A good start to 4Q for equities

October was a positive month for stocks, with the U.S. market hitting multiple record levels during the month as a surge in technology sector shares and signs that the economy is on solid footing pushed the market higher. Tax legislation, a change in Federal Reserve ("Fed") leadership, and Washington drama dominated the headlines, but strong earnings results and better-than-expected GDP growth in spite of hurricane disruptions helped maintain investor optimism. Foreign developed equity markets were similarly positive for the month, but a rebound in the U.S. dollar was a drag on relative performance. Emerging market equities added to their remarkable run year-to-date, led by South Korea and China. Refer to Table 1 and Chart 1 for trailing returns across equity markets.

What worked in October?

Investors cheered strong quarterly earnings from technology companies, with several mega cap names hitting all time highs during the month. The tech sector has handily outperformed the broader U.S. stock market this year. The materials sector was another outperformer, with some strength among chemicals and construction materials companies. Bond proxy sectors such as telecom and consumer staples trailed the market, pressured by rising yields. Small caps lagged larger companies and growth oriented stocks were favored over value. Year-to-date, growth has outperformed value in 8 out of 10 months. Refer to Chart 1 for trailing returns across sectors in equity markets.

Bonds worry about new Fed chair

U.S. bonds were flat for the month, held back by a sustained rise in rates across the curve. Renewed expectations for U.S. tax reform and speculation about the next Fed chair hinted at higher interest rates ahead. And while inflation trends continued to be sluggish, the odds for a December rate hike remained elevated. The yield on the 10-year Treasury note reached the 2.40% level for first time in five months, but ended the month five basis points higher at 2.38%. Reflecting favorable economic conditions, credit spreads reached multi-year lows, supporting corporate and high-yield bonds during the month. Refer to Table 1 for trailing returns across fixed income sectors.

Fed to unwind gradually, a new leadership may change track

The U.S. Federal Reserve’s balance sheet normalization is the reversal of the quantitative easing (QE) program that the Fed initiated during the depths of the recession. What could this mean for investors? While QE promoted growth by pushing long-term bond yields and interest rates below their equilibrium levels, a reduction of the balance sheet may increase the supply of long-term bonds that could lead to a steeper yield curve, raising long-term rates in the Treasury and mortgage markets. The direct effect of rising rates is reduced aggregate demand which may dampen employment and inflation. Since inflation is still below the Fed’s target, the Fed will likely try to moderate the pace of increases in short-term interest rates to partially offset the economic impact.

Will 2017 create history for the stock market?

Do you know how many all-time highs the 3 major indices—S&P 500, Dow Jones Industrial Average (Dow) and NASDAQ—have achieved in 2017? Almost 30% of the trading days so far! It’s incredible that these record new highs were achieved despite a series of natural disasters and geopolitical tensions and uncertainty globally. Another incredible fact—the frequency of these all-time new highs is not the highest in the history of these indices. S&P 500 saw 77 new highs in 1995 and the Dow saw 69 new highs in 1995. NASDAQ already matches its previous best that it saw in 1980. But, with 2 trading months ahead of us, 2017 could still create history for any of these popular indices. Stay tuned!

All-time New Highs in 2017*

<table>
<thead>
<tr>
<th>Index</th>
<th>Number of New Highs</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>50</td>
</tr>
<tr>
<td>Dow</td>
<td>54</td>
</tr>
<tr>
<td>NASDAQ</td>
<td>62</td>
</tr>
</tbody>
</table>

* As of October 31, 2017
of higher long-term interest rates. Long-term rates may get a
further tailwind from other factors such as steady U.S. economic
growth—which may lead to a pickup in inflation—and potential
progress on tax reform. Interestingly, after being burnt by the
2013 taper tantrum, the Fed’s well-telegraphed unwinding
process and gradual move on the balance sheet roll-off could
sustain the current favorable outlook for risky assets like equity
markets. It is important, however, to highlight the uncertainty that
revolves around the nomination of a new Fed chairman in early
November. A new leadership could potentially change the fate
of the unwinding program with different implications altogether.

U.S. Economy accelerating into year-end
Despite recent hurricanes, political discord, and geopolitical
concerns, the U.S. economy has accelerated since the beginning
of the year and looks to finish 2017 strong. The Citigroup
Economic Surprise Index, which measures how often economic
data beats expectations, has moved sharply higher in recent
months. The U.S. economy grew more than 3% in real terms
during the third quarter for the second quarter in a row. More
than 2 million new jobs have been created year-to-date.
Wages and benefits rose more than 2.5% year-over-year in the
third quarter, up from 2.3% in 2016. Inflation has remained
well below 2% despite low unemployment rates. Consumer
confidence is near historic highs. The economy is in its eighth
year of expansion, an unusually long time. This has led many
commentators to expect a slowdown in the near-term. But one
shouldn’t forget that the 2008 financial crisis was unusually deep
and the recovery up until now has been relatively slow. So while
there are still risks of economic, military or political ‘shocks’ to
the economy, in the meantime the prospects are for continued
economic growth through year-end and beyond.

### TABLE 1
Index performance for periods ending October 31, 2017

<table>
<thead>
<tr>
<th>Index Performance</th>
<th>1-Month</th>
<th>3-Month</th>
<th>YTD</th>
<th>1-Year (annualized)</th>
<th>3-Year (annualized)</th>
<th>5-Year (annualized)</th>
<th>10-Year (annualized)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Large Cap (S&amp;P 500)</td>
<td>2.33</td>
<td>4.76</td>
<td>16.91</td>
<td>23.63</td>
<td>10.77</td>
<td>15.18</td>
<td>7.51</td>
</tr>
<tr>
<td>U.S. Small Cap (Russell 2000)</td>
<td>0.85</td>
<td>5.78</td>
<td>11.89</td>
<td>27.85</td>
<td>10.12</td>
<td>14.49</td>
<td>7.63</td>
</tr>
<tr>
<td>U.S. Growth (Russell 3000 Growth)</td>
<td>3.69</td>
<td>7.14</td>
<td>24.87</td>
<td>29.80</td>
<td>12.94</td>
<td>16.71</td>
<td>9.06</td>
</tr>
<tr>
<td>U.S. Value (Russell 3000 Value)</td>
<td>0.68</td>
<td>2.66</td>
<td>8.46</td>
<td>18.30</td>
<td>8.11</td>
<td>13.48</td>
<td>6.07</td>
</tr>
<tr>
<td>Foreign Developed Markets (MSCI EAFE)</td>
<td>1.52</td>
<td>4.01</td>
<td>21.78</td>
<td>23.44</td>
<td>6.08</td>
<td>8.53</td>
<td>1.10</td>
</tr>
<tr>
<td>Foreign Emerging Markets (MSCI EM)</td>
<td>3.51</td>
<td>5.39</td>
<td>32.26</td>
<td>26.45</td>
<td>5.70</td>
<td>4.83</td>
<td>0.60</td>
</tr>
<tr>
<td>U.S. Bonds (Bloomberg Barclays U.S. Aggregate)</td>
<td>0.06</td>
<td>0.47</td>
<td>3.20</td>
<td>0.90</td>
<td>2.40</td>
<td>2.04</td>
<td>4.19</td>
</tr>
<tr>
<td>U.S. TIPS (Bloomberg Barclays U.S. TIPS)</td>
<td>0.21</td>
<td>0.63</td>
<td>1.94</td>
<td>-0.11</td>
<td>1.40</td>
<td>-0.11</td>
<td>3.81</td>
</tr>
<tr>
<td>U.S. HY Bonds (Bloomberg Barclays U.S. HY 2% Issuer Cap)</td>
<td>0.42</td>
<td>1.29</td>
<td>7.45</td>
<td>8.92</td>
<td>5.58</td>
<td>6.27</td>
<td>7.90</td>
</tr>
</tbody>
</table>

Sources: SAAMCo and Wilshire Compass. Indices are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

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**Bonds** may cause the value of your investment to go up or down in response to changes in interest rates or defaults (or even the potential for future defaults) by bond issuers.

**Value Investing** - The investor’s judgment that a particular security is undervalued in relation to the company’s fundamental economic value may prove incorrect.

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**International** investing involves a greater degree of risk and increased volatility. In emerging countries, these risks may be more significant.

**S&P 500® Index** tracks the common stock performance of 500 large-capitalization companies publicly traded in the United States.

**Russell 2000® Index** measures the performance of the 2,000 smallest companies in the Russell 3000® Index and is widely recognized as representative of small-cap stocks.

**Russell 3000® Growth Index** measures the performance of those Russell 3000® Index companies with higher price-to-book ratios and higher forecasted growth values.

**Russell 3000® Value Index** measures the performance of those Russell 3000® Index companies with lower price-to-book ratios and lower forecasted growth values.

**MSCI EAFE Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of developed markets. It includes stocks from 21 developed markets, but excludes U.S. and Canada.

**MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

**Bloomberg Barclays U.S. Aggregate Bond Index** is an unmanaged index of domestic investment-grade bonds, including corporate, government and mortgage-backed securities.

**Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index** is a component of the Bloomberg Barclays U.S. Corporate High-Yield Bond Index, which covers fixed-rate, non-investment grade corporate debt of issuers in non-emerging market countries. It is not market capitalization-weighted—each issuer is capped at 2% of the index.

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