

## Q2 2017 Commentary

“You can’t keep a good market down.” Global stock markets collectively had their best opening half-year in years, but market turbulence last week could be a harbinger of greater volatility.

All but four of 30 major indexes representing the world’s biggest stock markets by value have risen this year. Investors attribute the rally’s breadth to strengthening corporate earnings, improving economies and continued support from central banks.

Many of the risks that investors were worried about at the start of the year have failed to turn into real problems, helping stocks to perform well. While hopes of a rapid boost to U.S. growth from President Donald Trump’s administration have faded, equally there has been little action on topics that might concern markets, like barriers to trade and tax reform.

Despite the slowdown of the “Trump trade” – the idea that stocks would get a boost from tax cuts, fiscal spending, and deregulation – optimistic investors could always point to a potential pickup in economic growth, even without policy action. But, the U.S. economy continues to expand, and earnings growth has been crucial to the market’s performance.

The global economy and corporate profits are showing signs of strength, boosting stocks in the U.S. and elsewhere. We have not seen this type of synchronized global recovery like this in years. Rising expectations for global GDP expansion, including Europe, Japan, and China, are also providing support for corporate growth plans even as the embattled White House’s pro-growth agenda may be on hold for the time being.

European markets have reacted positively to the economic growth, relative political calm and a sense that the worst of Europe’s sovereign-debt crisis is behind it. Europe looks to see economic growth between 2% and 3% in the next two to three years.

We saw pressure on technology stocks in late June and into July. The strength of the technology sector attracted a lot of money in the first half of the year because they are growing sales at a time of sluggish U.S. economic growth. Five large mega-cap stocks have accounted for an oversized (44%) of the Nasdaq year-to-date performance. This has concerned some investors that the trade is becoming “crowded”.

In addition, there was market commentary out on how stocks are looking “expensive” and vulnerable to “summer fatigue” as well as rising anxiety over whether Congress can make pragmatic decisions in a timely manner to help support the market rally.

With this in mind, while the technology sector might be vulnerable to a drop, any drop is not necessarily a negative, as the sector is still a good investment based on the longer-term prospects for earnings growth.

The architects of the U.S. monetary policy at the Federal Reserve should be happy. They have succeeded in beyond their own expectations in bringing down the unemployment rate without triggering and outburst of inflation. Stock indexes are near record highs, and interest rates remain low.

But the Fed is in a bit of a pickle, largely of it own doing. Unemployment and inflation are within acceptable levels and the Fed has slowly begun to raise interest rates. Some economist worry that the Fed rate increases will abruptly cool the economy by increasing the cost of borrowing via credit cards, auto loans, and student loans, as well as business loans which could lead to a recession, and thus, falling stock prices. Today, more household wealth is parked in the equity markets than ever before. So, in the coming months, the consumer spending data will become more and more important to carry the economy until Washington can deliver on its promise to boost growth.

With the U.S. economy increasingly dependent on consumption, which is, in turn, increasingly dependent on asset prices, a correction in financial markets would be a significant headwind for economic growth.

One bright picture with consumers is that credit scores for U.S. consumers reached a record high this spring while the share of Americans deemed to be some of the riskiest borrowers hit a record low – a potential boon for lending and economic activity. Banks and credit card companies are seeing more activity in loan approvals and credit-card approvals. This is very positive in that we need to see continued strength in consumer spending.

As global economic expansion continues, and business and consumer confidence remain strong; these conditions should provide support for stocks. Strong corporate earnings have supported stock indexes and valuations-which are trading at higher-than-average levels-have not risen to excessive levels.

Investors are expecting another strong earnings season that begins next week.