.11)	<u>Food</u> Food Distributors Packaged Foods (3.58)
Consumer Discretionary VERY ATTRACTIVE	<u>Consumer Electronics</u> (1.94) found via: Internet Retail Computer & Electronics Retail Photographic Products <u>Autos/Tires/Trucks</u> Auto Retail, Automotive Manufacturer, Tires & Rubber, Auto Parts & Equipment Distributors (2.14) Other Cons Disc (2.36) Publishing (2.48)	<u>Leisure Service</u> Casinos & Gaming Hotels Leisure Products Restaurants (2.74) <u>Apparel</u> Footwear, Apparel & Accessories, Apparel Retail (2.79)	<u>Media</u> Movies & Entertainment Cable & Satellite, Advertising (2.97)	Home Furnishing-Appliance (3.07)	<u>Non-Food Retail/Wholesale</u> Department Stores, General Merch. Stores, Specialty Stores (3.34)

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.81 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Energy MARKET WEIGHT		Coal & Consumable Fuels (2.56) Energy - Alternate Sources (2.65)	Oil Misc. – (2.88)	Oil & Gas – Integrated (3.03) Oil Exp & Prod (3.05)	Oil & Gas Prod. Pipeline (3.28) Oil & Gas Drilling (3.28)
Financials UNATTRACTIVE	<u>Banks-Major</u> Regional Banks Diversified Banks, Other Diverse Financial Svcs. (2.59)		Invest Banking & Brokering (2.89) <u>Real Estate</u> (REITs), Real Est. Mgmt& Dev. (2.96)	Investment Funds (3.00) Banks & Thrifts (3.02) <u>Finance</u> Specialized & Consumer Finance (3.11)	<u>Insurance</u> Insurance Brokers Multi-Line Insurance Life & Health Insurance Property & Casualty Insurance (3.22)
Health Care ATTRACTIVE	<u>Medical Care</u> Health Care Distributors, Health Care Supplies, Health Care Facilities, Managed Health Care (2.33)		<u>Drugs</u> Biotech, Pharma (2.84) <u>Medical Products</u> Life Science Tools & Services, Health Care Equipment (2.94)		

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.81 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Industrials VERY ATTRACTIVE	<u>Machinery</u> <u>Electrical</u> Electrical Comp. & Equip. (2.46) <u>Business S'vices</u> HR & Employment Services Trade Comps & Distributors (2.60) Machinery (2.62)	<u>Business Products</u> Commercial Printing Office Services. & Supplies (2.68) Metal Fabricating (2.75) Construction –Building Services (2.86) Industrial Products-Services (2.86)	Railroads & Trucking (2.82) Aerospace & Defense (2.94)	Conglomerates (3.09) Pollution Control (3.17)	Airlines Air Freight & Logistics (3.30)
Info Tech VERY ATTRACTIVE	<u>Electronic-Semiconductors</u> Semiconductors Semiconductor Equipment Electronic Manufacturing Services (2.21) <u>Electronics</u> Electronic Components Equipment & Instruments Computer Hardware, Computer Storage & Peripherals (2.25)	<u>Computer Software-Services</u> Home Entertainment Software, Application Software, Systems Software, Internet Software & Services (2.57) <u>Misc. Tech</u> Data Processing & Outsourcing Services Consulting & Services (2.63))		<u>Computer-Office Equipment</u> Office Electronics, (3.04)	Telco Equip (3.31)

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.82 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Materials MARKET WEIGHT	<u>Paper</u> Paper Packaging Paper & Forest Products, (2.63)	<u>Metals non-Ferrous</u> Diversified Metals & Mining, Gold, Aluminum, (2.76)	<u>Chemicals</u> Fertilizers & Ag. Chemicals Industrial Gases Specialty Chemicals Diversified Chemicals (2.89) Steel (2.95)	Building Products/Construction Materials, (3.05)	Containers & Glass (3.30)
Telecom Services UNATTRACTIVE		<u>Telco Services</u> Wireless Telecom Services Integrated Telecom Services (2.71)	Utility Telephone (2.96)		Telco Equipment (3.31)
Utilities UNATTRACTIVE			Utilities Gas Dist. (2.87)	Utilities Electric Power (3.11)	Utilities – Water Supply (3.39)

ASSET ALLOCATION

7. October Sell-Side and Buy-Side— Consensus at a Glance***Sell-Side Consensus*****Top-Down S&P 500 End-Of-Year Target****S&P 500 Returns – 2017*****Consensus sees another modest bull market year.***

In early 2017, 17 sell-side strategists pegged YE 2017 annual returns from +1% (S&P500 at 2,275) to +11% (S&P500 at 2,500). Two high-end strategists were +9% and +11%. Six strategists were “Middle-of-the-Road” bulls at +4% to +7% annually.

The mode? Eight of 17 strategists were low-end bulls at +1% to +3% annually.

The Zacks view difference? We are more bullish than this sell-side consensus. The S&P500 will reach 2475 (+10%) by YE 2017.

Other Sell-Side Views

The “Equity Risk Premium” is an excess return the overall stock market provides above a risk-free fixed income rate. This excess return compensates investors for taking on the relatively higher risk of equities.

A number of sell-side strategists believe the equity risk premium is still a positive force for stocks in 2017.

If low long-term rates linger in 2017, an arbitrage incentive is there is to buy stocks. In April 2017, the 10-yr U.S. Treasury was 2.3%.

Bottom-up S&P 500 Earnings

Bottom-up consensus forecasts on EPS growth for individual companies in the S&P 500 index expect growth of +11.1% in 2018 and +9.6% in 2017 vs. +0.5% in 2016 and +0.5% in 2015. Consensus calls for very strong EPS growth tied to stronger U.S. real GDP growth in 2017 -- and blowout EPS and GDP growth in 2018 if Trump tax policy passes.

The Zacks view difference? 2017 will achieve +9% nominal S&P500 earnings growth, and go up further in 2018 on any Trump tax policy. Unlike in the past 2 years, both the global economy and U.S. consumer spending propels the system.

With strong expansion in earnings and revenue y/y growth in Q2-17, markets look much more confidently to 2H-17 and 1H- 2018 and beyond. Q3-17 EPS rests at +6.1%.

Top-down S&P 500 Earnings

Top-down strategists, who track macro forces and apply top-down judgment to forecast S&P 500 earnings, look for +10.1% in 2017, after +0.5% EPS growth in 2016, and a -1.1% average earnings growth in 2015.

U.S. GDP growth can get to +3.0% in 2018. Consensus is for +2.3% in 2017. The U.S. garnered +1.6% GDP growth in 2016 and +2.6% GDP growth in 2015.

Buy-Side Consensus

S&P 500 and Russell 2000

Our August 2017 survey-- buy-side consensus came in at 88% positive again (versus 88% in April and 85% in Jan).

45% of CIOs were positive on the S&P500 in October (before the election), versus 63% in July and 77% in March 2016.

In August 2017, 0% expect worse than -5% returns. 11% expect -5% to 0% returns. 77% expect 0 to +5% returns in 12 months. 11% expect +5% to +10% returns over the next 12 months; 0% expect 10 to 15% returns. 0% of CIOs expect large cap S&P500 returns to be more than +15%.

The January '17 CIO mode called for 0% to +10% returns (same as April).

Small cap Russell2000 returns deliver a slightly better returns profile the next 12 months. The small cap mode is 0% to +10% returns. I noted a more positive bias.

S&P 500 and Russell 2000: Value or Growth

The August and April 2017 surveys show a buy-side preference for value over growth stocks in the large cap space. The same consensus is there on small and mid caps the next 12 months.

Fed Funds

We saw Fed rates out 12 months from now in our latest survey as – 150 to 200 bps.

(0%) in the August 2017 survey showed the buy-side thinks the Fed Funds rate will be 0 to 100 basis points in 12 months. (22%) think 100 to 150 basis points. (66%) think 150 to 200 bps. (11%) of CIOs see 250 to 300 bps.

The CIO mode for the 5-year U.S. Treasury rate looks to be 200 to 250 bps (44%). The rest are coming in lower than that. The 5-yr was 180 basis points on August 1, 2017. It was 129 bps on October 25th, 2016. It was 135 bps on March 21, 2016. It was 162 bps on January 12, 2016. Looking even further back, it was 136 bps on April 27, 2015.

10-yr Treasury

In August 2017, the most (44%) CIOs in our survey think the 10-year Treasury rate is likely to be in a tight range between +2.5 to +3.0% in 12 months time. 22% of calls are on the low side. One saw 0.5 to 1.0%.

Corporate High Yield and Investment Grade Bonds

In August 2017, 66% of CIOs expects high yield (HY) spreads to expand.

For perspective, the Nov. 2015 CIO survey showed a majority expected credit risk spreads (i.e. the risk a bond issuer defaults) on HY Corporate bonds to blow up. An Energy HY blowout was seen in late 2015.

This time around, there is concern that HY spreads have come in too much. There needs to be a pullback/correction.

Corporate Investment Grade credit spreads should remain unchanged. A mode in the Consensus thinks IG corporate spreads are about right. Unchanged. This has been consensus for some time.

Municipal Bonds In August, April, Jan, and Oct. 2016 munis get a neutral to bearish nod, shifting from bullish last July 2016, a year ago now. It's more neutral than bearish.

WTO Oil and Commodities GSCI Index Both August and April survey were neutral on Oil. This is a change in sentiment. Jan. 2017 was bullish Oil.

Commodities stayed neutral in August 2017, the same as April 2017, Jan. 2017 & Oct. 2016. You have to look back to March 2016 for when the commodities looked bullish.

Gold The August 12 month outlook is neutral here. In April and Jan. 2017, Gold looked bullish to CIOs. This was due to rising inflation worry early in the year. The inflation worry has abated.

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