FFTW Weekly Commentary

FOR PROFESSIONAL INVESTORS

Early third quarter earnings trends beginning to show a shift in momentum

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Key takeaways

- Housing data over the past week were mixed, but economic indicators are pointing to modest U.S. economic growth
- With a quarter of the S&P 500 companies having reported, third quarter earnings so far are coming in better than expected
- AT&T announced acquisition of Time Warner Inc. has placed large scale M&A deals on the front burner again

Full commentary

With the third quarter wrapped up and economic data largely in, indicators show that the U.S. economy is growing at a modest pace. Other than the housing market, this past week, macro data was generally positive. The economy picked up, after a slow first half start, largely due to consumer spending. Capital expenditures remain a drag, and while the pullback in mining spending accounted for a meaningful source of weakness over the past several quarters, business investment, excluding energy, also decelerated. Third quarter earnings took center stage during the past week, with roughly a quarter of the S&P 500 having reported results.

Third quarter earnings reported so far, are better-than-expected, predominantly driven by positive surprises from banks. Based on Factset data, third quarter earnings for the S&P 500 declined 0.3%, representing the sixth consecutive quarter of year-over-year declines, but the trend was better than the low single digit decline expected going into the reporting season. Sales trends have also improved, showing low single digit growth during the quarter. If this positive trend continues, it will mark the first time the index has shown revenue growth since the fourth quarter of 2014. Consumer Discretionary and Healthcare sectors are targeted to remain the highest revenue growth industries, while Energy is the worst. Excluding Energy, third quarter revenue growth would have been over a percentage point higher.

The biggest surprise so far this reporting season came from the Banking sector. Third quarter capital markets revenues were the best results posted in seven years. Fixed income trading rose, ahead of regulatory reforms and central bank actions, and returns on equity improved across the board. Banks' management teams are optimistic on the outlook for future earnings, noting solid backlogs and pipelines. So far this year, global mergers and acquisitions (M&A) volume is down 26% versus the prior year, although the announcement this weekend of AT&T's $107 billion acquisition of Time Warner has placed large scale deals on the front burner again. Despite the significant earnings outperformance during the third quarter, trading and investment banking revenues so far this year are lower versus the prior year, resulting in management teams remaining focused on cost management initiatives.

Housing data over the past week was mixed. Housing starts were weaker than expected, with weakness primarily in multifamily starts. Existing home sales and building permits were ahead of expectations, of which the latter should be supportive to starts in the upcoming months. The price premium between new and existing homes is at historic highs, which has caused some affordability challenges for homebuyers. Homebuilders' confidence declined 2 points to 63 points in October, but the single family market outlook is still supported by lean inventory levels, improved permitting activity, low mortgage rates and a solid outlook for jobs.

Following a 0.2% increase in August, the 0.3% increase in consumer prices in September was due largely to higher energy prices, while core consumer prices increased only 0.1%, pushing the annual core inflation rate back down from 2.3% to 2.2%. The modest decrease supports the more cautious outlook from the Fed and makes an interest rate hike in November unlikely.

The third quarter earnings season is offering a glimmer of hope for revenue growth and a reversal of negative earnings trends. On the macroeconomic front, except for the housing data, this week's economic releases were generally positive. While residential investment will likely be a drag on third quarter Gross domestic product (GDP), higher than expected permits supported by low inventory levels, healthy buyer traffic and solid job growth, should drive construction spending in the coming months. The U.S. continues to chug along, slow and steady, with the expansion driven largely by the consumer, while business spending and manufacturing remain lethargic

This week's market developments

Monday, October 17

- Eurozone CPI growth increased to 0.4% m.o.m. (s.a.) for September
- US Industrial Production growth increased to 0.1% m.o.m. (s.a.) for September
- US Capacity Utilization decreased to 75.4% (s.a.) for September

Tuesday, October 18

- UK CPI growth decreased to 0.2% m.o.m. (s.a.) for September
- UK PPI Output growth increased to 0.2% m.o.m. for September
- US CPI growth increased to 0.3% m.o.m. (s.a.) for September

Wednesday, October 19

- Japan All Industry Activity Index growth decreased to 0.2% m.o.m. (s.a.) for August
- US Housing Starts decreased to 1,074,000 for September

Thursday, October 20

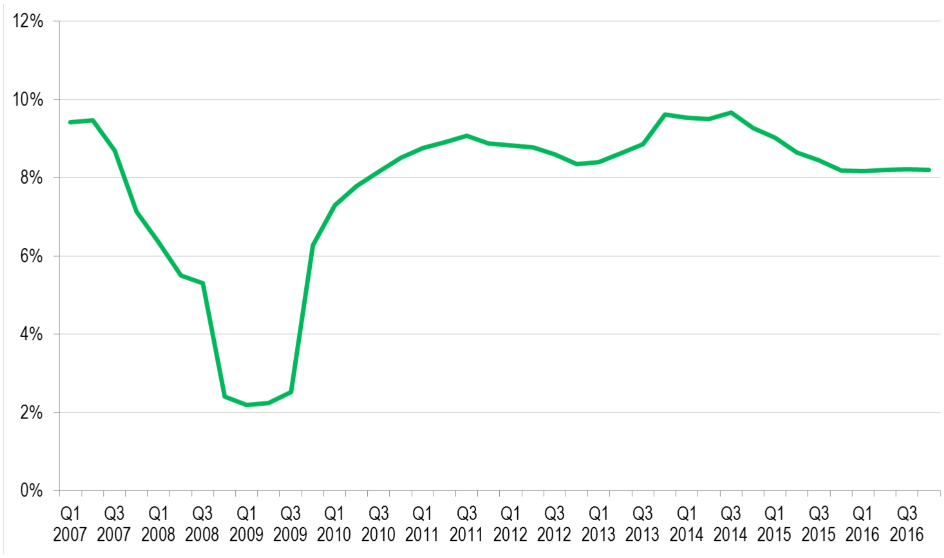
- US Existing Home Sales increased to 5,470,000 for September
- US Leading Index growth increased to 0.2% m.o.m. for September

Friday, October 21

- Eurozone Consumer Confidence (advance estimate) increased to -8.0 for October

Source: Bloomberg, as of end October 24, 2016

Chart of the Week
Quarterly Profit Margins



Source: Bloomberg, as of end October 24, 2016

Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3m rate on March 2016 Interest Rates Futures Contract	Next meeting
Fed	+25 basis points	December 16, 2015	0.25 % - 0.50 %	0.50 %	November 2, 2016
ECB	-5 basis points	March 10, 2016	0.00%	-0.18 %	December 8, 2016
BoJ	-20 basis points	February 16, 2016	-0.10 % - 0.00%	0.06 %	November 1, 2016
BoE	-25 basis points	August 4, 2016	0.25 %	0.40 %	November 3, 2016

Source: Bloomberg, as of end October 24, 2016

Next week's market developments

Monday, October 24

- Markit Germany Manufacturing PMI (prelim estimate) is expected to increase to 54.4 for October
- Markit Germany Services PMI (prelim estimate) is expected to increase to 51.5 for October
- Markit Eurozone Manufacturing PMI (prelim estimate) is expected to increase to 52.7 for October
- Markit Eurozone Services PMI (prelim estimate) is expected to increase to 52.4 for October
- Markit US Manufacturing PMI (prelim estimate) is expected to remain at 51.5 for October

Tuesday, October 25

- US Consumer Confidence Index is expected to decrease to 101.0 for October

Wednesday, October 26

- US Wholesale Inventories growth (prelim estimate) is expected to increase to 0.1% m.o.m. (s.a.) for September
- Markit US Services PMI (prelim estimate) is expected to increase to 52.4 for October
- US New Home Sales are expected to decrease to 600,000 for September

Thursday, October 27

- UK GDP growth (advance estimate) is expected to decrease to 0.3% q.o.q. for the 3rd Quarter
- US Durable Goods Orders (prelim estimate) is expected to decrease to 0.0% m.o.m. (s.a.) for September
- Japan National CPI growth is expected to remain at -0.5% y.o.y. for September

Friday, October 28

- Germany CPI growth (prelim estimate) is expected to increase to 0.2% m.o.m. (s.a.) for October

Source: Bloomberg, as of end October 24, 2016