ZACKS MARKET OUTLOOK AND STRATEGY COMMENTARY

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Q3 was arguably the most turbulent quarter we've seen in this nine- year bull market, but not due to volatility in the capital markets. It was a quarter beset by immensely impactful events that shook just about every part of the country. Hurricane Harvey, Hurricane Irma, Hurricane Maria, the demonstration in Charlottesville, escalating rhetoric with North Korea, the deadliest shooting in modern U.S. history in Las Vegas, and raging wildfires in Northern California. It's difficult to fathom that all of these events took place in just three months.

Meanwhile, the capital markets functioned in a 'business as usual' manner. With volatility hovering around multi-year lows, the market gave no indication that anything was amiss. In fact, stocks kept moving higher! The S&P 500 rose +4.5% on the quarter led by Technology (+8.3%), Energy (+6.8%) and Telecom (+6.8%), and global stocks fared even better. If there's a lesson here, it's not that markets are insensitive to catastrophic events but that they're often more resilient than many would expect. The U.S. economy is just as resilient, much like the American spirit of problem solving and rebuilding in the wake of these tragedies.
As I've written many times before, it is rarely wise to bet against the U.S. economy. Over the long-term, I'd argue that it's never wise to do so.

A Brief Note on the Impact of Hurricanes
A historical analysis of hurricanes and economic/market impact underscores why markets managed to be so resilient. Damages from Q3's hurricanes could reach as high as 2% of GDP. That would be the first time in history hurricanes have disrupted the economy to this extent.
But, calculating a 2% for 2% tradeoff misses some key points. On one hand, the 2% hit can be significant as real assets are destroyed, refineries and ports are shut down, and job losses rise. On the other hand, there will be major rebuilding efforts, significant outlays of new government spending, and consumer spending upticks that should add to GDP over Q4 2017 and Q1 2018. If one considers that new growth and spending should effectively offset short-term losses, then it becomes easier to understand how markets managed to move past these disasters with little impact.

A brief look at the S&P 500's returns in the year following large-scale natural disasters:

Storm	Date	Damages	S&P 500 Return Following 1-Year
Hurricane Andrew	Aug-92	$48 billion	8.70%
Great Flood of 1993	May-93	$36 billion	2.30%
Hurricane Charley	Aug-04	$21 billion	14.20%
Hurricane Katrina	Aug-05	$160 billion	5.50%
Hurricane Ike	Sep-08	$35 billion	-18.60%
Superstorm Sandy	Sep-12	$70 billion	18.50%
Hurricane Harvey/ Irma/Maria	Sep-17	To Be Determined	To Be Determined

Valuations and Tax Reform

Valuations and tax reform are two of the hottest topics moving into Q4. I'll start with valuations, which a majority of 'experts' would label as 'stretched.' I don't disagree wholeheartedly as valuations, from a historical perspective, are indeed on the high side. But, not by much.

Metric	Current	20-Yr Avg.	Current Relative Avg
Trailing P/E (S&P)	21.3	19.7	1.08
Forward Consensus P/E	17.7	16.4	1.08
Trailing Normalized P/E	27.4	25.7	1.06
Shiller P/E	30.3	27	1.12

A factor to consider along with 'stretched' valuations is that interest rates remain near historical lows. That's a key point. If interest rates were higher and valuations were at these levels, I'd have a different take. But, low interest rates make stretched valuations look fair, since investors in search of yield get nudged into equities even at these levels. Consider that 37% of the companies in the S&P 500 provide dividend yields greater than the 10-year Treasury. That's significant.

Earnings are another factor to consider. If strong earnings continue in Q4 and into the first half of 2018, as we expect, it can relieve some valuation pressure on stocks and justify higher prices. However, steeper valuations make the market more vulnerable to corrections and volatility, two things we have not experienced in some time. Stay prepared mentally for that possibility, though this won't necessarily mean making changes to your current allocations. If anything, your mental preparedness should prevent you from making any knee jerk reactions.

On tax reform, there is seemingly a lot of weight being placed on the possibility, and need for, tax reform. I believe there could be some clear winners from tax reform as proposed, but it's also probably true that many of the potential benefits are already baked into stock prices at this stage. At any rate, we have to look at what politicians do and not what they say, so expect a long road ahead on this issue.

Many believe that tax cuts are automatically great for the economy and stocks while tax hikes have the opposite effect. But, history doesn't necessarily support this argument. In the end, the economy and markets do well more often than not regardless of the tax situation. There have been times when tax cuts led to recession and when tax hikes led to growth. But, more often than not, the market moves higher and the economy grows regardless:

President	Mo/Yr	Tax Change	GDP	GDP 1-Year Later	S&P 500 1-Year Later
Reagan	Oct-81	Cut	2.60%	-1.90%	9.91%
Reagan	Apr-83	Hike	4.60%	7.30%	8.73%
Reagan	Oct-86	Cut	3.50%	4.20%	43.42%
G.H.W Bush	Nov-90	Hike	1.90%	-0.10%	33.12%
Clinton	Aug-93	Hike	2.70%	4.00%	5.75%
G.W. Bush	Jun-01	Cut	1.00%	1.80%	-13.85%
G.W. Bush	May-03	Cut	2.80%	3.80%	22.68%
Obama	Dec-10	Cut	2.50%	1.60%	7.61%
Obama	Jan-13	Hike	1.70%	2.60%	31.23%

Bottom Line for Investors

Economic conditions in the U.S. and abroad remain conducive to growth, and we believe corporate earnings will follow in kind. Perhaps the greatest story never told in this unloved bull market is that, for the first time in many years, we have all 43 OECD countries around the world growing in sync, with most accelerating. Stocks care much less about politics and tax reform than they do about economic and earnings growth. I recommend using these, and other fundamentals, as guides for navigating the market moving forward. If so, you’ll be optimistic about the road ahead, as we are here at Zacks Investment Management.

All The Best,

Mitch Zacks

Dividend Strategy

Strategy Description: The Zacks Dividend Strategy seeks tax efficient total returns from both capital appreciation and dividend payments. We focus on companies with attractive valuations, strong dividends and low risk characteristics.

The third quarter was notable considering the slate of events – Hurricane Harvey, Hurricane Irma, Hurricane Maria, the Las Vegas tragedy, and more. But, the big story for investors was rarely told. That is, the resurgence of worldwide, synchronized economic growth (U.S corporate profits and employment growth were also strong in Q3). Accounting for weak inflation and destruction caused by hurricanes, the Federal Reserve stayed quiet over the quarter and kept rates steady. Toward the end of the quarter, the Trump Administration proposed tax reform measures largely viewed as stimulative. We believe the expectation for major tax reform supported positive market momentum, in addition to the underlying growth fundamentals. Some offsetting forces, which proved minimal, were Federal Reserve projections of tighter monetary policy and persistent tension with North Korea.

In the 'large value' space, Energy, Materials, and Technology outperformed over the quarter. Consumer Staples, Discretionary, and Industrials underperformed. The strategy's overweight to Technology and underweight to Discretionary supported relative performance.

If favorable fiscal policies are implemented such that runaway inflation is avoided, this should allow the Federal Reserve to maintain their measured approach to raising interest rates. That would keep pressure off the U.S. economy and corporate profits. With global economic growth gaining traction, and the U.S. moving along nicely, we believe the market has additional upside potential in the near to medium-term. Should that be the case, we believe the Dividend Strategy is positioned to produce attractive returns. Finally, due to the tax-advantaged nature of the dividend payments, and more attractive yield of 3.05% compared to the 10-year US Treasury yield of 2.33%, we believe the strategy remains well-suited for investors seeking moderate growth and income.

Disclosure

Past performance is no guarantee of future results.

Results for the Zacks Strategies ("Strategies") reflect the reinvestment of dividends and other earnings. The results portrayed are the performance history of a single representative managed separate account that ZIM believes is representative of client accounts invested in the Strategy. A representative account must meet the following ZIM criteria to be selected: 1) there are no restrictions placed on the account, 2) ZIM has discretionary authority over the account, 3) the account has no capital additions and withdrawals and 4) dividends are reinvested. If the single representative account in use no longer meets ZIM selection criteria, ZIM will replace the representative account with another that meets the above ZIM selection criteria.

Prospective clients and clients should not assume identical performance results to those shown would have been achieved for their account if it was invested in the Strategies during the period. Clients of the firm may receive different performance than the representative account. Client performance may differ due to factors such as timing of investment(s), timing of withdrawal(s), and client-mandated investment restrictions. Wholesale, retail and institutional clients of the firm may have differing performance due to timing of trades.

Investments in the Strategies are not deposits of any bank, are not guaranteed by any bank, are not insured by FDIC or any other agency, and involve investment risks, including possible loss of the principal amount invested. Lower fees may apply to larger accounts; higher fees may apply to smaller accounts. Separately managed account minimums apply. Inherent in any investment is the potential for loss. Standard management fees are available on request and are described in Part 2A of Form ADV.

Indexes Presented:

The S&P 500 Index is a well-known, unmanaged index of the prices of 500 large company common stocks, mainly blue-chip stocks, selected by Standard & Poor's. The S&P 500 Index assumes reinvestment of dividends but does not reflect advisory fees or other expenses. An investor cannot invest directly in this Index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell 1000 Growth Index is a well-known, unmanaged index of the prices of 1000 large-company growth common stocks selected by Russell. The Russell 1000 Growth Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell 1000 Value Index is a well-known, unmanaged index of the price of 1000 large-company growth common stocks selected by Russell. The Russell 1000 Growth Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot directly invest in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell 3000 Index is a well-known, unmanaged index of the prices of 3000 broad U.S. equity company common stocks, selected by Russell. The Russell 3000 Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The MSCI EAFE is an index from Morgan Stanley Capital International. The MSCI EAFE is a well-known, unmanaged index representing developed nation countries around the world. The MSCI EAFE Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

Zacks Investment Management may utilize mutual funds in some client portfolios. Zacks Investment Management is the advisor to these funds and will receive compensation from the funds and their shareholders for advisory services. Additional information is available upon request.

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