Broadly speaking, the third quarter saw stocks outperform bonds, non-U.S. stocks outperform U.S. stocks, and shorter duration bonds outperform longer duration bonds. In most cases reversing the performance trends observed in the first half of 2016. There was also a shift in sector leadership with utilities and staples, which had performed so well in the first half of the year, declining during the third quarter. Meanwhile more cyclical stocks, like the technology sector that had lagged the broader markets, exhibited significant outperformance in the third quarter. The search for income that fueled the rise in higher yielding sectors suffered as it became clear that the Fed had at least one Fed Funds rate hike planned for this year. Fed concerns also dampened the rally in bonds with most sectors little changed since June 30th.

The third quarter surprisingly exhibited below average levels of volatility in the U.S. equity markets as the broad market indexes slowly climbed higher and higher. Despite the ongoing "melt up" in stock prices, investors remained cautious with the AAII Sentiment index tracking below the historical average around 40 and ending the quarter near 25. It appears investors are still reluctant to believe in this rally following the pain inflicted during the 2008-2009 declines. These concerns aren't limited to the average investor. Several notable investing "legends" including Stanley Druckenmiller, George Soros, and Bill Gross have voiced concerns ranging from inflated equity valuations and lowered future expected returns to broken credit markets as reflected by negative interest rates in many international markets. We point-out these concerns not to mock investor caution in the face of rising markets, rather quite the opposite. We seek to provide a candid reminder of the challenges faced in trying to earn a return for our clients in what is an increasingly uncertain world. At RiverGlades we acknowledge the trust our clients put in us when they elect to work with our firm. We therefore focus on prudent long-term investment strategies as opposed to pursuing short-term gains from the hot sector or chasing yield while hoping we can move faster than the Fed.

Going forward we believe that third quarter earnings results here in the U.S. will set the tone for how markets trade into year-end. Analyst estimates have come down and expectations have been lowered given a disproportionate number of companies providing more conservative guidance. While this raises an apparent red flag for what is to come, any upside surprise could prove to be a positive catalyst for the next few months. We believe that investors are currently more focused on what earnings say about the current state of the economy than what either of the presidential candidates has to say about the other. If earnings decline again this quarter it will represent the sixth consecutive quarter of year-over-year earnings declines and would make it increasingly difficult to justify elevated valuations in the U.S. While the international markets face their own challenges, valuations are relatively more attractive and may provide some buffer against potential declines and could represent increasingly attractive opportunities should a decline occur. Bonds have had a strong run this year due in large part to back tracking by the Fed. However, we believe that the Fed will likely raise rates a quarter point in December, limiting the likelihood of any significant upside in the bond market. We will be awaiting the Fed's comments following the potential rate hike for guidance as to future actions. Indications that the Fed would be slow to raise again would be a net positive for both stocks and bonds. Whereas guidance similar to last December when they forecast several rate hikes in the coming year might cause concerns as we enter 2017.

We continue to believe that the investment markets provide potential for long-term gains but as the bull market ages the risks only increase. We do not anticipate a crisis along the lines of 2008-2009 but we recognize that for many of our clients even a decline of 10-15% might feel like one. As always, we remain vigilant in our management of your assets and focused on generating a reasonable risk adjusted rate of return over the long-term.